

LINCOLN NATIONAL CORP  
Form 10-Q  
August 08, 2008

**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, 2008.

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number 1-6028

**LINCOLN NATIONAL CORPORATION**

(Exact name of registrant as specified in its charter)

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Indiana  
(State or other jurisdiction of  
incorporation or organization)

35-1140070  
(I.R.S. Employer  
Identification No.)

150 N. Radnor Chester Road, 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 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 is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

(Check one): Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

As of August 1, 2008, there were 256,827,934 shares of the registrant's common stock outstanding.

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

## LINCOLN NATIONAL CORPORATION

## CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

	As of June 30, 2008 (Unaudited)	As of December 31, 2007
<b>ASSETS</b>		
Investments:		
Available-for-sale securities, at fair value:		
Fixed maturity (amortized cost: 2008 - \$56,553; 2007 - \$56,069)	\$ 54,518	\$ 56,276
Equity (cost: 2008 - \$617; 2007 - \$548)	464	518
Trading securities	2,550	2,730
Mortgage loans on real estate	7,678	7,423
Real estate	136	258
Policy loans	2,802	2,835
Derivative investments	890	807
Other investments	1,163	1,075
Total investments	70,201	71,922
Cash and invested cash	1,921	1,665
Deferred acquisition costs and value of business acquired	10,608	9,580
Premiums and fees receivable	399	401
Accrued investment income	876	843
Reinsurance recoverables	8,220	8,237
Goodwill	4,045	4,144
Other assets	2,716	3,530
Separate account assets	85,295	91,113
Total assets	\$ 184,281	\$ 191,435
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Liabilities</b>		
Future contract benefits	\$ 16,218	\$ 16,007
Other contract holder funds	60,363	59,640
Short-term debt	900	550
Long-term debt	4,102	4,618
Reinsurance related derivative liability	112	220
Funds withheld reinsurance liabilities	2,069	2,117
Deferred gain on indemnity reinsurance	658	696
Payables for collateral under securities loaned and derivatives	1,490	1,135
Other liabilities	2,576	3,621
Separate account liabilities	85,295	91,113
Total liabilities	173,783	179,717

**Contingencies and Commitments (See Note 9)****Stockholders Equity**

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Series A preferred stock - 10,000,000 shares authorized

Common stock - 800,000,000 shares authorized; 256,801,622 and 264,233,303 shares issued and outstanding as of June 30, 2008, and December 31, 2007, respectively

Retained earnings	7,023	7,200
Accumulated other comprehensive income (loss)	4,283	4,293
	(808)	225

Total stockholders' equity	10,498	11,718
----------------------------	--------	--------

Total liabilities and stockholders' equity	\$ 184,281	\$ 191,435
--	------------	------------

See accompanying Notes to Consolidated Financial Statements

## LINCOLN NATIONAL CORPORATION

## CONSOLIDATED STATEMENTS OF INCOME

(in millions, except per share data)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007	2008	2007
	(Unaudited)			
<b>Revenues</b>				
Insurance premiums	\$ 530	\$ 489	\$ 1,039	\$ 948
Insurance fees	842	742	1,654	1,506
Investment advisory fees	76	93	152	183
Net investment income	1,077	1,133	2,142	2,223
Realized gain (loss)	(108)	7	(143)	41
Amortization of deferred gain on business sold through reinsurance	19	26	38	45
Other revenues and fees	146	181	292	346
<b>Total revenues</b>	<b>2,582</b>	<b>2,671</b>	<b>5,174</b>	<b>5,292</b>
<b>Benefits and Expenses</b>				
Interest credited	613	606	1,225	1,206
Benefits	684	651	1,362	1,244
Underwriting, acquisition, insurance and other expenses	847	816	1,656	1,625
Interest and debt expense	65	73	140	135
Impairment of intangibles	173		173	
<b>Total benefits and expenses</b>	<b>2,382</b>	<b>2,146</b>	<b>4,556</b>	<b>4,210</b>
Income from continuing operations before taxes	200	525	618	1,082
Federal income taxes	75	155	200	324
Income from continuing operations	125	370	418	758
Income (loss) from discontinued operations, net of federal incomes taxes		6	(4)	14
<b>Net income</b>	<b>\$ 125</b>	<b>\$ 376</b>	<b>\$ 414</b>	<b>\$ 772</b>
<b>Earnings Per Common Share Basic</b>				
Income from continuing operations	\$ 0.48	\$ 1.37	\$ 1.61	\$ 2.78
Income (loss) from discontinued operations		0.02	(0.02)	0.05
<b>Net income</b>	<b>\$ 0.48</b>	<b>\$ 1.39</b>	<b>\$ 1.59</b>	<b>\$ 2.83</b>
<b>Earnings Per Common Share Diluted</b>				
Income from continuing operations	\$ 0.48	\$ 1.35	\$ 1.60	\$ 2.74
Income (loss) from discontinued operations		0.02	(0.02)	0.05
<b>Net income</b>	<b>\$ 0.48</b>	<b>\$ 1.37</b>	<b>\$ 1.58</b>	<b>\$ 2.79</b>

See accompanying Notes to Consolidated Financial Statements



## LINCOLN NATIONAL CORPORATION

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in millions, except per share data)

	For the Six Months Ended June 30, 2008      2007 (Unaudited)	
<b>Series A Preferred Stock</b>		
Balance at beginning-of-year	\$	\$ 1
Balance at end-of-period		1
<b>Common Stock</b>		
Balance at beginning-of-year	7,200	7,449
Issued for acquisition		20
Stock compensation	41	85
Deferred compensation payable in stock	3	4
Retirement of common stock/cancellation of shares	(221)	(195)
Balance at end-of-period	7,023	7,363
<b>Retained Earnings</b>		
Balance at beginning-of-year	4,293	4,138
Cumulative effect of adoption of SOP 05-1		(41)
Cumulative effect of adoption of FIN 48		(15)
Cumulative effect of adoption of EITF 06-10	(4)	
Comprehensive income (loss)	(619)	308
Less other comprehensive loss, net of tax	(1,033)	(464)
Net income	414	772
Retirement of common stock	(205)	(317)
Dividends declared: Common (2008 - \$.83; 2007 - \$.79)	(215)	(214)
Balance at end-of-period	4,283	4,323
<b>Net Unrealized Gain on Available-for-Sale Securities</b>		
Balance at beginning-of-year	86	493
Change during the period	(1,025)	(476)
Balance at end-of-period	(939)	17
<b>Net Unrealized Gain on Derivative Instruments</b>		
Balance at beginning-of-year	53	39
Change during the period	(12)	(4)
Balance at end-of-period	41	35
<b>Foreign Currency Translation Adjustment</b>		
Balance at beginning-of-year	175	165
Change during the period	2	16

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Balance at end-of-period	177	181
<b>Funded Status of Employee Benefit Plans</b>		
Balance at beginning-of-year	(89)	(84)
Change during the period	2	
Balance at end-of-period	(87)	(84)
Total stockholders' equity at end-of-period	\$ 10,498	\$ 11,836

See accompanying Notes to Consolidated Financial Statements

**LINCOLN NATIONAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in millions)

	<b>For the Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(Unaudited)</b>	
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 414	\$ 772
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred acquisition costs and value of business acquired deferrals and interest, net of amortization	(357)	(484)
Trading securities purchases, sales and maturities, net	96	218
Change in derivative investments	(7)	(8)
Change in premiums and fees receivable	2	(76)
Change in accrued investment income	(33)	5
Change in reinsurance recoverables	17	(120)
Change in future contract benefits	223	196
Change in other contract holder funds	183	895
Change in funds withheld reinsurance liability	(48)	61
Change in federal income tax accruals	(230)	295
Change in net periodic benefit accruals		(4)
Realized (gain) loss	143	(41)
Loss on disposal of discontinued operations	12	
Impairment of intangibles	173	
Amortization of deferred gain on business sold through reinsurance	(38)	(45)
Stock-based compensation expense	19	29
Depreciation, amortization and accretion, net	24	15
Other	(142)	(319)
Net adjustments	37	617
Net cash provided by operating activities	451	1,389
<b>Cash Flows from Investing Activities</b>		
Purchases of available-for-sale securities	(3,615)	(7,995)
Sales of available-for-sale securities	1,014	5,206
Maturities of available-for-sale securities	1,924	2,125
Purchases of other investments	(1,213)	(1,251)
Sales or maturities of other investments	914	1,157
Increase (decrease) in payables for collateral under securities loaned and derivatives	355	(132)
Proceeds from sale of subsidiaries/businesses and disposal of discontinued operations	644	
Other	(53)	10
Net cash used in investing activities	(30)	(880)
<b>Cash Flows from Financing Activities</b>		
Payment of long-term debt, including current maturities	(100)	(553)
Issuance of long-term debt		750
Issuance (decrease) in commercial paper	(65)	30
Deposits of fixed account values, including the fixed portion of variable	4,913	4,500
Withdrawals of fixed account values, including the fixed portion of variable	(2,787)	(4,071)
Transfers to and from separate accounts, net	(1,233)	(1,131)

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Maturities of funding agreements	(300)	
Common stock issued for benefit plans and excess tax benefits	25	62
Repurchase of common stock	(401)	(512)
Dividends paid to stockholders	(217)	(216)
Net cash used in financing activities	(165)	(1,141)
Net increase (decrease) in cash and invested cash	256	(632)
Cash and invested cash at beginning-of-year	1,665	1,621
Cash and invested cash at end-of-period	\$ 1,921	\$ 989

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 and investment management businesses through six business segments, see Note 16. The collective group of businesses uses Lincoln Financial Group as its marketing identity. Through our business segments, we sell a wide range of wealth protection, accumulation and retirement income products and solutions. These products include institutional and/or retail fixed and indexed annuities, variable annuities, universal life insurance, term life insurance, mutual funds and managed accounts.

**Basis of Presentation**

The accompanying unaudited consolidated financial statements are prepared in accordance with United States of America generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions for the Securities and Exchange Commission ( SEC ) Quarterly Report on Form 10-Q, including Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Therefore, the information contained in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 ( 2007 Form 10-K ), should be read in connection with the reading of these interim unaudited consolidated financial statements.

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 three and six month periods ended June 30, 2008, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2008. All material intercompany accounts and transactions have been eliminated in consolidation.

Certain amounts reported in prior periods consolidated financial statements have been reclassified to conform to the presentation adopted in the current year. These reclassifications have no effect on net income or stockholders' equity of the prior periods.

We have reclassified the results of certain derivatives and embedded derivatives to realized gain (loss), which were previously reported within insurance fees, net investment income, interest credited or benefits. The associated amortization expense of deferred acquisition costs ( DAC ) and value of business acquired ( VOBA ) (previously reported within underwriting, acquisition, insurance and other expenses), deferred sales inducements ( DSI ) (previously reported within interest credited), deferred front-end loads ( DFEL ) (previously reported within insurance fees) and changes in contract holder funds (previously reported within benefits) have also been reclassified to realized gain (loss).

The detail of the reclassifications from what was previously reported in prior period financial statements (in millions) was as follows:

	For the Three Months Ended		For the Six Months Ended
	March 31, 2008	June 30, 2007	June 30, 2007
Realized gain (loss), as previously reported	\$ (38)	\$ (5)	\$ 22
Effect of reclassifications to:			
Insurance fees	32	16	31
Net investment income	(97)	37	36
Interest credited	102	(25)	(30)
Benefits	(13)	(5)	(1)
Underwriting, acquisition, insurance and other expenses	(21)	(11)	(17)
Realized gain (loss), as adjusted	\$ (35)	\$ 7	\$ 41



## 2. New Accounting Standards

### Adoption of New Accounting Standards

#### *Statement of Financial Accounting Standards No. 157 Fair Value Measurements*

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value under current accounting pronouncements that require or permit fair value measurement and enhances disclosures about fair value instruments. SFAS 157 retains the exchange price notion, but clarifies that exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability (exit price) in the principal market, or the most advantageous market in the absence of a principal market, for that asset or liability, as opposed to the price that would be paid to acquire the asset or receive a liability (entry price). Fair value measurement is based on assumptions used by market participants in pricing the asset or liability, which may include inherent risk, restrictions on the sale or use of an asset or non-performance risk, which would include the reporting entity's own credit risk. SFAS 157 establishes a three-level fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value. The three-level hierarchy for fair value measurement is defined as follows:

Level 1 inputs to the valuation methodology are quoted prices available in active markets for identical investments as of the reporting date. Blockage discounts for large holdings of unrestricted financial instruments where quoted prices are readily and regularly available for an identical asset or liability in an active market are prohibited;

Level 2 inputs to the valuation methodology are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value can be determined through the use of models or other valuation methodologies; and

Level 3 inputs to the valuation methodology are unobservable inputs in situations where there is little or no market activity for the asset or liability and the reporting entity makes estimates and assumptions related to the pricing of the asset or liability, including assumptions regarding risk.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the investment.

We have certain guaranteed benefit features within our annuity products that, prior to January 1, 2008, were recorded using fair value pricing. These benefits will continue to be measured on a fair value basis with the adoption of SFAS 157, utilizing Level 3 inputs and some Level 2 inputs, which are reflective of the hypothetical market participant perspective for fair value measurement, including liquidity assumptions and assumptions regarding the Company's own credit or non-performance risk. In addition, SFAS 157 expands the disclosure requirements for annual and interim reporting to focus on the inputs used to measure fair value, including those measurements using significant unobservable inputs and the effects of the measurements on earnings. See Note 15 for additional information.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

We adopted SFAS 157 effective January 1, 2008, by recording increases (decreases) to the following categories (in millions) on our consolidated financial statements:

<b>Assets</b>	
DAC	\$ 13
VOBA	(8)
Other assets DSI	2
<b>Total assets</b>	<b>\$ 7</b>
<b>Liabilities</b>	
Other contract holder funds:	
Remaining guaranteed interest and similar contracts	\$ (20)
Embedded derivative instruments living benefits liabilities	48
DFEL	3
Other liabilities income tax liabilities	(8)
<b>Total liabilities</b>	<b>\$ 23</b>
<b>Revenues</b>	
Realized loss	\$ (24)
Federal income tax benefit	(8)
<b>Loss from continuing operations</b>	<b>\$ (16)</b>

The impact for the first quarter adoption of SFAS 157 to basic and diluted per share amounts was a decrease of \$0.06.

*FASB Staff Position No. FAS 157-2 Effective Date of FASB Statement No. 157*

In February 2008, the FASB issued FASB Staff Position ( FSP ) No. FAS 157-2, Effective Date of FASB Statement No. 157 ( FSP 157-2 ). FSP 157-2 delays the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Accordingly, we did not apply the provisions of SFAS 157 to nonfinancial assets and nonfinancial liabilities within the scope of FSP 157-2. Examples of items to which the deferral is applicable include, but are not limited to:

Nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination or other new basis event, but not measured at fair value in subsequent periods;

Reporting units measured at fair value in the goodwill impairment test under SFAS No. 142, Goodwill and Other Intangible Assets ( SFAS 142 ), and indefinite-lived intangible assets measured at fair value for impairment assessment under SFAS 142;

Nonfinancial long-lived assets measured at fair value for an impairment assessment under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ;

Asset retirement obligations initially measured at fair value under SFAS No. 143, Accounting for Asset Retirement Obligations ; and

Nonfinancial liabilities for exit or disposal activities initially measured at fair value under SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities.

## Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

### *SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities*

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ), which allows an entity to make an irrevocable election, on specific election dates, to measure eligible items at fair value. The election to measure an item at fair value may be determined on an instrument by instrument basis, with certain exceptions. If the fair value option is elected, unrealized gains and losses will be recognized in earnings at each subsequent reporting date, and any upfront costs and fees related to the item will be recognized in earnings as incurred. In addition, the presentation and disclosure requirements of SFAS 159 are designed to assist in the comparison between entities that select different measurement attributes for similar types of assets and liabilities. SFAS 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS 157. At the effective date, the fair value option may be elected for eligible items that exist on that date. Effective January 1, 2008, we elected not to adopt the fair value option for any financial assets or liabilities that existed as of January 1, 2008.

---

*Emerging Issues Task Force Issue No. 06-10 Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements*

In March 2007, the FASB Board ratified the consensus reached by the Emerging Issues Task Force ( EITF ) in EITF Issue No. 06-10, Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements ( EITF 06-10 ). EITF 06-10 requires an employer to recognize a liability related to a collateral assignment split-dollar life insurance arrangement in accordance with SFAS No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions, if the employer has agreed to maintain a life insurance policy during the employee s retirement. In addition, based on the split-dollar arrangement, an asset should be recognized by the employer for the estimated future cash flows to which the employer is entitled. The adoption of EITF 06-10 can be recognized either as a change in accounting principle through a cumulative-effect adjustment to retained earnings or through retrospective application to all prior periods. The consensus is effective for fiscal years beginning after December 15, 2007, including interim periods within those fiscal years.

We maintain collateral assignment split-dollar life insurance arrangements related to frozen policies that are within the scope of EITF 06-10. Effective January 1, 2008, we adopted EITF 06-10 by recording a \$4 million cumulative effect adjustment to the opening balance of retained earnings, offset by an increase to our liability for postretirement benefits. We also recorded notes receivable for the amounts due to us from participants under the split-dollar arrangements. The recording of the notes receivable did not have a material effect on our consolidated financial condition or results of operations.

*Derivative Implementation Group Statement 133 Implementation Issue No. E23 Issues Involving the Application of the Shortcut Method Under Paragraph 68*

In December 2007, the FASB issued Derivative Implementation Group ( DIG ) Statement 133 Implementation Issue No. E23, Issues Involving the Application of the Shortcut Method under Paragraph 68 ( DIG E23 ), which gives clarification to the application of the shortcut method of accounting for qualifying fair value hedging relationships involving an interest-bearing financial instrument and/or an interest rate swap, originally outlined in paragraph 68 in SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ). We adopted DIG E23 effective January 1, 2008, for hedging relationships designated on or after that date. The adoption did not have a material impact on our consolidated financial condition or results of operations.

**Future Adoption of New Accounting Standards**

*SFAS No. 141(R) Business Combinations*

In December 2007, the FASB issued SFAS No. 141(revised 2007), Business Combinations ( SFAS 141(R) ), which is a revision of SFAS No. 141 Business Combinations ( SFAS 141 ). SFAS 141(R) retains the fundamental requirements of SFAS 141, but establishes principles and requirements for the acquirer in a business combination to recognize and measure the identifiable assets acquired, liabilities assumed and any noncontrolling interests in the acquiree and the goodwill acquired or the gain from a bargain purchase. The revised statement requires, among other things, that assets acquired, liabilities assumed and any noncontrolling interest in the acquiree shall be measured at their acquisition-date fair values. For business combinations completed upon adoption of SFAS 141(R), goodwill will be measured as the excess of the consideration transferred, plus the fair value of any noncontrolling interest in the acquiree, in excess of the fair values of the identifiable net assets acquired. Any contingent consideration shall be recognized at the acquisition-date fair value, which improves the accuracy of the goodwill measurement. Under SFAS 141(R), contractual pre-acquisition contingencies will be recognized at their acquisition-date fair values and non-contractual pre-acquisition contingencies will be recognized at their acquisition date fair values if it is more likely than not that the contingency gives rise to an asset or liability. Deferred recognition of pre-acquisition contingencies will no longer be permitted. Acquisition costs will be expensed in the period the costs are incurred, rather than included in the cost of the acquiree, and disclosure requirements will be enhanced to provide users with information to evaluate the nature and financial effects of the business combination. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after December 15, 2008, with earlier adoption prohibited. We will adopt SFAS 141(R) for acquisitions occurring after January 1, 2009.

*SFAS No. 160 Noncontrolling Interests in Consolidated Financial Statements an Amendment of Accounting Research Bulletin No. 51*

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51 ( SFAS 160 ), which aims to improve the relevance, comparability and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards surrounding noncontrolling interests, or minority interests, which are the portions of equity in a subsidiary not attributable, directly or indirectly, to a parent. The ownership interests in subsidiaries held by parties other than the parent shall be clearly identified, labeled and presented in the consolidated statement of financial position within equity, but separate from the parent s equity. The amount of consolidated net income attributable to the parent and to the noncontrolling



interest must be clearly identified and presented on the face of the Consolidated Statements of Income. Changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary must be accounted for consistently as equity transactions. A parent's ownership interest in a subsidiary changes if the parent purchases additional ownership interests in its subsidiary, sells some of its ownership interests in its subsidiary, the subsidiary reacquires some of its ownership interests or the subsidiary issues additional ownership interests. When a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary must be initially measured at fair value. The gain or loss on the deconsolidation of the subsidiary is measured using the fair value of any noncontrolling equity investment rather than the carrying amount of that retained investment. Entities must provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We will adopt SFAS 160 effective January 1, 2009, and do not expect the adoption will have a material impact on our consolidated financial condition and results of operations.

*FSP FAS No. 140-3 Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*

In February 2008, the FASB issued FSP FAS No. 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions (FSP 140-3), regarding the criteria for a repurchase financing to be considered a linked transaction under SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities. A repurchase financing is a transaction where the buyer (transferee) of a financial asset obtains financing from the seller (transferor) and transfers the financial asset back to the seller as collateral until the financing is repaid. Under FSP 140-3, the transferor and the transferee shall not separately account for the transfer of a financial asset and a related repurchase financing unless the two transactions have a valid and distinct business or economic purpose for being entered into separately and the repurchase financing does not result in the initial transferor regaining control over the financial asset. In addition, an initial transfer of a financial asset and a repurchase financing entered into contemporaneously with, or in contemplation of, one another, must meet the criteria identified in FSP 140-3 in order to receive separate accounting treatment. FSP 140-3 is effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. FSP 140-3 will be applied prospectively to initial transfers and repurchase financings executed on or after the beginning of the fiscal year in which FSP 140-3 is initially applied. Early application is not permitted. We will adopt FSP 140-3 effective January 1, 2009, and do not expect the adoption will have a material impact on our consolidated financial condition and results of operations.

*SFAS No. 161 Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133*

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133 (SFAS 161), which amends and expands current qualitative and quantitative disclosure requirements for derivative instruments and hedging activities. Enhanced disclosures will include: how and why we use derivative instruments; how derivative instruments and related hedged items are accounted for under SFAS 133; and how derivative instruments and related hedged items affect our financial position, financial performance and cash flows. Quantitative disclosures will be enhanced by requiring a tabular format by primary underlying risk and accounting designation for the fair value amount and location of derivative instruments in the financial statements and the amount and location of gains and losses in the financial statements for derivative instruments and related hedged items. The tabular disclosures should improve transparency of derivative positions existing at the end of the reporting period and the effect of using derivatives during the reporting period. SFAS 161 also requires the disclosure of credit-risk-related contingent features in derivative instruments and cross-referencing within the notes to the consolidated financial statements to assist users in locating information about derivative instruments. The amended and expanded disclosure requirements apply to all derivative instruments within the scope of SFAS 133, non-derivative hedging instruments and all hedged items designated and qualifying as hedges under SFAS 133. SFAS 161 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We will adopt SFAS 161 effective January 1, 2009, at which time we will include these required enhanced disclosures related to derivative instruments and hedging activities in our financial statements.

*FSP FAS No. 142-3 Determination of the Useful Life of Intangible Assets*

In April 2008, the FASB issued FSP FAS No. 142-3, Determination of the Useful Life of Intangible Assets (FSP 142-3), which applies to recognized intangible assets accounted for under the guidance in SFAS 142. When developing renewal or extension assumptions in determining the useful life of recognized intangible assets, FSP 142-3 requires an entity to consider its own historical experience in renewing or extending similar arrangements. Absent the historical experience, an entity should use the assumptions a market participant would make when renewing and extending the intangible asset consistent with the highest and best use of the asset by market participants. In addition, FSP 142-3 requires financial statement disclosure regarding the extent to which expected future cash flows associated with the asset are affected by an entity's intent and/or ability to renew or extend an arrangement. FSP 142-3 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008, with early adoption prohibited. FSP 142-3 should be applied prospectively to determine the useful life of a recognized intangible asset acquired after the effective date. In addition, FSP 142-3 requires prospective application of the disclosure

requirements to all intangible assets recognized as of, and subsequent to, the effective date. We will adopt FSP 142-3 on January 1, 2009 and do not expect the adoption will have a material impact on our consolidated financial condition and results of operations.

*SFAS No. 163 Accounting for Financial Guarantee Insurance Contracts an Interpretation of FASB Statement No. 60*

In May 2008, the FASB issued SFAS No. 163, *Accounting for Financial Guarantee Insurance Contracts* an interpretation of FASB Statement No. 60 ( SFAS 163 ), which applies to financial guarantee insurance and reinsurance contracts not accounted for as derivative instruments, and issued by entities within the scope of SFAS No. 60, *Accounting and Reporting by Insurance Enterprises*. SFAS 163 changes current accounting practice related to the recognition and measurement of premium revenue and claim liabilities such that premium revenue recognition is linked to the amount of insurance protection and the period in which it is provided, and a claim liability is recognized when it is expected that a claim loss will exceed the unearned premium revenue. In addition, SFAS 163 expands disclosure requirements to include information related to the premium revenue and claim liabilities, as well as information related to the risk-management activities used to evaluate credit deterioration in insured financial obligations. SFAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years; early application is not permitted. However, the disclosure requirements related to risk-management activities are effective in the first period (including interim periods) beginning after May 2008. We will adopt SFAS 163 effective January 1, 2009, except for the disclosure requirements which, if applicable, will be provided in the third quarter of 2008. Since we do not hold a significant amount of financial guarantee insurance and reinsurance contracts, we expect the adoption of SFAS 163 will not be material to our consolidated financial condition or results of operations.

*EITF No. 07-5 Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock*

In June 2008, the FASB issued EITF No. 07-5, *Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock* ( EITF 07-5 ). EITF 07-5 provides guidance to determine whether an instrument (or an embedded feature) is indexed to an entity's own stock when evaluating the instrument as a derivative under SFAS 133. An instrument that is both indexed to an entity's own stock and classified in stockholders' equity in the entity's statement of financial position is not considered a derivative for the purposes of applying the guidance in SFAS 133. EITF 07-5 provides a two-step process to determine whether an equity-linked instrument (or embedded feature) is indexed to its own stock first by evaluating the instrument's contingent exercise provisions, if any, and second, by evaluating the instrument's settlement provisions. EITF 07-5 is applicable to outstanding instruments as of the beginning of the fiscal year in which the issue is adopted and is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We will adopt EITF 07-5 on January 1, 2009, and do not expect the adoption will be material to our consolidated financial condition and results of operations.

**3. Dispositions***Discontinued Media Operations*

During the fourth quarter of 2007, we entered into a definitive agreement to sell our television broadcasting, Charlotte radio and sports programming businesses. These businesses were acquired as part of the Jefferson-Pilot merger on April 3, 2006. The sports programming sale closed on November 30, 2007, the Charlotte radio broadcasting sale closed on January 31, 2008, and the television broadcasting sale closed on March 31, 2008. Accordingly, in the periods prior to the closings, the assets and liabilities of these businesses were reclassified as held-for-sale and were reported within other assets and other liabilities on our Consolidated Balance Sheets. The major classes of assets and liabilities held-for-sale (in millions) were as follows:

	As of June 30, 2008	As of December 31, 2007
Goodwill	\$	\$ 340
Specifically identifiable intangible assets		266
Other		146
Total assets held-for-sale	\$	\$ 752
Liabilities held-for-sale	\$	\$ 354

The results of operations of these businesses were reclassified into income (loss) from discontinued operations on our Consolidated Statements of Income, and the amounts (in millions) were as follows:

	For the Three Months Ended June 30, 2008		For the Six Months Ended June 30, 2007	
<b>Discontinued Operations Before Disposal</b>				
Media revenues, net of agency commissions	\$	\$ 29	\$ 22	\$ 71
Income from discontinued operations before disposal, before federal income taxes	\$	\$ 10	\$ 8	\$ 22
Federal income taxes		4	3	8
Income from discontinued operations before disposal		6	5	14
<b>Disposal</b>				
Loss on disposal, before federal income taxes			(12)	
Federal income tax benefit			(3)	
Loss on disposal			(9)	
Income (loss) from discontinued operations	\$	\$ 6	\$ (4)	\$ 14

*Fixed Income Investment Management Business*

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

## Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

During the fourth quarter of 2007, we received \$25 million of the purchase price, with additional scheduled payments over the next three years. During 2007, we recorded an after-tax loss of \$2 million on our Consolidated Statements of Income as a result of the goodwill we attributed to this business. Any adjustment to the purchase price, if necessary, will be determined at October 31, 2008. During the three and six months ended June 30, 2008, we recorded an after-tax gain of \$1 million and \$3 million, respectively, on our Consolidated Statements of Income related to this transaction.

**4. Investments****Available-for-Sale Securities**

The amortized cost, gross unrealized gains and losses and fair value of available-for-sale securities (in millions) were as follows:

	As of June 30, 2008			Fair Value
	Amortized Cost	Gross Unrealized Gains	Losses	
Corporate bonds	\$ 44,160	\$ 675	\$ 2,216	\$ 42,619
U.S. Government bonds	191	13	1	203
Foreign government bonds	887	43	23	907
Asset and mortgage-backed securities:				
Mortgage pass-through securities	1,712	17	24	1,705
Collateralized mortgage obligations	6,730	64	418	6,376
Commercial mortgage-backed securities	2,628	21	182	2,467
State and municipal bonds	142	1	2	141
Redeemable preferred stocks	103	2	5	100
Total fixed maturity securities	56,553	836	2,871	54,518
Equity securities	617	39	192	464
Total available-for-sale securities	\$ 57,170	\$ 875	\$ 3,063	\$ 54,982

	As of December 31, 2007			Fair Value
	Amortized Cost	Gross Unrealized Gains	Losses	
Corporate bonds	\$ 43,973	\$ 1,120	\$ 945	\$ 44,148
U.S. Government bonds	205	17		222
Foreign government bonds	979	67	9	1,037
Asset and mortgage-backed securities:				
Mortgage pass-through securities	1,226	24	4	1,246
Collateralized mortgage obligations	6,721	78	130	6,669
Commercial mortgage-backed securities	2,711	49	70	2,690
State and municipal bonds	151	2		153
Redeemable preferred stocks	103	9	1	111
Total fixed maturity securities	56,069	1,366	1,159	56,276
Equity securities	548	13	43	518
Total available-for-sale securities	\$ 56,617	\$ 1,379	\$ 1,202	\$ 56,794

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

The amortized cost and fair value of fixed maturity available-for-sale securities by contractual maturities (in millions) were as follows:

	As of June 30, 2008	
	Amortized Cost	Fair Value
Due in one year or less	\$ 1,893	\$ 1,901
Due after one year through five years	12,993	13,049
Due after five years through ten years	15,715	14,916
Due after ten years	14,882	14,104
Subtotal	45,483	43,970
Asset and mortgage-backed securities	11,070	10,548
Total fixed maturity available-for-sale securities	\$ 56,553	\$ 54,518

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 of available-for-sale securities (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, 2008					
	Less Than Or Equal to Twelve Months		Greater Than Twelve Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds	\$ 17,482	\$ 945	\$ 6,742	\$ 1,271	\$ 24,224	\$ 2,216
U.S. Government bonds	37	1			37	1
Foreign government bonds	274	8	98	15	372	23
Asset and mortgage-backed securities:						
Mortgage pass-through securities	664	16	67	8	731	24
Collateralized mortgage obligations	2,024	159	896	259	2,920	418
Commercial mortgage-backed securities	1,082	51	647	131	1,729	182
State and municipal bonds	55	2	5		60	2
Redeemable preferred stocks	60	5	1		61	5
Total fixed maturity securities	21,678	1,187	8,456	1,684	30,134	2,871
Equity securities	350	190	15	2	365	192
Total available-for-sale securities	\$ 22,028	\$ 1,377	\$ 8,471	\$ 1,686	\$ 30,499	\$ 3,063
Total number of securities in an unrealized loss position						3,320

	As of December 31, 2007					
	Less Than Or Equal to Twelve Months		Greater Than Twelve Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds	\$ 11,540	\$ 679	\$ 4,467	\$ 266	\$ 16,007	\$ 945
U.S. Government bonds			3		3	
Foreign government bonds	95	4	51	4	146	8
Asset and mortgage-backed securities:						
Mortgage pass-through securities	32	1	193	4	225	5
Collateralized mortgage obligations	1,742	101	1,116	29	2,858	130
Commercial mortgage-backed securities	520	47	562	23	1,082	70
State and municipal bonds	29		17		46	
Redeemable preferred stocks	13	1			13	1
Total fixed maturity securities	13,971	833	6,409	326	20,380	1,159
Equity securities	402	42	8	1	410	43
Total available-for-sale securities	\$ 14,373	\$ 875	\$ 6,417	\$ 327	\$ 20,790	\$ 1,202
Total number of securities in an unrealized loss position						2,441

The fair value, gross unrealized losses (in millions) and number of available-for-sale securities where the fair value had declined below amortized cost by greater than 20%, were as follows:

	As of June 30, 2008		
	Fair Value	Gross Unrealized Losses	Number of Securities
Less than six months	\$ 198	\$ 102	59
Six months or greater, but less than nine months	354	255	27
Nine months or greater, but less than twelve months	225	128	38
Twelve months or greater	1,512	981	255
Total available-for-sale securities	\$ 2,289	\$ 1,466	379

	As of December 31, 2007		
	Fair Value	Gross Unrealized Losses	Number of Securities
Less than six months	\$ 136	\$ 49	22
Six months or greater, but less than nine months	427	138	32
Nine months or greater, but less than twelve months	364	110	17
Twelve months or greater	183	81	60
Total available-for-sale securities	\$ 1,110	\$ 378	131

As described more fully in Note 1 of our 2007 Form 10-K, we regularly review our investment holdings for other-than-temporary impairments. Based upon this review, the cause of the \$1.9 billion increase in our gross unrealized losses for the six months ended June 30, 2008, was attributable primarily to the combination of reduced liquidity in several market segments, deterioration in credit fundamentals and an increase in treasury rates. We believe that the securities in an unrealized loss position as of June 30, 2008 were not other-than-temporarily impaired due to our ability and intent to hold for a period of time sufficient for recovery.



**Trading Securities**

Trading securities at fair value retained in connection with modified coinsurance and coinsurance with funds withheld reinsurance arrangements (in millions) consisted of the following:

	As of June 30, 2008	As of December 31, 2007
Corporate bonds	\$ 1,850	\$ 1,999
U.S. Government bonds	376	367
Foreign government bonds	39	46
Asset and mortgage-backed securities:		
Mortgage pass-through securities	21	22
Collateralized mortgage obligations	137	160
Commercial mortgage-backed securities	99	107
State and municipal bonds	17	19
Redeemable preferred stocks	9	8
Total fixed maturity securities	2,548	2,728
Equity securities	2	2
Total trading securities	\$ 2,550	\$ 2,730

The portion of trading losses that relate to trading securities still held as of June 30, 2008, was \$91 million for the second quarter of 2008.

**Mortgage Loans on Real Estate**

Mortgage loans on real estate principally involve commercial real estate. The commercial loans are geographically diversified throughout the United States with the largest concentrations in California and Texas, which accounted for approximately 29% of mortgage loans as of June 30, 2008.

**Net Investment Income**

The major categories of net investment income (in millions) were as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007	2008	2007
Fixed maturity available-for-sale securities	\$ 855	\$ 845	\$ 1,713	\$ 1,689
Equity available-for-sale securities	8	12	17	20
Trading securities	42	44	85	90
Mortgage loans on real estate	129	132	250	262
Real estate	6	13	14	28
Policy loans	43	44	88	87
Invested cash	15	17	34	36
Alternative investments	13	70	8	90
Other investments	(3)	3	(2)	12
Investment income	1,108	1,180	2,207	2,314
Investment expense	(31)	(47)	(65)	(91)
Net investment income	\$ 1,077	\$ 1,133	\$ 2,142	\$ 2,223



**Realized Gain (Loss) Related to Investments**

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007	2008	2007
<b>Fixed maturity available-for-sale securities:</b>				
Gross gains	\$ 22	\$ 26	\$ 31	\$ 82
Gross losses	(138)	(46)	(238)	(53)
<b>Equity available-for-sale securities:</b>				
Gross gains		4	3	6
Gross losses	(7)		(7)	
Gain on other investments	3	5	28	1
Associated amortization expense of DAC, VOBA, DSI and DFEL and changes in other contract holder funds	24	(2)	49	(22)
<b>Total realized gain (loss) on investments, excluding trading securities</b>	<b>(96)</b>	<b>(13)</b>	<b>(134)</b>	<b>14</b>
Gain (loss) on certain derivative instruments	(29)	4	(32)	4
<b>Total realized gain (loss) on investments and certain derivative instruments, excluding trading securities</b>	<b>\$ (125)</b>	<b>\$ (9)</b>	<b>\$ (166)</b>	<b>\$ 18</b>
Write-downs for other-than-temporary impairments included in realized loss on available-for-sale securities above	\$ (120)	\$ (30)	\$ (211)	\$ (34)

See Note 11 for a comprehensive listing of realized gain (loss).

**Securities Lending**

The carrying values of securities pledged under securities lending agreements were \$602 million and \$655 million as of June 30, 2008, and December 31, 2007, respectively. The fair values of these securities were \$578 million and \$634 million as of June 30, 2008, and December 31, 2007, respectively.

**Reverse Repurchase Agreements**

The carrying values of securities pledged under reverse repurchase agreements were \$480 million as of June 30, 2008, and December 31, 2007. The fair values of these securities were \$508 million and \$502 million as of June 30, 2008, and December 31, 2007, respectively.

**Investment Commitments**

As of June 30, 2008, our investment commitments for fixed maturity securities (primarily private placements), limited partnerships, real estate and mortgage loans on real estate were \$1.2 billion, which includes \$337 million of standby commitments to purchase real estate upon completion and leasing.

**Concentrations of Financial Instruments**

As of June 30, 2008, and December 31, 2007, we did not have a significant concentration of financial instruments in a single investee, industry or geographic region of the U.S.

**Credit-Linked Notes**

As of June 30, 2008, and December 31, 2007, other contract holder funds on our Consolidated Balance Sheets included \$850 million and \$1.2 billion outstanding in funding agreements of the Lincoln National Life Insurance Company ( LNL ), respectively. LNL invested the proceeds of

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

\$850 million received for issuing three funding agreements in 2006 and 2007 into three separate credit-linked notes originated by third party companies. These credit-linked notes are classified as asset-backed securities and are

included in our fixed maturity securities on our Consolidated Balance Sheets. An additional \$300 million funding agreement was assumed as a result of the merger of Jefferson-Pilot, but was not invested into credit-linked notes. This \$300 million funding agreement matured on June 2, 2008.

We earn a spread between the coupon received on the credit-linked notes and the interest credited on the funding agreement. Our credit-linked notes were created using a trust that combines highly rated assets with credit default swaps to produce a multi-class structured security. Our affiliate, Delaware Investments, actively manages the credit default swaps in the underlying portfolios. The high quality asset in two of these transactions is a AAA-rated asset-backed security secured by a pool of credit card receivables. The high quality asset in the third transaction is a guaranteed investment contract issued by MBIA, which is further secured by a pool of high quality assets.

Consistent with other debt market instruments, we are exposed to credit losses within the structure of the credit-linked notes, which could result in principal losses to our investments. However, we have attempted to protect our investments from credit losses through the multi-tiered class structure of the credit-linked note, which requires the subordinated classes of the investment pool to absorb all of the initial credit losses. LNL owns the mezzanine tranche of these investments, which currently carries a mid- or low-AA rating. To date, there have been no defaults in any of the underlying collateral pools. Similar to other debt market instruments, our maximum principal loss is limited to our original investment of \$850 million as of June 30, 2008.

As in the general markets, spreads on these transactions have widened, causing unrealized losses. We had unrealized losses of \$390 million and \$190 million on the \$850 million in credit-linked notes as of June 30, 2008, and December 31, 2007, respectively. As described more fully in Note 1 of our 2007 Form 10-K, we regularly review our investment holdings for other-than-temporary impairments. Based upon this review, we believe that these securities were not other-than-temporarily impaired as of June 30, 2008, and December 31, 2007.

The following summarizes information regarding our investments in these securities (dollars in millions):

	Amount and Date of Issuance		
	\$400 December 2006	\$200 April 2007	\$250 April 2007
Amount of subordination <sup>(1)</sup>	\$ 2,184	\$ 410	\$ 1,167
Maturity	12/20/16	3/20/17	6/20/17
Current rating of tranche <sup>(1)</sup>	AA-	Aa2	A-
Number of entities <sup>(1)</sup>	125	100	102
Number of countries <sup>(1)</sup>	20	21	14

<sup>(1)</sup> As of June 30, 2008.

**5. DAC, VOBA, DSI and DFEL**

Changes in DAC (in millions) were as follows:

	<b>For the Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Balance at beginning-of-year	\$ 6,510	\$ 5,116
Cumulative effect of adoption of Statement of Position ( SOP ) 05-1 ( SOP 05-1 )		(31)
Deferrals	896	968
Amortization, net of interest:		
Unlocking	(10)	31
Other amortization	(403)	(385)
Adjustment related to realized gains on available-for-sale securities and derivatives	(10)	(27)
Adjustment related to unrealized losses on available-for-sale securities and derivatives	332	188
Foreign currency translation adjustment	1	13
Balance at end-of-period	\$ 7,316	\$ 5,873

Changes in VOBA (in millions) were as follows:

	<b>For the Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Balance at beginning-of-year	\$ 3,070	\$ 3,304
Cumulative effect of adoption of SOP 05-1		(35)
Business acquired		14
Deferrals	26	24
Amortization:		
Unlocking	(20)	9
Other amortization	(199)	(233)
Accretion of interest	67	70
Adjustment related to realized (gains) losses on available-for-sale securities and derivatives	13	(11)
Adjustment related to unrealized losses on available-for-sale securities and derivatives	334	78
Foreign currency translation adjustment	1	8
Balance at end-of-period	\$ 3,292	\$ 3,228

Changes in DSI (in millions) were as follows:

	<b>For the Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Balance at beginning-of-year	\$ 279	\$ 194
Cumulative effect of adoption of SOP 05-1		(3)
Deferrals	52	51
Amortization, net of interest:		
Unlocking	1	2
Other amortization	(15)	(16)
Adjustment related to realized gains on available-for-sale securities and derivatives	(3)	(3)
Balance at end-of-period	\$ 314	\$ 225

Changes in DFEL (in millions) were as follows:

	<b>For the Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Balance at beginning-of-year	\$ 1,183	\$ 977
Cumulative effect of adoption of SOP 05-1		(2)
Deferrals	206	203
Amortization, net of interest:		
Unlocking	(14)	9
Other amortization	(95)	(90)
Adjustment related to realized (gains) losses on available-for-sale securities and derivatives	1	(1)
Foreign currency translation adjustment	1	10
Balance at end-of-period	\$ 1,282	\$ 1,106

**6. Goodwill and Specifically Identifiable Intangibles**

The changes in the carrying amount of goodwill (in millions) by reportable segment were as follows:

	For the Six Months Ended June 30, 2008				Balance At End- of-Period
	Balance At Beginning- of-Year	Purchase Accounting Adjustments	Impairment	Foreign Currency Translation Adjustment	
<b>Individual Markets:</b>					
Life Insurance	\$ 2,201	\$ (9)	\$	\$	\$ 2,192
Annuities	1,046	(6)			1,040
<b>Employer Markets:</b>					
Retirement Products	20				20
Group Protection	274				274
Investment Management	247	1			248
Lincoln UK	17				17
Other Operations	339	(2)	(83)		254
<b>Total goodwill</b>	<b>\$ 4,144</b>	<b>\$ (16)</b>	<b>\$ (83)</b>	<b>\$</b>	<b>\$ 4,045</b>

The purchase accounting adjustments above relate to income tax deductions recognized when stock options attributable to mergers were exercised.

As a result of declines in current and forecasted advertising revenue for the entire radio market, we updated our intangible impairment review in the second quarter of 2008, which was outside of our annual process normally completed as of October 1 each year. This impairment test showed the implied fair value of our remaining radio properties were lower than their carrying amounts, therefore we recorded non-cash impairments of goodwill (set forth above) and specifically identifiable intangible (set forth below), based upon the guidance of SFAS 142. The impairment of goodwill did not have any offsetting tax benefit; therefore, our effective tax rate for the three and six months ended June 30, 2008, was elevated over the corresponding periods in 2007.

The gross carrying amounts and accumulated amortization (in millions) for each major specifically identifiable intangible asset class by reportable segment were as follows:

	As of June 30, 2008		As of December 31, 2007	
	Gross Carrying Amount	Accumulated Amortiza- tion	Gross Carrying Amount	Accumulated Amortiza- tion
<b>Individual Markets Life Insurance:</b>				
Sales force	\$ 100	\$ 9	\$ 100	\$ 7
<b>Employer Markets Retirement Products:</b>				
Mutual fund contract rights <sup>(1)</sup>	3		3	
<b>Investment Management:</b>				
Client lists	92	91	92	90
Other <sup>(1)</sup>	4		3	
<b>Other Operations:</b>				
FCC licenses <sup>(1)(2)</sup>	294		384	
Other	4	3	4	3
<b>Total</b>	<b>\$ 497</b>	<b>\$ 103</b>	<b>\$ 586</b>	<b>\$ 100</b>

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

- (1) No amortization recorded as the intangible asset has indefinite life.
- (2) We recorded FCC licenses impairment of \$90 million during the second quarter of 2008, as discussed above.

See Note 3 for goodwill and specifically identifiable intangibles included within discontinued operations.

## 7. Other Contract Holder Funds

Details of other contract holder funds (in millions) were as follows:

	As of June 30, 2008	As of December 31, 2007
Account values and other contract holder funds	\$ 58,337	\$ 57,698
Deferred front-end loads	1,282	1,183
Contract holder dividends payable	519	524
Premium deposit funds	133	140
Undistributed earnings on participating business	92	95
Total other contract holder funds	\$ 60,363	\$ 59,640

## 8. Federal Income Taxes

The effective tax rate was 38% and 30% for the three months ended June 30, 2008 and 2007, respectively. The effective tax rate for the six months ended June 30, 2008 and 2007 was 32% and 30%, respectively. Differences in the effective rates and the U.S. statutory rate of 35% in 2008 were the result of certain tax preferred investment income, separate account dividends-received deduction ( DRD ), foreign tax credits, other tax preference items and the impact of the goodwill impairment related to media operations, which did not have a corresponding tax effect. See Note 6 for additional information.

Changes to the Internal Revenue Code, administrative rulings or court decisions could increase our effective tax rate. In this regard, on August 16, 2007, the Internal Revenue Service ( IRS ) issued a revenue ruling that purports, among other things, to modify the calculation of the separate account DRD received by life insurance companies. Subsequently, the IRS issued another revenue ruling that suspended the August 16, 2007, ruling and announced a new regulation project on the issue. The current separate account DRD lowered the effective tax rate by approximately 12% and 4% for the three months ended June 30, 2008 and 2007, respectively, and 7% and 4% for the six months ended June 30, 2008 and 2007, respectively. The separate account deduction for dividends was relatively flat compared to prior quarters; however, its impact to the effective tax rate was the result of lower pre-tax income for the three months ended June 30, 2008.

We are required to establish a valuation allowance for any gross deferred tax assets that are unlikely to reduce taxes payable in future years tax returns. As of June 30, 2008, we believed that it was more likely than not that all gross deferred tax assets will reduce taxes payable in future years.

As of June 30, 2008, there have been no material changes to the balance of unrecognized tax benefits reported at December 31, 2007. We anticipate a change to our unrecognized tax benefits within the next 12 months in the range of none to \$12 million.

We recognize interest and penalties, if any, accrued related to unrecognized tax benefits as a component of tax expense.

In the normal course of business, we are subject to examination by taxing authorities throughout the U.S. and the U.K. At any given time, we may be under examination by state, local or non-U.S. income tax authorities.

## 9. Contingencies and Commitments

See Contingencies and Commitments in Note 13 to the consolidated financial statements in our 2007 Form 10-K for a discussion of commitments and contingencies, which information is incorporated herein by reference.

### *Regulatory and Litigation Matters*

Federal and state regulators continue to focus on issues relating to fixed and variable insurance products, including, but not limited to, suitability, replacements and sales to seniors. Like others in the industry, we have received inquiries including requests for information regarding sales to seniors from the Financial Industry Regulatory Authority, and we have responded to these inquiries. We continue to cooperate fully with such

authority.

In the ordinary course of its business, LNC and its subsidiaries are involved in various pending or threatened legal proceedings, including purported class actions, arising from the conduct of business. In some instances, these proceedings include claims for unspecified or substantial punitive damages and similar types of relief in addition to amounts for alleged contractual liability or requests for equitable relief. After consultation with legal counsel and a review of available facts, it is management's opinion that these proceedings, after consideration of any reserves and rights to indemnification, ultimately will be resolved without materially affecting the consolidated financial position of LNC. However, given the large and indeterminate amounts sought in certain of these proceedings and the inherent difficulty in predicting the outcome of such legal proceedings, including the proceeding described below, it is possible that an adverse outcome in certain matters could be material to our operating results for any particular reporting period.

*Transamerica Investment Management, LLC and Transamerica Investments Services, Inc. v. Delaware Management Holdings, Inc. (dba Delaware Investments), Delaware Investment Advisers and certain individuals*, was filed in the San Francisco County Superior Court on April 28, 2005. The plaintiffs are seeking substantial compensatory and punitive damages. The complaint alleges breach of fiduciary duty, breach of duty of loyalty, breach of contract, breach of the implied covenant of good faith and fair dealing, unfair competition, interference with prospective economic advantage, conversion, unjust enrichment and conspiracy, in connection with Delaware Investment Advisers' hiring of a portfolio management team from the plaintiffs. We and the individual defendants dispute the allegations and are vigorously defending these actions.

## 10. Stockholders' Equity and Shares

### Stockholders' Equity

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007	2008	2007
<b>Series A Preferred Stock</b>				
Balance at beginning-of-period	11,662	12,526	11,960	12,706
Conversion into common stock		(165)	(298)	(345)
Balance at end-of-period	11,662	12,361	11,662	12,361
<b>Common Stock</b>				
Balance at beginning-of-period	259,206,033	270,685,522	264,233,303	275,752,668
Conversion of Series A preferred stock		2,640	4,768	5,520
Stock compensation <sup>(1)</sup>	300,262	734,675	691,644	2,838,673
Deferred compensation payable in stock	17,725	25,929	67,079	69,161
Retirement of common stock by repurchase/cancellation of shares	(2,722,398)	(7,153)	(8,195,172)	(7,224,409)
Balance at end-of-period	256,801,622	271,441,613	256,801,622	271,441,613
Common stock at end-of-period:				
Assuming conversion of preferred stock	256,988,214	271,639,389	256,988,214	271,639,389
Diluted basis	257,825,399	274,489,187	257,825,399	274,489,187

<sup>(1)</sup> Amount includes non stock option awards issued, including issuances for benefit plans and stock options exercised.

**Earnings Per Share**

The income used in the calculation of our diluted earnings per share ( EPS ) is our income from continuing operations and net income, reduced by minority interest adjustments related to outstanding stock options under the Delaware Investments U.S., Inc. ( DIUS ) stock option incentive plan of less than \$1 million for all periods presented, and preferred dividends declared and payable. A reconciliation of the denominator (number of shares) in the calculations of basic and diluted net income and income from discontinued operations per share was as follows:

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Weighted-average shares, as used in basic calculation	257,785,473	270,566,521	259,368,519	272,716,140
Shares to cover conversion of preferred stock	186,592	199,012	187,824	199,980
Shares to cover non-vested stock	273,307	354,054	256,615	751,427
Average stock options outstanding during the period	9,199,383	13,307,765	9,596,842	13,815,359
Assumed acquisition of shares with assumed proceeds and benefits from exercising stock options (at average market price for the year)	(8,998,441)	(11,111,321)	(9,411,397)	(11,613,259)
Shares repurchasable from measured but unrecognized stock option expense	(100,707)	(257,704)	(85,157)	(256,675)
Average deferred compensation shares	1,271,413	1,345,246	1,277,542	1,326,853
Weighted-average shares, as used in diluted calculation	259,617,020	274,403,573	261,190,788	276,939,825

In the event the average market price of LNC common stock exceeds the issue price of stock options, such options would be dilutive to our EPS and will be shown in the table above. Participants in our deferred compensation plans that select LNC stock for measuring the investment return attributable to their deferral amounts will be paid out in LNC stock. The obligation to satisfy these deferred compensation plan liabilities is dilutive and is shown in the table above.

**11. Realized Gain (Loss)**

Details underlying realized gain (loss) (in millions) were as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007	2008	2007
Total realized gain (loss) on investments and certain derivative instruments, excluding trading securities <sup>(1)</sup>	\$ (125)	\$ (9)	\$ (166)	\$ 18
Gain (loss) on certain reinsurance derivative/trading securities <sup>(2)</sup>	1	4	2	4
Indexed annuity net derivative results <sup>(3)</sup> :				
Gross	3	13	11	11
Associated amortization expense of DAC, VOBA, DSI and DFEL	(1)	(6)	(6)	(6)
Guaranteed living benefits <sup>(4)</sup> :				
Gross	20	12	38	30
Associated amortization expense of DAC, VOBA, DSI and DFEL	(8)	(6)	(27)	(15)
Guaranteed death benefits <sup>(5)</sup> :				
Gross		(2)	2	(2)
Associated amortization expense of DAC, VOBA, DSI and DFEL		1	(1)	1
Gain on sale of subsidiaries/businesses	2		4	
<b>Total realized gain (loss)</b>	<b>\$ (108)</b>	<b>\$ 7</b>	<b>\$ (143)</b>	<b>\$ 41</b>

(1) See Note 4 Realized Gain (Loss) Related to Investments for detail.

(2) Represents changes in the fair value of total return swaps (embedded derivatives) related to various modified coinsurance and coinsurance with funds withheld reinsurance arrangements that have contractual returns related to various assets and liabilities associated with these arrangements. Changes in the fair value of these derivatives are offset by the change in fair value of trading securities in the portfolios that support these arrangements.

(3) Represents the net difference between the change in the fair value of the Standard & Poor's (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 products 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 as required under SFAS 133 and 157. The six months ended June 30, 2008, includes a \$10 million gain from the initial impact of adopting SFAS 157.

(4) Represents the net difference in the change in fair value of the embedded derivative liabilities of our guaranteed living benefit (GLB) products and the change in the fair value of the derivative instruments we own to hedge, including the cost of purchasing the hedging instruments. The six months ended June 30, 2008, includes a \$34 million loss from the initial impact of adopting SFAS 157.

(5) Represents the change in the fair value of the derivatives used to hedge our guaranteed death benefit (GDB) riders.

*Guaranteed Benefit Features*

We issue variable annuity contracts through our separate accounts for which investment income and investment gains and losses accrue directly to, and investment risk is borne by, the contract holder (traditional variable annuities). We also issue variable annuity and life contracts through separate accounts that include various types of GDB, guaranteed withdrawal benefit (GWB) and guaranteed income benefit (GIB) features. The GDB features include those where we contractually guarantee to the contract holder either: return of no less than total deposits made to the contract less any partial withdrawals (return of net deposits); total deposits made to the contract less any partial withdrawals plus a minimum return (minimum return); or the highest contract value on any contract anniversary date through age 80 minus any payments or withdrawals following the contract anniversary (anniversary contract value).

These guarantees are considered embedded derivatives and are recorded in future contract benefits on our Consolidated Balance Sheets at fair value under SFAS 133 and SFAS 157. Effective January 1, 2008, we adopted SFAS 157, which affected the valuation of our embedded derivatives. See Note 2 of this report for details on the adoption of SFAS 157. We use derivative instruments to hedge our exposure to the risks and earnings volatility that result from the embedded derivatives for living benefits in certain of our variable annuity products. The change in fair value of these instruments tends to move in the opposite direction of the change in fair value of the embedded derivatives. The net impact of these changes is reported as GLB, which is a component of realized gain (loss) discussed above.

Information in the event of death on the GDB features outstanding (dollars in millions) was as follows (our variable contracts with guarantees may offer more than one type of guarantee in each contract; therefore, the amounts listed are not mutually exclusive):

	As of June 30, 2008	As of December 31, 2007
<b>Return of Net Deposits</b>		
Variable annuity account value	\$ 43,337	\$ 44,833
Net amount at risk <sup>(1)</sup>	701	93
Average attained age of contract holders	56 years	55 years
<b>Minimum Return</b>		
Variable annuity account value	\$ 297	\$ 355
Net amount at risk <sup>(1)</sup>	46	25
Average attained age of contract holders	68 years	68 years
Guaranteed minimum return	5%	5%
<b>Anniversary Contract Value</b>		
Variable annuity account value	\$ 23,625	\$ 25,537
Net amount at risk <sup>(1)</sup>	2,104	359
Average attained age of contract holders	64 years	64 years

<sup>(1)</sup> Represents the amount of death benefit in excess of the current account balance at the end-of-period.

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 GDB (in millions), which were recorded in future contract benefits on our Consolidated Balance Sheets:

	For the Six Months Ended June 30,	
	2008	2007
Balance at beginning-of-year	\$ 38	\$ 23
Cumulative effect of adoption of SOP 05-1		(4)
Changes in reserves	25	10
Benefits paid	(11)	(3)
Balance at end-of-period	\$ 52	\$ 26

The changes to the benefit reserves amounts above are reflected in benefits on our Consolidated Statements of Income.

The results of the hedging program are included in realized gain (loss), which included gains of less than \$1 million and \$2 million for GDB for the three months and six months ended June 30, 2008, respectively, and losses of \$1 million and \$2 million for the three and six months ended June 30, 2007, respectively.

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

<b>Asset Type</b>	<b>As of June 30, 2008</b>	<b>As of December 31, 2007</b>
Domestic equity	\$ 37,447	\$ 44,982
International equity	11,899	8,076
Bonds	9,740	8,034
Money market	4,831	6,545
<b>Total</b>	<b>\$ 63,917</b>	<b>\$ 67,637</b>
Percent of total variable annuity separate account values	98%	97%

**12. Underwriting, Acquisition, Insurance and Other Expenses**

Details underlying underwriting, acquisition, insurance and other expenses (in millions) were as follows:

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Commissions	\$ 499	\$ 536	\$ 992	\$ 1,050
General and administrative expenses	422	452	844	863
DAC and VOBA deferrals and interest, net of amortization	(156)	(272)	(357)	(484)
Other intangibles amortization	2	3	3	5
Media expenses	15	15	31	30
Taxes, licenses and fees	49	52	112	117
Merger-related expenses	16	30	31	44
<b>Total</b>	<b>\$ 847</b>	<b>\$ 816</b>	<b>\$ 1,656</b>	<b>\$ 1,625</b>

**13. Employee Benefit Plans****Pension and Other Postretirement Benefit Plans**

The components of net defined benefit pension plan and postretirement benefit plan expense (in millions) were as follows:

	<b>For the Three Months Ended June 30,</b>			
	<b>Pension Benefits</b>		<b>Other Postretirement Benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>U.S. Plans</b>				
Service cost	\$	\$ 7	\$ 1	\$ 1
Interest cost	15	14	2	2
Expected return on plan assets	(20)	(20)		
Amortization of prior service cost		(1)		
Recognized net actuarial gain			(1)	(1)
<b>Net periodic benefit expense (recovery)</b>	<b>\$ (5)</b>	<b>\$</b>	<b>\$ 2</b>	<b>\$ 2</b>
<b>Non-U.S. Plans</b>				
Service cost	\$ 1	\$		
Interest cost	5	5		
Expected return on plan assets	(5)	(5)		
Recognized net actuarial loss	1	1		
<b>Net periodic benefit expense</b>	<b>\$ 2</b>	<b>\$ 1</b>		

	<b>For the Six Months Ended June 30,</b>			
	<b>Pension Benefits</b>		<b>Other Postretirement Benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>U.S. Plans</b>				
Service cost	\$	\$ 16	\$ 1	\$ 2
Interest cost	30	30	4	4
Expected return on plan assets	(39)	(40)	(1)	(1)
Amortization of prior service cost		(1)		
Recognized net actuarial gain	1		(1)	(1)
<b>Net periodic benefit expense (recovery)</b>	<b>\$ (8)</b>	<b>\$ 5</b>	<b>\$ 3</b>	<b>\$ 4</b>
<b>Non-U.S. Plans</b>				
Service cost	\$ 1	\$ 1		
Interest cost	10	9		
Expected return on plan assets	(11)	(10)		
Recognized net actuarial loss	2	2		
<b>Net periodic benefit expense</b>	<b>\$ 2</b>	<b>\$ 2</b>		

On May 1, 2007, simultaneous with our announcement of the freeze of our primary defined benefit pension plans, we announced a number of enhancements to our employees' 401(k) plan effective January 1, 2008. Consequently, we are no longer accruing service costs in our U.S. pension plans.

For any additional disclosures and other general information regarding our benefit plans, see Note 16 in our 2007 Form 10-K.



**14. Stock-Based Incentive Compensation Plans**

We sponsor various incentive plans for our employees, agents, directors and our subsidiaries that provide for the issuance of stock options, stock incentive awards, stock appreciation rights, restricted stock awards, restricted stock units ( performance shares ) and deferred stock units. DIUS has a separate stock-based incentive compensation plan, which has DIUS stock underlying the awards.

In the first quarter of 2008, a performance period from 2008-2010 was approved for our executive officers by the Compensation Committee. Executive officers participating in this performance period received one-half of their award in 10-year LNC or DIUS restricted stock units, with the remainder of the award in a combination of either: 100% performance shares or 75% performance shares and 25% cash. LNC stock options granted for this performance period vest ratably over the three-year period, based solely on a service condition. DIUS restricted stock units granted for this performance period vest ratably over a four-year period, based solely on a service condition and were granted only to employees of DIUS. Depending on the performance, the actual amount of performance shares could range from zero to 200% of the granted amount. Under the 2008-2010 plan, a total of 1,564,800 LNC stock options were granted; 2,726 DIUS restricted stock units were granted; and 218,308 LNC performance shares were granted during the six months ended June 30, 2008.

In addition to the stock-based grants noted above, various other LNC stock-based awards were granted in the three and six months ended June 30, 2008, which are summarized in the table below:

	<b>For the Three Months Ended June 30, 2008</b>	<b>For the Six Months Ended June 30, 2008</b>
<b>Awards</b>		
10-year LNC stock options	10,772	14,326
Non-employee director stock options		60,489
Non-employee agent stock options	20,982	197,113
Restricted stock	18,776	163,397
Stock appreciation rights		234,800

**15. Financial Instruments Carried at Fair Value**

See Fair Value of Financial Instruments in Note 19 to the consolidated financial statements in our 2007 Form 10-K and *SFAS No. 157 Fair Value Measurements* in Note 2 above for discussions of the methodologies and assumptions used to determine the fair value of our financial instruments.

The following table summarizes our financial instruments carried at fair value (in millions) on a recurring basis by the SFAS 157 fair value hierarchy levels described in Note 2. We did not have any assets or liabilities measured at fair value on a non-recurring basis during the second quarter of 2008 or as of June 30, 2008.

	As of June 30, 2008			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
<b>Assets</b>				
Investments:				
Available-for-sale securities:				
Fixed maturities	\$ 234	\$ 50,053	\$ 4,231	\$ 54,518
Equity	66	252	146	464
Trading securities	5	2,444	101	2,550
Derivative instruments		24	866	890
Cash and invested cash		1,921		1,921
Separate account assets		85,295		85,295
<b>Total assets</b>	<b>\$ 305</b>	<b>\$ 139,989</b>	<b>\$ 5,344</b>	<b>\$ 145,638</b>
<b>Liabilities</b>				
Other contract holder funds:				
Remaining guaranteed interest and similar contracts	\$	\$	\$ (298)	\$ (298)
Embedded derivative instruments – living benefits liabilities			(335)	(335)
Reinsurance related derivative liability		(112)		(112)
<b>Total liabilities</b>	<b>\$</b>	<b>\$ (112)</b>	<b>\$ (633)</b>	<b>\$ (745)</b>

Our investment securities are valued using market inputs, including benchmark yields, reported trades, broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. In addition, market indicators, industry and economic events are monitored and further market data is acquired if certain triggers are met. For certain security types, additional inputs may be used, or some of the inputs described above may not be applicable. For broker-quoted only securities, quotes from market makers or broker-dealers are obtained from sources recognized to be market participants. In order to validate the pricing information and broker-dealer quotes, we employ, where possible, procedures that include comparisons with similar observable positions, comparisons with subsequent sales, discussions with senior business leaders and brokers as well as observations of general market movements for those asset classes.

The following tables summarize changes to our financial instruments carried at fair value (in millions) and classified within level 3 of the fair value hierarchy. This summary excludes any impact of amortization on DAC, VOBA, DSI and DFEL. When a determination is made to classify an asset or liability within level 3 of the fair value hierarchy, the determination is based upon the significance of the unobservable inputs to the overall fair value measurement. Certain securities trade in less liquid or illiquid markets with limited or no pricing information, and the determination of fair value for these securities is inherently more difficult. However, level 3 fair value investments may include, in addition to the unobservable or level 3 inputs, observable components (that is, components that are actively quoted or can be validated to market-based sources). The gains and losses in the table below may include changes in fair value due in part to observable inputs that are a component of the valuation methodology.



## For the Three Months Ended June 30, 2008

	Beginning Fair Value	Items Included in Earnings, Net	Gains (Losses) in OCI	Sales, Issuances, Maturities, Settlements, Calls, Net	Transfers In or Out of Level 3, Net <sup>(1)</sup>	Ending Fair Value
<b>Investments:</b>						
Available-for-sale securities:						
Fixed maturities	\$ 4,223	\$ (13)	\$ (22)	\$ 133	\$ (90)	\$ 4,231
Equity	35	(6)	50	67		146
Trading securities	108	(6)		(1)		101
Derivative instruments	969	(118)	(5)	20		866
Other contract holder funds:						
Remaining guaranteed interest and similar contracts	(321)	21		2		(298)
Embedded derivative instruments living benefits liabilities	(535)	2	234	(36)		(335)
<b>Total, net</b>	<b>\$ 4,479</b>	<b>\$ (120)</b>	<b>\$ 257</b>	<b>\$ 185</b>	<b>\$ (90)</b>	<b>\$ 4,711</b>

## For the Six Months Ended June 30, 2008

	Beginning Fair Value	Items Included in Earnings, Net	Gains (Losses) in OCI	Sales, Issuances, Maturities, Settlements, Calls, Net	Transfers In or Out of Level 3, Net <sup>(1)</sup>	Ending Fair Value
<b>Investments:</b>						
Available-for-sale securities:						
Fixed maturities	\$ 4,420	\$ (15)	\$ (428)	\$ 62	\$ 192	\$ 4,231
Equity	54	(6)	31	67		146
Trading securities	112	(8)		(8)	5	101
Derivative instruments	767	(8)	5	102		866
Other contract holder funds:						
Remaining guaranteed interest and similar contracts	(389)	47		44		(298)
Embedded derivative instruments living benefits liabilities	(279)	4	9	(69)		(335)
<b>Total, net</b>	<b>\$ 4,685</b>	<b>\$ 14</b>	<b>\$ (383)</b>	<b>\$ 198</b>	<b>\$ 197</b>	<b>\$ 4,711</b>

<sup>(1)</sup> Transfers in or out of level 3 for available-for-sale and trading securities are displayed at amortized cost at the beginning of the period. For available-for-sale and trading securities, the difference between beginning of period amortized cost and beginning of period fair value was included in other comprehensive income ( OCI ) and earnings, respectively, in prior periods.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

The following tables provide the components of the items included in earnings, net, excluding any impact of amortization on DAC, VOBA, DSI and DFEL and changes in other contract holder funds, (in millions) as reported in the table above:

	For the Three Months Ended June 30, 2008				
	(Amortization) Accretion, Net	Other- Than- Temporary Impairment	Gains (Losses) from Sales, Maturities, Settlements, Calls	Unrealized Holding Gains (Losses)	Total
Investments:					
Available-for-sale securities:					
Fixed maturities <sup>(1)</sup>	\$ 1	\$ (14)	\$	\$	\$ (13)
Equity		(6)			(6)
Trading securities <sup>(1)</sup>	1	(7)			(6)
Derivative instruments <sup>(2)</sup>			4	(122)	(118)
Other contract holder funds:					
Remaining guaranteed interest and similar contracts <sup>(2)</sup>			6	15	21
Embedded derivative instruments living benefits liabilities <sup>(2)</sup>				2	2
Total, net	\$ 2	\$ (27)	\$ 10	\$ (105)	\$ (120)

	For the Six Months Ended June 30, 2008				
	(Amortization) Accretion, Net	Other- Than- Temporary Impairment	Gains (Losses) from Sales, Maturities, Settlements, Calls	Unrealized Holding Gains (Losses)	Total
Investments:					
Available-for-sale securities:					
Fixed maturities <sup>(1)</sup>	\$ 1	\$ (16)	\$	\$	\$ (15)
Equity		(6)			(6)
Trading securities <sup>(1)</sup>	1	(7)		(2)	(8)
Derivative instruments <sup>(2)</sup>			(23)	15	(8)
Other contract holder funds:					
Remaining guaranteed interest and similar contracts <sup>(2)</sup>			10	37	47
Embedded derivative instruments living benefits liabilities <sup>(2)</sup>				4	4
Total, net	\$ 2	\$ (29)	\$ (13)	\$ 54	\$ 14

<sup>(1)</sup> Amortization and accretion, net and unrealized holding losses are included in net investment income on our Consolidated Statements of Income. All other amounts are included in realized gain (loss) on our Consolidated Statements of Income.

<sup>(2)</sup> All amounts are included in realized gain (loss) on our Consolidated Statements of Income.



The fair value of available-for-sale fixed maturity securities (in millions) classified within level 3 of the fair value hierarchy was as follows:

	<b>As of June 30, 2008</b>	
	<b>Fair Value</b>	<b>% of Total Fair Value</b>
Corporate bonds	\$ 2,327	55.0%
Asset-backed securities	807	19.1%
Commercial mortgage-backed securities	360	8.5%
Collateralized mortgage obligations	223	5.3%
Mortgage pass-through securities	105	2.5%
Municipals	129	3.0%
Government and government agencies	249	5.9%
Redeemable preferred stock	31	0.7%
<b>Total available-for-sale fixed maturity securities</b>	<b>\$ 4,231</b>	<b>100.0%</b>

	<b>As of December 31, 2007</b>	
	<b>Fair Value</b>	<b>% of Total Fair Value</b>
Corporate bonds	\$ 2,143	48.5%
Asset-backed securities	1,113	25.2%
Commercial mortgage-backed securities	395	8.9%
Collateralized mortgage obligations	296	6.7%
Mortgage pass-through securities	31	0.7%
Municipals	139	3.1%
Government and government agencies	272	6.2%
Redeemable preferred stock	31	0.7%
<b>Total available-for-sale fixed maturity securities</b>	<b>\$ 4,420</b>	<b>100.0%</b>

## 16. Segment Information

As of June 30, 2008, we provided products and services in four operating businesses: Individual Markets, Employer Markets, Investment Management and Lincoln UK, and report results through six business segments. We also have Other Operations, which includes the financial data for operations that are not directly related to the business segments. Other Operations also includes the Institutional Pension business, which was previously reported in Employer Markets Retirement Products.

On July 21, 2008, we announced the realignment of our segments under our former Employer Markets and Individual Markets operating businesses into two new operating businesses Retirement Solutions and Insurance Solutions. We believe the new structure more closely aligns with consumer needs and should lead to more coordinated product development and greater effectiveness across the enterprise. The only change to our current segment reporting will be to report the results of the Executive Benefits business, which as of June 30, 2008, was part of the Retirement Products segment, in the Life Insurance segment. Accordingly, for the third quarter of 2008, we will provide products and services in four operating business and report results through six segments as follows:

<b>Business</b>	<b>Corresponding Segments</b>
Retirement Solutions	Annuities Defined Contribution (formerly Retirement Products)
Insurance Solutions	Life Insurance (including Executive Benefits business) Group Protection
Investment Management	Investment Management
Lincoln UK	Lincoln UK

These changes to the Retirement Products and the Life Insurance segments are in accordance with the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, and reflect the manner in which we are organized for purposes of making operating decisions and assessing performance. Our segment results will be reported under this new structure beginning in the third quarter of 2008, and we will restate results from prior periods in a consistent manner. We view the changes to the existing segments as immaterial.

Beginning with the quarter ended June 30, 2008, we changed our definitions of segment operating revenues and income from operations to better reflect: the underlying economics of our variable and indexed annuities that employ derivative instruments to hedge policy benefits and the manner in which management evaluates that business. Our change in the definition of income from operations is primarily the result of our adoption of SFAS 157 during the first quarter of 2008. See Note 2. Under SFAS 157's fair value calculation, we are required to fair value these annuities from an exit value perspective, (i.e., what a market participant or willing buyer would charge to assume the liability). We, therefore, must include margins that a market participant buyer would require as well as a factor for non-performance risk related to our credit quality. We do not believe that these factors relate to the economics of the underlying business and do not reflect the manner in which management evaluates the business. The items that are now excluded from our operating results that were previously included are as follows: GLB net derivatives results; indexed annuity forward-starting option; and GDB derivatives results. See Note 11 for more information about these items.

We continue to exclude the effects of any realized gain (loss) on investments from segment operating revenues and income from operations as we believe that such items are not necessarily indicative of current operating fundamentals or future performance of the business segments, and, in many instances, decisions regarding these items do not necessarily relate to the operations of the individual segments.

We believe that our new definitions of operating revenues and income (loss) from operations will provide investors with a more valuable measure of our performance because it better reveals trends in our business.

Segment operating revenues and income (loss) from operations are internal measures used by our management and Board of Directors to evaluate and assess the results of our segments. Income (loss) from operations is GAAP net income excluding the after-tax effects of the following items, as applicable:

Realized gains and losses associated with the following ( excluded realized gain (loss) ):

Sale or disposal of securities;

Impairments of securities;

Change in the fair value of embedded derivatives within certain reinsurance arrangements and the change in the fair value of related trading securities;

Change in the fair value of the embedded derivatives of our GLBs within our variable annuities net of the change in the fair value of the derivatives we own to hedge the changes in the embedded derivative;

Net difference between the benefit ratio unlocking of SOP No. 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts reserves on our GDB riders within our variable annuities and the change in the fair value of the derivatives excluding our expected cost of purchasing the hedging instruments; and

Changes in the fair value of the 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 as required under SFAS 133 and 157.

Income (loss) from the initial adoption of changes in accounting principles;

Income (loss) from reserve changes (net of related amortization) on business sold through reinsurance;

Losses on early retirement of debt, including subordinated debt;

Losses from the impairment of intangible assets; and

Income (loss) from discontinued operations.

Operating revenues represent GAAP revenues excluding the pre-tax effects of the following items, as applicable:

Excluded realized gain (loss);

Amortization of deferred gains arising from the reserve changes on business sold through reinsurance; and

Revenue adjustments from the initial impact of the adoption of changes in accounting principles. Operating revenues and income (loss) from operations do not replace revenues and net income as the GAAP measures of our consolidated results of operations.

Segment information (in millions) was as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2008	2007	2008	2007
<b>Revenues</b>				
Operating revenues:				
Individual Markets:				
Annuities	\$ 618	\$ 624	\$ 1,241	\$ 1,214
Life Insurance	1,021	957	2,008	1,929
Total Individual Markets	1,639	1,581	3,249	3,143
Employer Markets:				
Retirement Products	304	318	608	634
Group Protection	425	391	824	751
Total Employer Markets	729	709	1,432	1,385
Investment Management <sup>(1)</sup>	125	151	245	301
Lincoln UK <sup>(2)</sup>	98	93	183	183
Other Operations	110	123	229	233
Excluded realized gain (loss), pre-tax	(120)	6	(166)	39
Amortization of deferred gain arising from reserve changes on business sold through reinsurance, pre-tax	1	8	2	8
Total revenues	\$ 2,582	\$ 2,671	\$ 5,174	\$ 5,292

(1) Revenues for the Investment Management segment included inter-segment revenues for asset management services provided to our other segments. These inter-segment revenues totaled \$21 million and \$19 million for the three months ended June 30, 2008 and 2007, respectively, and \$41 million and \$44 million for the six months ended June 30, 2008 and 2007, respectively.

(2) Revenues from our Lincoln UK segment represent our revenues from a foreign country.

	For the Three Months Ended June 30, 2008		For the Six Months Ended June 30, 2007	
<b>Net Income</b>				
Income (loss) from operations:				
Individual Markets:				
Annuities	\$ 116	\$ 123	\$ 234	\$ 240
Life Insurance	153	176	298	343
Total Individual Markets	269	299	532	583
Employer Markets:				
Retirement Products	52	58	104	120
Group Protection	32	29	58	52
Total Employer Markets	84	87	162	172
Investment Management	15	11	27	28
Lincoln UK	18	12	29	23
Other Operations	(44)	(35)	(86)	(65)
Excluded realized gain (loss), after-tax	(78)	4	(108)	25
Income (loss) from reserve changes (net of related amortization) on business sold through reinsurance, after-tax		(8)	1	(8)
Impairment of intangibles, after-tax	(139)		(139)	
Income from continuing operations, after-tax	125	370	418	758
Income (loss) from discontinued operations, after-tax		6	(4)	14
Net income	\$ 125	\$ 376	\$ 414	\$ 772

### 17. Supplemental Disclosures of Cash Flow and Fair Value of Financial Instruments Information

The following summarizes our supplemental cash flow data (in millions):

	For the Six Months Ended June 30, 2008		2007	
Significant non-cash investing and financing transactions:				
Business combinations:				
Fair value of assets acquired (includes cash and invested cash)	\$	\$ 86		
Fair value of common stock issued and stock options recognized		(20)		
Cash paid for common shares		(1)		
Liabilities assumed			65	
Business dispositions:				
Assets disposed (includes cash and invested cash)		(732)		
Liabilities disposed		127		
Cash received		647		
Realized gain on disposal		42		
Estimated gain on net assets held-for-sale in prior periods		(54)		
Loss on discontinued operations in current period	\$	(12)	\$	

Sale of subsidiaries/businesses:

Proceeds from sale of subsidiaries/businesses, reported as gain on sale of subsidiaries/businesses	\$	5	\$
--	----	---	----

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

	As of June 30, 2008		As of December 31, 2007	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Short-term debt	\$ (900)	\$ (896)	\$ (550)	\$ (550)
Long-term debt	(4,102)	(3,817)	(4,618)	(4,511)

#### 18. Subsequent Event

During July 2008, we borrowed \$200 million under a new \$200 million borrowing facility. The facility expires, and all outstanding loans under the facility mature, on July 18, 2013. Proceeds from this borrowing were used for general corporate purposes and to repay maturing debt.

On July 21, 2008, we announced the realignment of our Employer Markets and Individual Markets businesses into two new businesses Retirement Solutions and Insurance Solutions. Our other businesses, including Investment Management, Lincoln UK and Other Operations, remain unchanged. The new structure is more closely aligned with consumer needs and will lead to more coordinated product development and greater effectiveness across the enterprise. Our segment results will be reported under this new structure beginning in the third quarter of 2008, and we will restate results from prior periods in a consistent manner. For more information regarding the realignment, see Note 16.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following Management's Discussion and Analysis ( MD&A ) is intended to help the reader understand the financial condition of Lincoln National Corporation and its consolidated subsidiaries ( LNC, Lincoln or the Company, which also may be referred to as we, our or us ) as of June 30, 2008, compared with December 31, 2007, and the results of operations of LNC for the three and six months ended June 30, 2008, as compared with the corresponding periods in 2007. The MD&A is provided as a supplement to and should be read in conjunction with our consolidated financial statements and the accompanying notes to the consolidated financial statements ( Notes ) presented in Item 1. Financial Statements and our Form 10-K for the year ended December 31, 2007 ( 2007 Form 10-K ), including the sections entitled Part I Item 1A. Risk Factors, Part II Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Part II Item 8. Financial Statements and Supplementary Data.

In this report, in addition to providing consolidated revenues and net income (loss), we also provide segment operating revenues and income (loss) from operations because we believe they are meaningful measures of revenues and the profitability of our operating segments. Income (loss) from operations is net income recorded in accordance with United States of America generally accepted accounting principles ( GAAP ) excluding the after-tax effects of the following items, as applicable:

Realized gains and losses associated with the following ( excluded realized gain (loss) ):

Sale or disposal of securities;

Impairments of securities;

Change in the fair value of embedded derivatives within certain reinsurance arrangements and the change in the fair value of related trading securities;

Change in the fair value of the embedded derivatives of our guaranteed living benefits ( GLB ) within our variable annuities net of the change in the fair value of the derivatives we own to hedge the changes in the embedded derivative;

Net difference between the benefit ratio unlocking of Statement of Position ( SOP ) No. 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts ( SOP 03-1 ) reserves on our guaranteed death benefit ( GDB ) riders within our variable annuities and the change in the fair value of the derivatives excluding our expected cost of purchasing the hedging instruments; and

Changes in the fair value of the 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 as required under Statements of Financial Accounting Standards ( SFAS ) No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ) and SFAS No. 157, Fair Value Measurements ( SFAS 157 ).

Income (loss) from the initial adoption of changes in accounting principles;

Income (loss) from reserve changes (net of related amortization) on business sold through reinsurance;

Losses on early retirement of debt, including subordinated debt;

## Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Losses from the impairment of intangible assets; and

Income (loss) from discontinued operations.

Operating revenues represent GAAP revenues excluding the pre-tax effects of the following items, as applicable:

Excluded realized gain (loss);

Amortization of deferred gains arising from the reserve changes on business sold through reinsurance; and

Revenue adjustments from the initial impact of the adoption of changes in accounting principles.

Operating revenues and income (loss) from operations are the financial performance measures we use to evaluate and assess the results of our segments. Accordingly, we report operating revenues and income (loss) from operations by segment in Note 16. Our management and Board of Directors believe that operating revenues and income (loss) from operations explain the results of our ongoing businesses in a manner that allows for a better understanding of the underlying trends in our current businesses because the excluded items are unpredictable and not necessarily indicative of current operating fundamentals or future performance of the business segments, and, in many instances, decisions regarding these items do not necessarily relate to the operations of the individual segments. Operating revenues and income (loss) from operations do not replace revenues and net income as the GAAP measures of our consolidated results of operations.

Beginning with the quarter ended June 30, 2008, we changed our definitions of segment operating revenues and income from operations to better reflect: the underlying economics of our variable and indexed annuities that employ derivative instruments to hedge policy benefits; and the manner in which management evaluates that business. Our change in the definition of income from operations is primarily the result of our adoption of SFAS 157 during the first quarter of 2008. See Note 2. Under SFAS 157's fair value calculation, we are required to fair value these annuities from an exit value perspective, (i.e., what a market participant or

willing buyer would charge to assume the liability). We, therefore, must include margins that a market participant buyer would require as well as a factor for non-performance risk related to our credit quality. We do not believe that these factors relate to the economics of the underlying business and do not reflect the manner in which management evaluates the business. The items that are now excluded from our operating results that were previously included are as follows: GLB net derivatives results; indexed annuity forward-starting option; and GDB derivatives results. For more information regarding this change, see our current report on Form 8-K dated July 16, 2008.

We continue to exclude the effects of any realized gain (loss) on investments from segment operating revenues and income from operations as we believe that such items are not necessarily indicative of current operating fundamentals or future performance of the business segments, and, in many instances, decisions regarding these items do not necessarily relate to the operations of the individual segments.

We believe that our new definitions of operating revenues and income (loss) from operations will provide investors with a more valuable measure of our performance because it better reveals trends in our business. See Realized Gain (Loss) below for more information about these items.

Certain reclassifications have been made to prior periods' financial information. Included in these reclassifications is the change in our definition of segment operating revenues and income (loss) from operations as discussed above. In addition, we have reclassified the results of certain derivatives and embedded derivatives to realized gain (loss), which were previously reported within insurance fees, net investment income, interest credited or benefits. The associated amortization expense of deferred acquisition costs ( DAC ) and value of business acquired ( VOBA ) (previously reported within underwriting, acquisition, insurance and other expenses), deferred sales inducements ( DSI ) (previously reported within interest credited), deferred front-end loads ( DFEL ) (previously reported within insurance fees) and changes in contract holder funds (previously reported within benefits) have also been reclassified to realized gain (loss). See Note 1 for additional information.

#### FORWARD-LOOKING STATEMENTS CAUTIONARY LANGUAGE

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

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

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

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

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

A decline in the equity markets causing a reduction in the sales of LNC's products, a reduction of asset-based fees that LNC charges on various investment and insurance products, an acceleration of amortization of DAC, VOBA, DSI and DFEL and an increase in liabilities related to guaranteed benefit features of LNC's variable annuity products;

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

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

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

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

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

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

The impact of acquisitions and divestitures, restructurings, product withdrawals and other unusual items, including LNC's ability to integrate acquisitions and to obtain the anticipated results and synergies from acquisitions, including LNC's ability to successfully integrate Jefferson-Pilot Corporation ( Jefferson-Pilot ) businesses acquired on April 3, 2006, to achieve the expected synergies from the merger or to achieve such synergies within our expected timeframe;

The adequacy and collectibility of reinsurance that LNC has purchased;

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

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

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

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

Changes in general economic or business conditions, both domestic and foreign, that may be less favorable than expected and may affect foreign exchange rates, premium levels, claims experience, the level of pension benefit costs and funding and investment results; and

Continued economic declines and credit market volatility that could cause us to realize additional impairments on investments and certain intangible assets and dampen future earnings.

The risks included here are not exhaustive. Other sections of this report, our 2007 Form 10-K, current reports on Form 8-K and other documents filed with the Securities and Exchange Commission ( SEC ) include additional factors that could impact LNC's business and financial performance, including Item 3. Quantitative and Qualitative Disclosures About Market Risk and the risk discussions included in this section under Critical Accounting Policies and Estimates, Consolidated Investments and Reinsurance, which are incorporated herein by reference. Moreover, LNC operates in a rapidly changing and competitive environment. New risk factors emerge from time to time, and it is not possible for management to predict all such risk factors.

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

obligation to update any forward-looking statements to reflect events or circumstances that occur after the date of this report.

## INTRODUCTION

### *Executive Summary*

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

As of June 30, 2008, we provided products and services in four operating businesses: Individual Markets, Employer Markets, Investment Management and Lincoln UK, and reported results through six business segments: Individual Markets Annuities; Individual Markets Life Insurance; Employer Markets Retirement Products; Employer Markets Group Protection; Investment Management; and Lincoln UK. These operating businesses and their segments are described in Part I Item 1. Business of our 2007 Form 10-K. We also have Other Operations, which includes the financial data for operations that are not directly related to the business segments. Other Operations also includes the Institutional Pension business, which was previously reported in Employer Markets Retirement Products.

On July 21, 2008, we announced the realignment of our segments under our former Employer Markets and Individual Markets operating businesses into two new operating businesses Retirement Solutions and Insurance Solutions. We believe the new structure more closely aligns with consumer needs and should lead to more coordinated product development and greater effectiveness across the enterprise. The only change to our current segment reporting will be to report the results of the Executive Benefits business, which as of June 30, 2008, was part of the Retirement Products segment, in the Life Insurance segment. Accordingly, for the third quarter of 2008, we will provide products and services in four operating business and report results through six segments as follows:

<b>Business</b>	<b>Corresponding Segments</b>
Retirement Solutions	Annuities Defined Contribution (formerly Retirement Products)
Insurance Solutions	Life Insurance (including Executive Benefits business) Group Protection
Investment Management	Investment Management
Lincoln UK	Lincoln UK

These changes to the Retirement Products and the Life Insurance segments are in accordance with the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, and reflect the manner in which we are organized for purposes of making operating decisions and assessing performance. Our segment results will be reported under this new structure beginning in the third quarter of 2008, and we will restate results from prior periods in a consistent manner. We view the changes to the existing segments as immaterial.

### **Current Market Conditions**

During the first half of the year, the capital markets continued to experience high volatility that affected both equity market returns and interest rates. In addition, we also saw the widening of credit spreads across asset classes and reduced liquidity in the credit markets. Earnings in the second half of 2008 will be unfavorably impacted by the significant decline in the Standard & Poor's (S&P) 500 Index during June. While the average S&P 500 Index<sup>®</sup> for second quarter was higher than first quarter, the S&P 500 Index<sup>®</sup> ended June at a lower level than the average because favorable equity market performance in April and May was largely offset by unfavorable performance in June. Due to these challenges, the capital markets had a significant effect on our segment operating income and consolidated net income for the three and six months ended June 30, 2008. The markets impact primarily the following areas:

#### *Earnings from Assets Under Management*

Our asset-gathering segments: Individual Markets Annuities; Employer Markets Retirement Products; and Investment Management; are sensitive to the equity markets. We discuss the earnings impact of the equity markets on account values, assets under management and the related asset-based fees below in Item 3. Quantitative and Qualitative Disclosures About Market Risk Equity Market Risk Impact of Equity Market Sensitivity. From the end of 2007 to June 30, 2008, the daily average value of the S&P 500 Index<sup>®</sup> decreased 7%. Solely as a result of the equity markets, our assets under management as of June 30, 2008, were down \$14.1 billion from the end of the year. Strong deposits over the last year helped to more than offset this impact for the three and six months ended June 30, 2008, compared to the same periods in 2007.

#### *Investment Income on Alternative Investments*

We believe that overall market conditions in both the equity and credit markets caused our alternative investments portfolio, which consists mostly of hedge funds and various limited partnership investments, to under-perform relative to our long-term expectations and the prior periods. This impact was primarily in our Individual Markets Life Insurance, Employer Markets Retirement Products and Individual Markets Annuities segments. See Consolidated Investments Alternative Investments for additional information on our investment portfolio.

#### *Variable Annuity Living Benefit Hedge Program Results*

We offer variable annuity products with living benefit guarantees. These guarantees are considered embedded derivatives and are recorded on our Consolidated Balance Sheets at fair value under SFAS 133 and SFAS 157. Effective January 1, 2008, we adopted SFAS 157, which affected the valuation of our embedded derivatives. See Note 2 of this report for details on the adoption of SFAS 157. As described below in Critical Accounting Policies and Estimates Derivatives Guaranteed Living Benefits, we use



derivative instruments to hedge our exposure to the risks and earnings volatility that result from the embedded derivatives for living benefits in certain of our variable annuity products. The change in fair value of these instruments tends to move in the opposite direction of the change in fair value of the embedded derivatives. For the three and six months ended June 30, 2008, the market conditions noted above negatively affected the net result of the change in the fair value of the living benefit embedded derivative, excluding the effect of a change in our non-performance risk factor, and the change in fair value of the hedging derivatives. The change in our non-performance risk factor used in the calculation of the embedded derivative liability had a favorable effect resulting in an overall positive outcome. These results are excluded from operating revenues and income (loss) from operations.

#### *Credit Losses, Impairments and Unrealized Losses*

Related to our investments in fixed income and equity securities, we experienced net realized losses of \$125 million and \$166 million for the three and six months ended June 30, 2008, which included gross write-downs of securities for other-than-temporary impairments of \$120 million and \$211 million, respectively. Widening spreads was the primary cause of an increase in gross unrealized losses of \$1.7 billion on investments in our general account for the six months ended June 30, 2008, for our available-for-sale fixed maturity securities. These unrealized losses were concentrated in the investment grade category of investments and demonstrate how reduced liquidity in the credit markets have resulted in a decline in asset values as investors shift their investments to safer government securities, such as U.S. Treasuries.

We recorded \$139 million, after-tax, of impairment of goodwill and our Federal Communications Commission ( FCC ) license intangible assets on our remaining radio clusters attributable primarily to declines in advertising revenues for the entire radio market.

The effect of the negative equity markets on our assets under management in the first six months of 2008 will continue to dampen our earnings throughout 2008 even if, for the remainder of the year, the equity market returns are consistent with our long-term assumptions. Accordingly, we may continue to report lower asset-based fees relative to expectations or prior periods. The volatility and uncertainty in the capital markets will also likely result in lower than expected returns on alternative investments. In addition, a continued weakness in the economic environment could lead to increased credit defaults.

In the face of these capital market challenges, we continue to focus on building our businesses through these difficult markets and beyond by developing and introducing high quality products, expanding distribution in new and existing key accounts and channels and targeting market segments that have high growth potential while maintaining a disciplined approach to managing our expenses.

#### **Strategic and Operational Review**

Continual product development and distribution expansion are important to our ability to meet the challenges of the competitive marketplace. In February 2008, our Individual Markets Annuities segment launched a new guaranteed withdrawal benefit ( GWB ), *Lincoln Lifetime Income Advantage*, which includes features such as: a reduced minimum age for lifetime income eligibility; a 5% benefit enhancement in each year an owner does not take a withdrawal; a health care benefit; and a guaranteed minimum accumulation benefit. In our Individual Markets Life Insurance segment, we intend to launch a variable life insurance product in the third quarter of 2008 after receiving appropriate regulatory approvals. Within the mid-sized market of our Employer Markets Retirement Products segment, in the first quarter we launched our *Lincoln SmartFuture*<sup>SM</sup> retirement program to fill the gap between our Alliance program and our group variable annuities.

In terms of increasing our distribution breadth, we launched variable annuity products into three large banks during the first half of 2008. In support of these and other activities, Lincoln Financial Distributors ( LFD ) increased the number of wholesalers by 9% since the end of 2007 with additional increases expected in the remainder of the year.

#### **Challenges and Outlook**

For the remainder of 2008, we expect major challenges to include:

Continuation of volatility in the equity and credit markets;

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

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Continuation of challenges in the economy or a recession;

Achieving success in our portfolio of products and marketplace acceptance of new variable annuity features that will help maintain our competitive position;

Continuation of the successful expansion of our wholesale distribution businesses;

Ability to improve financial and sales results and increase scale in our Employer Markets Defined Contribution and Investment Management businesses;

Continuation of focus by the government on tax reform including potential changes in company dividends-received deduction calculations, which may impact our products and overall earnings;

Continuation of competitive pressures in the life insurance and annuity marketplace; and

Regulatory scrutiny of the life and annuity industry, which may lead to higher product costs and negative perceptions about the industry. In the face of these challenges, we expect to focus on the following throughout the remainder of 2008:

Continue to significantly invest in expanding our distribution in each of our core Retirement Solutions, Insurance Solutions and Investment Management businesses;

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

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

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

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

***Critical Accounting Policies and Estimates***

The MD&A included in our 2007 Form 10-K contains a detailed discussion of our critical accounting policies and estimates. The following information updates the critical accounting policies and estimates provided in our 2007 Form 10-K and, accordingly, should be read in conjunction with the critical accounting policies and estimates discussed in our 2007 Form 10-K.

**Adoption of SFAS No. 157 Fair Value Measurements**

We adopted SFAS 157 for all our financial instruments effective January 1, 2008. For detailed discussions of the methodologies and assumptions used to determine the fair value of our financial instruments and a summary of our financial instruments carried at fair value as of June 30, 2008, see Notes 2 and 15 of this report and Notes 1 and 19 to the consolidated financial statements in our 2007 Form 10-K.

The adoption of SFAS 157 decreased income from continuing operations by \$16 million. The impact to revenue is reported in realized gain (loss) and such amount along with the associated federal income taxes is excluded from income from operations of our segments. For a detailed description of the impact of adoption on our consolidated financial statements, see Note 2.

We did not make any material changes to valuation techniques or models used to determine the fair value of our assets and liabilities carried at fair value during the three and six months ended June 30, 2008, subsequent to the adoption of SFAS 157. As part of our on-going valuation process, we assess the reasonableness of all our valuation techniques or models and make adjustments as necessary.

Our investment securities are valued using market inputs, including benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. In addition, market indicators and industry and economic events are monitored, and further market data is acquired if certain triggers are met. For certain security types, additional inputs may be used, or some of

the inputs described above may not be applicable. For broker-quoted only securities, quotes from market makers or broker-dealers are obtained from sources recognized to be market participants. In order to validate the pricing information and broker/dealer quotes, we employ, where possible, procedures that include comparisons with similar observable positions, comparisons with subsequent sales, discussions with senior business leaders and brokers as well as observations of general market movements for those asset classes. It is possible that different valuation techniques and models could produce materially different estimates of fair values.

Our insurance liabilities that contain embedded derivatives are valued based on a stochastic projection of scenarios of the embedded derivative fees, benefits and expenses. The scenario assumptions, at each valuation date, are those we view to be appropriate for a hypothetical market participant and include assumptions for capital markets, actuarial lapse, benefit utilization, mortality, risk margin, administrative expenses and a margin for profit. In addition, a non-performance risk component is determined each valuation date that reflects our risk of not fulfilling the obligations of the underlying liability. The spread for the non-performance risk is added to the discount rates used in determining the fair value from the net cash flows. We believe these assumptions are consistent with those that would be used by a market participant; however, as the related markets develop we will continue to reassess our assumptions. It is possible that different valuation techniques and assumptions could produce a materially different estimate of fair value.

The adoption of SFAS 157 increased our exposure to earnings volatility from period to period due primarily to the inclusion of the non-performance risk into the calculation of the GLB embedded derivative liability. For additional information, see our discussion in Realized Gain (Loss) below.

The following summarizes the percentages of our financial instruments carried at fair value on a recurring basis by the SFAS 157 hierarchy levels:

	As of June 30, 2008			Total Fair Value
	Level 1	Level 2	Level 3	
Assets	1%	90%	9%	100%
Liabilities	0%	15%	85%	100%

Note: The percentages above are calculated excluding separate account assets.

Changes of our financial instruments carried at fair value and classified within level 3 of the fair value hierarchy result from changes in market conditions, as well as changes in our portfolio mix and increases and decreases in fair values as a result of those classifications. During the three and six months ended June 30, 2008, there were no material changes in financial instruments classified as level 3 of the fair value hierarchy. For further detail, see Note 15.

See Consolidated Investments below for a summary of our investments in available-for-sale securities backed by pools of residential mortgages.

## Derivatives

To protect us from a variety of equity market and interest rate risks that are inherent in many of our life insurance and annuity products, we use various derivative instruments. Assessing the effectiveness of these hedging programs and evaluating the carrying values of the related derivatives often involve a variety of assumptions and estimates. We use derivatives to hedge equity market risks, interest rate risk and foreign currency exposures that are embedded in our annuity and life insurance product liabilities or investment portfolios. Derivatives held as of June 30, 2008, contain industry standard terms and are entered into with financial institutions with long-standing, superior performance records. Our accounting policies for derivatives and the potential impact on interest spreads in a falling rate environment are discussed in Item 3. Quantitative and Qualitative Disclosures About Market Risk of this report and Part II Item 7A. Quantitative and Qualitative Disclosures About Market Risk and Note 5 to the consolidated financial statements in our 2007 Form 10-K.

### Guaranteed Living Benefits

We have a hedging strategy designed to mitigate the risk and income statement volatility caused by changes in the equity markets, interest rates and market implied volatilities associated with the *Lincoln SmartSecurity*<sup>®</sup> Advantage GWB feature and our *i4LIFE*<sup>®</sup> Advantage guaranteed income benefit ( GIB ) feature that is available in our variable annuity products. In the second quarter of 2007, we also began hedging our 4LATER<sup>®</sup> Advantage GIB feature available in our variable annuity products. These living benefit features are collectively referred to as GLBs. During 2007, we made adjustments to our hedging program to purchase longer dated volatility protection and increased our hedges related to volatility to better match liability sensitivities under SFAS 157. In addition, in early January 2008, we added the variable annuity business in our New York insurance subsidiary, with total account values of approximately \$1.2 billion as of June 30, 2008, to our hedge program. In February 2008, we also added our new GWB *Lincoln Lifetime Income*<sup>SM</sup> Advantage to our hedging program.

The hedging strategy is designed such that changes in the value of the hedge contracts move in the opposite direction of changes in the value of the embedded derivative of the GWB and GIB features. This dynamic hedging strategy utilizes options on U.S.-based equity indices, futures on U.S.-based and international equity indices and variance swaps on U.S.-based equity indices, as well as interest rate futures and swaps. The notional amounts of the underlying hedge instruments are such that the magnitude of the change in the value of the hedge instruments due to changes in equity markets, interest rates and implied volatilities is designed to offset the magnitude of the change in the fair value of the GWB and GIB guarantees caused by those same factors. As of June 30, 2008, the embedded derivatives for GWB, the *i4LIFE*<sup>®</sup> Advantage GIB and the 4LATER<sup>®</sup> Advantage GIB were liabilities valued at \$220 million, \$74 million and \$41 million, respectively.

For additional information on our hedging results, see our discussion in Realized Gain (Loss) below.

### Acquisitions and Dispositions

#### Dispositions

##### Media Business

On June 7, 2007, we announced plans to explore strategic options for our former business segment, Lincoln Financial Media. During the fourth quarter of 2007, we decided to divest our television and Charlotte radio broadcasting and sports programming businesses, and, on November 12, 2007, we signed agreements to sell them. The divestiture of the sports programming business closed on November 30, 2007, the Charlotte radio broadcasting business closed on January 31, 2008, and the television broadcasting business closed on March 31, 2008. Accordingly, we have reported the results of these businesses as discontinued operations on our Consolidated Statements of Income and the assets and liabilities as held for sale on our Consolidated Balance Sheets for all periods presented. We continue to actively manage our investment in our remaining radio clusters, which are now being reported within Other Operations, to maximize station performance and future valuation. For additional information, see Note 3.

The proceeds from the sales of the above media properties were used for repurchase of shares, repayment of debt and other strategic initiatives.

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

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Discontinued Operations Before Disposal</b>						
Media revenues, net of agency commissions	\$ 29	\$ 29	-100%	\$ 22	\$ 71	-69%
Income from discontinued operations before disposal, before federal income taxes	\$ 10	\$ 10	-100%	\$ 8	\$ 22	-64%
Federal income taxes		4	-100%	3	8	-63%
Income from discontinued operations before disposal		6	-100%	5	14	-64%
<b>Disposal</b>						
Loss on disposal, before federal income taxes			NM	(12)		NM
Federal income tax benefit			NM	(3)		NM
Loss on disposal			NM	(9)		NM
Income (loss) from discontinued operations	\$ 6	\$ 6	-100%	\$ (4)	\$ 14	NM

During the first quarter of 2008, we adjusted our loss on disposal of discontinued media properties due primarily to changes in the net assets disposed of for the television broadcasting business.

##### Fixed Income Investment Management Business

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

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

During the fourth quarter of 2007, we received \$25 million of the purchase price, with additional scheduled payments over the next three years. During 2007, we recorded an after-tax realized loss of \$2 million on our Consolidated Statements of Income as a result

of goodwill we attributed to this business. There were certain other pipeline accounts in process at the time of the transaction closing, and any adjustment to the purchase price, if necessary, will be determined at October 31, 2008. During the three and six months ended June 30, 2008, we recorded an after-tax gain of \$1 million and \$3 million, respectively, on our Consolidated Statements of Income related to this transaction.

For additional information about acquisitions and dispositions, See Part II Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Introduction Acquisition and Dispositions in our 2007 Form 10-K.

## RESULTS OF CONSOLIDATED OPERATIONS

### Net Income

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

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Revenues</b>						
Insurance premiums	\$ 530	\$ 489	8%	\$ 1,039	\$ 948	10%
Insurance fees	842	742	13%	1,654	1,506	10%
Investment advisory fees	76	93	-18%	152	183	-17%
Net investment income	1,077	1,133	-5%	2,142	2,223	-4%
Realized gain (loss)	(108)	7	NM	(143)	41	NM
Amortization of deferred gain on business sold through reinsurance	19	26	-27%	38	45	-16%
Other revenues and fees	146	181	-19%	292	346	-16%
<b>Total revenues</b>	<b>2,582</b>	<b>2,671</b>	<b>-3%</b>	<b>5,174</b>	<b>5,292</b>	<b>-2%</b>
<b>Benefits and Expenses</b>						
Interest credited	613	606	1%	1,225	1,206	2%
Benefits	684	651	5%	1,362	1,244	9%
Underwriting, acquisition, insurance and other expenses	847	816	4%	1,656	1,625	2%
Interest and debt expense	65	73	-11%	140	135	4%
Impairment of intangibles	173		NM	173		NM
<b>Total benefits and expenses</b>	<b>2,382</b>	<b>2,146</b>	<b>11%</b>	<b>4,556</b>	<b>4,210</b>	<b>8%</b>
<b>Income from continuing operations before taxes</b>	<b>200</b>	<b>525</b>	<b>-62%</b>	<b>618</b>	<b>1,082</b>	<b>-43%</b>
Federal income taxes	75	155	-52%	200	324	-38%
<b>Income from continuing operations</b>	<b>125</b>	<b>370</b>	<b>-66%</b>	<b>418</b>	<b>758</b>	<b>-45%</b>
Income (loss) from discontinued operations, net of federal incomes taxes		6	-100%	(4)	14	NM
<b>Net income</b>	<b>\$ 125</b>	<b>\$ 376</b>	<b>-67%</b>	<b>\$ 414</b>	<b>\$ 772</b>	<b>-46%</b>

	For the Three Months Ended June 30, 2008			For the Six Months Ended June 30, 2008		
	2008	2007	Change	2008	2007	Change
<b>Revenues</b>						
Operating revenues:						
Individual Markets:						
Annuities	\$ 618	\$ 624	-1%	\$ 1,241	\$ 1,214	2%
Life Insurance	1,021	957	7%	2,008	1,929	4%
Total Individual Markets	1,639	1,581	4%	3,249	3,143	3%
Employer Markets:						
Retirement Products	304	318	-4%	608	634	-4%
Group Protection	425	391	9%	824	751	10%
Total Employer Markets	729	709	3%	1,432	1,385	3%
Investment Management	125	151	-17%	245	301	-19%
Lincoln UK	98	93	5%	183	183	0%
Other Operations	110	123	-11%	229	233	-2%
Excluded realized gain (loss), pre-tax	(120)	6	NM	(166)	39	NM
Amortization of deferred gain arising from reserve changes on business sold through reinsurance, pre-tax	1	8	-88%	2	8	-75%
Total revenues	\$ 2,582	\$ 2,671	-3%	\$ 5,174	\$ 5,292	-2%

	For the Three Months Ended June 30, 2008			For the Six Months Ended June 30, 2008		
	2008	2007	Change	2008	2007	Change
<b>Net Income</b>						
Income (loss) from operations:						
Individual Markets:						
Annuities	\$ 116	\$ 123	-6%	\$ 234	\$ 240	-3%
Life Insurance	153	176	-13%	298	343	-13%
Total Individual Markets	269	299	-10%	532	583	-9%
Employer Markets:						
Retirement Products	52	58	-10%	104	120	-13%
Group Protection	32	29	10%	58	52	12%
Total Employer Markets	84	87	-3%	162	172	-6%
Investment Management	15	11	36%	27	28	-4%
Lincoln UK	18	12	50%	29	23	26%
Other Operations	(44)	(35)	-26%	(86)	(65)	-32%
Excluded realized gain (loss), after-tax	(78)	4	NM	(108)	25	NM
Income (loss) from reserve changes (net of related amortization) on business sold through reinsurance, after-tax		(8)	100%	1	(8)	113%
Impairment of intangibles, after-tax	(139)		NM	(139)		NM
Income from continuing operations	125	370	-66%	418	758	-45%
Income (loss) from discontinued operations		6	-100%	(4)	14	NM
Net income	\$ 125	\$ 376	-67%	\$ 414	\$ 772	-46%



	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Deposits</b>						
Individual Markets:						
Annuities	\$ 3,436	\$ 3,277	5%	\$ 6,462	\$ 6,098	6%
Life Insurance	952	1,005	-5%	1,919	2,044	-6%
Employer Markets:						
Retirement Products Defined Contribution	1,421	1,273	12%	2,972	2,760	8%
Retirement Products Executive Benefits	110	79	39%	275	144	91%
Investment Management	3,507	6,150	-43%	8,229	12,185	-32%
Consolidating adjustments <sup>(1)</sup>	(811)	(1,077)	25%	(2,394)	(1,989)	-20%
Total deposits	\$ 8,615	\$ 10,707	-20%	\$ 17,463	\$ 21,242	-18%
<b>Net Flows</b>						
Individual Markets:						
Annuities	\$ 1,589	\$ 1,137	40%	\$ 2,770	\$ 1,892	46%
Life Insurance	627	586	7%	1,207	1,283	-6%
Employer Markets:						
Retirement Products Defined Contribution	237	73	225%	517	294	76%
Retirement Products Executive Benefits	50	26	92%	121	(49)	NM
Investment Management	(1,471)	(424)	NM	(2,638)	(512)	NM
Consolidating adjustments <sup>(1)</sup>	(24)	304	NM	(90)	348	NM
Total net flows	\$ 1,008	\$ 1,702	-41%	\$ 1,887	\$ 3,256	-42%

<sup>(1)</sup> Consolidating adjustments represents the elimination of deposits and net flows on products affecting more than one segment.

	As of June 30,		Change
	2008	2007	
<b>Assets Under Management by Advisor</b>			
Investment Management:			
External assets	\$ 75,691	\$ 97,725	-23%
Inter-segment assets	65,997	66,423	-1%
Lincoln UK	7,833	9,168	-15%
Policy loans	2,802	2,787	1%
Assets administered through unaffiliated third parties	68,292	68,925	-1%
Total assets under management	\$ 220,615	\$ 245,028	-10%

*Comparison of the Three and Six Months Ended June 30, 2008 to 2007*

Net income decreased due primarily to the following:

Impairment of goodwill and our FCC license intangible assets on our remaining radio clusters attributable primarily to declines in advertising revenues for the entire radio market; however, these non-cash impairments will not impact our future liquidity;

Higher write-downs for other-than-temporary impairments on our available-for-sale securities attributable primarily to unfavorable changes in credit quality and increases in credit spreads;

Lower net investment income driven by less favorable results from our alternative investments and prepayment and bond makewhole premiums as well as certain capital transactions providing relief from Actuarial Guideline 38 ( AG38 ) reserve requirements in the fourth quarter of 2007;

Higher benefits due to growth in business in force and higher death claims;

Net unfavorable retrospective unlocking of DAC, VOBA, DSI and DFEL compared to net favorable retrospective unlocking for the same periods in 2007;

Lower earnings from our variable annuity and mutual fund products as a result of declines in assets under management caused by decreases in the level of the equity markets; and

The results for the second quarter of 2007 included a \$6 million one-time curtailment gain related to a change in our employee pension plan. The causes of decreases in net income were partially offset by:

Growth in insurance fees driven by increases in life insurance in force as a result of new sales since June 30, 2007, and favorable persistency along with increases in variable account values from positive net flows partially offset by adjustments during the second quarter of 2007 resulting from adjusting account values for certain of our life insurance policies and modifying the accounting for certain of our life insurance policies;

Lower litigation and merger-related expenses;

Lower incentive compensation accruals as a result of lower earnings and production performance relative to planned goals;

The results in the second quarter of 2007 included an \$8 million expense for an increase in reserves (net of related deferred gain amortization) on the personal accident business that was sold to Swiss Re through an indemnity reinsurance transaction in 2001;

Lower broker-dealer expenses driven by lower sales; and

Favorable benefit reserve adjustments in the second quarter of 2008 for our Lincoln UK segment.

In addition to the items discussed above, net income for the six months ended June 30, 2008, compared to the same period in 2007 was affected by:

A \$14 million reduction in benefits in the first quarter of 2007 related to a purchase accounting adjustment to the opening balance sheet of Jefferson-Pilot;

A \$16 million effect of the initial adoption of SFAS 157 on January 1, 2008;

Higher interest and debt expenses from increased debt; and

The first quarter of 2008 adjustment to our loss on disposition of our discontinued operations.

The foregoing items are discussed in further detail in results of operations by segment discussions and Realized Gain (Loss) below. In addition, for a discussion of the earnings impact of the equity markets, see Item 3. Quantitative and Qualitative Disclosures About Market Risk Equity Market Risk Impact of Equity Market Sensitivity.



## RESULTS OF INDIVIDUAL MARKETS

The Individual Markets business provides its products through two segments: Annuities and Life Insurance. Through its Annuities segment, Individual Markets provides tax-deferred investment growth and lifetime income opportunities for its clients by offering individual fixed annuities, including indexed annuities, and variable annuities. The Life Insurance segment offers wealth protection and transfer opportunities through term insurance, a linked-benefit product (which is a UL policy linked with riders that provide for long-term care costs) and both single and survivorship versions of UL and VUL.

### Individual Markets    Annuities

#### Income from Operations

Details underlying the results for Individual Markets    Annuities (in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Operating Revenues</b>						
Insurance premiums	\$ 19	\$ 17	12%	\$ 51	\$ 29	76%
Insurance fees	257	244	5%	503	465	8%
Net investment income	245	265	-8%	493	531	-7%
Operating realized gain	12	1	NM	23	2	NM
Other revenues and fees	85	97	-12%	171	187	-9%
<b>Total operating revenues</b>	<b>618</b>	<b>624</b>	<b>-1%</b>	<b>1,241</b>	<b>1,214</b>	<b>2%</b>
<b>Operating Expenses</b>						
Interest credited	163	165	-1%	325	326	0%
Benefits	35	27	30%	87	52	67%
Underwriting, acquisition, insurance and other expenses	268	267	0%	520	517	1%
<b>Total operating expenses</b>	<b>466</b>	<b>459</b>	<b>2%</b>	<b>932</b>	<b>895</b>	<b>4%</b>
<b>Income from operations before taxes</b>	<b>152</b>	<b>165</b>	<b>-8%</b>	<b>309</b>	<b>319</b>	<b>-3%</b>
Federal income taxes	36	42	-14%	75	79	-5%
<b>Income from operations</b>	<b>\$ 116</b>	<b>\$ 123</b>	<b>-6%</b>	<b>\$ 234</b>	<b>\$ 240</b>	<b>-3%</b>

#### *Comparison of the Three and Six Months Ended June 30, 2008 to 2007*

Income from operations for this segment decreased due primarily to a decrease in net investment income from lower earnings on surplus investments and alternative investments due to unfavorable equity markets.

The decrease in income from operations was partially offset by growth in insurance fees attributable to increases in variable annuity account values from positive net flows partially offset by the increase in attributed fees. The positive net flows served to mitigate the negative effect on fees from the decline in account values driven by the unfavorable performance of the equity markets.

The decrease in income from operations is discussed further below. For detail on the operating realized gain, see Realized Gain (Loss) below.

**Insurance Fees**

Details underlying insurance fees, account values and net flows (in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Insurance Fees</b>						
Mortality, expense and other assessments	\$ 257	\$ 242	6%	\$ 503	\$ 460	9%
Surrender charges	9	10	-10%	19	20	-5%
DFEL:						
Deferrals	(13)	(12)	-8%	(25)	(22)	-14%
Amortization, excluding unlocking	4	4	0%	7	7	0%
Retrospective unlocking			NM	(1)		NM
Total insurance fees	\$ 257	\$ 244	5%	\$ 503	\$ 465	8%

	As of June 30,		
	2008	2007	Change
<b>Account Values</b>			
Variable portion of variable annuities	\$ 55,855	\$ 55,171	1%
Fixed portion of variable annuities	3,478	3,458	1%
Total variable annuities	59,333	58,629	1%
Fixed annuities, including indexed	14,321	14,409	-1%
Fixed annuities ceded to reinsurers	(1,255)	(1,598)	21%
Total fixed annuities	13,066	12,811	2%
Total account values	\$ 72,399	\$ 71,440	1%

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Averages</b>						
Daily variable account values	\$ 57,763	\$ 53,465	8%	\$ 56,541	\$ 51,327	10%
Daily S&P 500 Index®	1,371.26	1,496.87	-8%	1,360.21	1,461.02	-7%

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Net Flows</b>						
Variable portion of variable annuity deposits	\$ 2,065	\$ 2,295	-10%	\$ 3,931	\$ 4,295	-8%
Variable portion of variable annuity withdrawals	(1,229)	(1,247)	1%	(2,488)	(2,426)	-3%
Variable portion of variable annuity net flows	836	1,048	-20%	1,443	1,869	-23%
Fixed portion of variable annuity deposits	878	662	33%	1,734	1,197	45%
Fixed portion of variable annuity withdrawals	(110)	(155)	29%	(234)	(306)	24%
Fixed portion of variable annuity net flows	768	507	51%	1,500	891	68%
Total variable annuity deposits	2,943	2,957	0%	5,665	5,492	3%
Total variable annuity withdrawals	(1,339)	(1,402)	4%	(2,722)	(2,732)	0%
Total variable annuity net flows	1,604	1,555	3%	2,943	2,760	7%
Fixed indexed annuity deposits	356	191	86%	574	351	64%
Fixed indexed annuity withdrawals	(102)	(61)	-67%	(186)	(123)	-51%
Fixed indexed annuity net flows	254	130	95%	388	228	70%
Other fixed annuity deposits	137	129	6%	223	255	-13%
Other fixed annuity withdrawals	(406)	(677)	40%	(784)	(1,351)	42%
Other fixed annuity net flows	(269)	(548)	51%	(561)	(1,096)	49%
Total annuity deposits	3,436	3,277	5%	6,462	6,098	6%
Total annuity withdrawals	(1,847)	(2,140)	14%	(3,692)	(4,206)	12%
Total annuity net flows	\$ 1,589	\$ 1,137	40%	\$ 2,770	\$ 1,892	46%

We charge contract holders mortality and expense assessments on variable annuity accounts to cover insurance and administrative expenses. These assessments are a function of the rates priced into the product and the average daily variable account values. Average daily account values are driven by net flows and equity markets. In addition, for our fixed annuity contracts and for some variable contracts, we collect surrender charges when contract holders surrender their contracts during their surrender charge periods to protect us from premature withdrawals. Insurance fees include charges on both our variable and fixed annuity products, but exclude the attributed fees on our GLB products. The attributed fees are the portion of rider charges used in the calculation of the embedded derivative and represent net valuation premium plus a margin that a theoretical market participant would include for risk/profit, including a non-performance risk factor required by SFAS 157. Net valuation premium represents a level portion of rider fees required to fund potential claims for the living benefit. Operating realized gain is the attributed fees less the net valuation premium, net of the associated amortization expense of DAC, VOBA, DSI and DFEL.

New deposits are an important component of our effort to grow the annuity business. Although deposits do not significantly impact current period income from operations, they are an important indicator of future profitability.

The other component of net flows relates to the retention of the business. One of the key assumptions in pricing a product is the account persistency, which we refer to as the lapse rate. The lapse rate compares the amount of withdrawals to the average account values.

#### *Comparison of the Three and Six Months Ended June 30, 2008 to 2007*

The growth in expense assessments was attributable to an increase in average daily variable annuity account values. The increase in account values reflects cumulative positive net flows, which offset the reduction in variable account values from unfavorable equity markets in the three and six months ended June 30, 2008.

## Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

In the past several years, we have concentrated our efforts on expanding both product and distribution breadth. Annuity deposits increased as a result of continued strong sales of products with GLB riders and the expansion of the wholesaling force in LFD.

Overall lapse rates for the three and six months ended June 30, 2008, were 8% compared to 10% for the same periods in 2007.

**Net Investment Income and Interest Credited**

Details underlying net investment income, interest credited (in millions) and our interest rate spread were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Net Investment Income</b>						
Fixed maturity securities, mortgage loans on real estate and other, net of investment expenses	\$ 224	\$ 229	-2%	\$ 453	\$ 467	-3%
Commercial mortgage loan prepayment and bond makewhole premiums <sup>(1)</sup>		3	-100%	1	5	-80%
Alternative investments <sup>(2)</sup>		1	-100%	(1)	2	NM
Surplus investments <sup>(3)</sup>	20	31	-35%	38	54	-30%
Broker-dealer	1	1	0%	2	3	-33%
<b>Total net investment income</b>	<b>\$ 245</b>	<b>\$ 265</b>	<b>-8%</b>	<b>\$ 493</b>	<b>\$ 531</b>	<b>-7%</b>
<b>Interest Credited</b>						
Amount provided to contract holders	\$ 180	\$ 184	-2%	\$ 363	\$ 367	-1%
Opening balance sheet adjustment <sup>(4)</sup>			NM		(4)	100%
DSI deferrals	(26)	(27)	4%	(52)	(51)	-2%
Interest credited before DSI amortization	154	157	-2%	311	312	0%
DSI amortization:						
Excluding unlocking	9	9	0%	15	16	-6%
Retrospective unlocking		(1)	100%	(1)	(2)	50%
<b>Total interest credited</b>	<b>\$ 163</b>	<b>\$ 165</b>	<b>-1%</b>	<b>\$ 325</b>	<b>\$ 326</b>	<b>0%</b>

<sup>(1)</sup> See Consolidated Investments Commercial Mortgage Loan Prepayment and Bond Makewhole Premiums below for additional information.

<sup>(2)</sup> See Consolidated Investments Alternative Investments below for additional information.

<sup>(3)</sup> Represents net investment income on the required statutory surplus for this segment.

<sup>(4)</sup> Net adjustment to the opening balance sheet of Jefferson-Pilot finalized in 2007.

	For the Three Months Ended			Basis Point Change	For the Six Months Ended		Basis Point Change
	June 30, 2008	June 30, 2007			June 30, 2008	June 30, 2007	
<b>Interest Rate Spread</b>							
Fixed maturity securities, mortgage loans on real estate and other, net of investment expenses	5.88%	5.82%	6	5.86%	5.84%	2	
Commercial mortgage loan prepayment and bond make whole premiums	0.00%	0.08%	(8)	0.02%	0.06%	(4)	
Alternative investments	-0.01%	0.02%	(3)	-0.01%	0.02%	(3)	
<b>Net investment income yield on reserves</b>	<b>5.87%</b>	<b>5.92%</b>	<b>(5)</b>	<b>5.87%</b>	<b>5.92%</b>	<b>(5)</b>	
Interest rate credited to contract holders	3.73%	3.73%		3.77%	3.68%	9	
<b>Interest rate spread</b>	<b>2.14%</b>	<b>2.19%</b>	<b>(5)</b>	<b>2.10%</b>	<b>2.24%</b>	<b>(14)</b>	

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Note: The yields, rates and spreads above are calculated using whole dollars instead of dollars rounded to millions.

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
Average invested assets on reserves	\$ 15,743	\$ 16,077	-2%	\$ 15,729	\$ 16,289	-3%
Average fixed account values, including the fixed portion of variable	17,373	17,548	-1%	17,343	17,697	-2%
Net flows for fixed annuities, including the fixed portion of variable	753	89	NM	1,327	23	NM

A portion of our investment income earned is credited to the contract holders of our fixed annuity products, including the fixed portion of variable annuity contracts. We expect to earn a spread between what we earn on the underlying general account investments supporting the fixed annuity product line, including the fixed portion of variable annuity contracts, and what we credit to our fixed annuity contract holders' accounts, including the fixed portion of variable annuity contracts. The interest rate spread for this segment represents the excess of the yield on invested assets on reserves over the average crediting rate. The yield on invested assets on reserves is calculated as net investment income, excluding the amounts attributable to our surplus investments, reverse repurchase agreement interest expense, inter-segment cash management account interest expense and interest on collateral divided by average invested assets on reserves. The average invested assets on reserves is calculated based upon total invested assets, excluding hedge derivatives and collateral. The average crediting rate is calculated as interest credited before DSI amortization, plus the immediate annuity reserve change (included within benefits) divided by the average fixed account values, including the fixed portion of variable, net of coinsured account values. Fixed account values reinsured under modified coinsurance agreements are included in account values for this calculation. Changes in commercial mortgage loan prepayments and bond makewhole premiums, investment income on alternative investments and surplus investment income can vary significantly from period to period due to a number of factors and, therefore, may contribute to investment income results that are not indicative of the underlying trends.

We expect to manage the effect of spreads for near-term income from operations through a combination of rate actions and portfolio management. Our expectation includes the assumption that there are no significant changes in net flows in or out of our fixed accounts or other changes that may cause interest rate spreads to differ from our expectation. For information on interest rate spreads and the interest rate risk due to falling interest rates, see Item 3. Quantitative and Qualitative Disclosures About Market Risk.

#### *Comparison of the Three and Six Months Ended June 30, 2008 to 2007*

The decline in surplus investment income was attributable to less favorable investment income on alternative investments.

The decline in investment income from fixed maturity securities, mortgage loans on real estate and other net investment income was due primarily to a decrease in fixed account values, including the fixed portion of variable, which included a \$300 million funding agreement that matured on June 2, 2008. Interest credited to contract holders remained relatively flat as a decline in our fixed account values, including the fixed portion of variable, was offset by an elevated rate.

Our fixed annuity business includes products with crediting rates that are reset on an annual basis and are not subject to surrender charges. Account values for these products were \$5.1 billion as of June 30, 2008, with 42% already at their minimum guaranteed rates. The average crediting rates for these products were approximately 41 basis points in excess of average minimum guaranteed rates. Our ability to retain annual reset annuities will be subject to current competitive conditions at the time interest rates for these products reset. In addition to the separate items identified in the interest rate spread table above, the other component of the interest rate credited to contract holders decreased due primarily to a roll-off of multi-year guarantee and annual reset annuities with higher interest rates.

**Benefits***Comparison of the Three and Six Months Ended June 30, 2008 to 2007*

The increase in benefits was attributable to an unfavorable variance in the SOP 03-1 benefit ratio unlocking, which was offset by changes in the value of the derivative included in operating realized gain, as well as an increase in reserves for single premium immediate annuities, which had a corresponding increase in insurance premiums.

**Underwriting, Acquisition, Insurance and Other Expenses**

Details underlying underwriting, acquisition, insurance and other expenses (in millions) were as follows:

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Underwriting, Acquisition, Insurance and Other Expenses</b>						
Commissions	\$ 186	\$ 179	4%	\$ 352	\$ 331	6%
General and administrative expenses	80	82	-2%	160	152	5%
Taxes, licenses and fees	8	6	33%	18	15	20%
<b>Total expenses incurred, excluding broker-dealer DAC and VOBA deferrals</b>	<b>274</b>	<b>267</b>	<b>3%</b>	<b>530</b>	<b>498</b>	<b>6%</b>
	(192)	(189)	-2%	(364)	(347)	-5%
<b>Total pre-broker-dealer expenses incurred, excluding amortization, net of interest</b>	<b>82</b>	<b>78</b>	<b>5%</b>	<b>166</b>	<b>151</b>	<b>10%</b>
<b>DAC and VOBA amortization, net of interest:</b>						
Retrospective unlocking		(9)	100%		(15)	100%
Other amortization	101	105	-4%	180	201	-10%
<b>Broker-dealer expenses incurred:</b>						
Commissions	64	72	-11%	131	141	-7%
General and administrative expenses	21	20	5%	43	39	10%
Taxes, licenses and fees		1	-100%			NM
<b>Total underwriting, acquisition, insurance and other expenses</b>	<b>\$ 268</b>	<b>\$ 267</b>	<b>0%</b>	<b>\$ 520</b>	<b>\$ 517</b>	<b>1%</b>

**DAC and VOBA deferrals**

As a percentage of sales/deposits	5.6%	5.8%	5.6%	5.7%
-----------------------------------	------	------	------	------

Commissions and other costs that vary with and are related primarily to the production of new business are deferred to the extent recoverable and are amortized over the lives of the contracts in relation to estimated gross profits (EGPs). We have certain trail commissions that are based upon account values that are expensed as incurred rather than being deferred and amortized.

Broker-dealer expenses that vary with and are related to sales are expensed as incurred and not deferred and amortized. These expenses are more than offset by increases to other income.

*Comparison of the Three Months Ended June 30, 2008 to 2007*

The increase in expenses incurred, excluding broker-dealer, was attributable primarily to growth in account values from sales, which increased commissions and general and administrative expenses.

The decrease in broker-dealer commissions was due to lower sales of non-proprietary products.

The second quarter of 2007 had favorable retrospective unlocking (decrease to DAC and VOBA amortization) due primarily to lower lapses and higher equity market returns than estimated in our model projections.



*Comparison of the Six Months Ended June 30, 2008 to 2007*

The increase in expenses incurred, excluding broker-dealer, was attributable primarily to growth in account values from sales, which increased commissions and general and administrative expenses.

The decrease in broker-dealer commissions was due to lower sales of non-proprietary products. The increase in broker-dealer general and administrative expenses was attributable primarily to increases in personnel costs.

The first six months of 2007 had favorable retrospective unlocking (decrease to DAC and VOBA amortization) due primarily to lower lapses and higher equity market returns than estimated in our model projections.

**Individual Markets Life Insurance****Income from Operations**

Details underlying the results for Individual Markets Life Insurance (in millions) were as follows:

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Operating Revenues</b>						
Insurance premiums	\$ 89	\$ 88	1%	\$ 176	\$ 176	0%
Insurance fees	460	368	25%	905	787	15%
Net investment income	467	493	-5%	914	947	-3%
Other revenues and fees	5	8	-38%	13	19	-32%
Total operating revenues	1,021	957	7%	2,008	1,929	4%
<b>Operating Expenses</b>						
Interest credited	262	254	3%	520	506	3%
Benefits	300	263	14%	597	509	17%
Underwriting, acquisition, insurance and other expenses	228	171	33%	440	392	12%
Total operating expenses	790	688	15%	1,557	1,407	11%
Income from operations before taxes	231	269	-14%	451	522	-14%
Federal income taxes	78	93	-16%	153	179	-15%
Income from operations	\$ 153	\$ 176	-13%	\$ 298	\$ 343	-13%

*Comparison of the Three Months Ended June 30, 2008 to 2007*

Income from operations for this segment decreased due primarily to the following:

Higher death claims resulting in increased benefits;

Lower net investment income from a reduction in statutory reserves as a result of the merger of several of our insurance subsidiaries and certain assumption changes in the fourth quarter of 2007, capital transactions providing relief from AG38 reserve requirements in the fourth quarter of 2007 and less favorable results from our investment income on alternative investments and prepayment and bond makewhole premiums; and

## Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

A decrease attributable to unfavorable retrospective unlocking of DAC and VOBA for the second quarter of 2008 compared to favorable retrospective unlocking for the second quarter of 2007.

The decrease in income from operations was partially offset by the following:

Growth in insurance fees driven by an increase in business in force as a result of new sales since June 30, 2007, and favorable persistency partially offset by the impact on insurance fees from lower sales in the second quarter of 2008 compared to the second quarter of 2007 and adjustments during the second quarter of 2007 resulting from adjusting account values for certain of our life insurance policies and modifying the accounting for certain of our life insurance policies.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

Income from operations for this segment decreased due primarily to the following:

Higher death claims in 2008 and lower benefits in the first quarter of 2007 partially related to a \$14 million reduction in benefits related to a purchase accounting adjustment to the opening balance sheet of Jefferson-Pilot;

Lower net investment income from a reduction in statutory reserves as a result of the merger of several of our insurance subsidiaries and certain assumption changes in the fourth quarter of 2007, capital transactions providing relief from AG38 reserve requirements in the fourth quarter of 2007 and less favorable results from our investment income on alternative investments and prepayment and bond makewhole premiums; and

A decrease attributable to unfavorable retrospective unlocking of DAC and VOBA for the first six months of 2008 compared to favorable retrospective unlocking for the first six months of 2007.

The decrease in income from operations was partially offset by the following:

Growth in insurance fees driven by an increase in business in force as a result of new sales since June 30, 2007, and favorable persistency partially offset by the impact on insurance fees from lower sales in the first six months of 2008 compared to the first six months of 2007 and adjustments during the second quarter of 2007 resulting from adjusting account values for certain of our life insurance policies and modifying the accounting for certain of our life insurance policies.

The foregoing items are discussed further below.

**Insurance Premiums**

Insurance premiums relate to traditional products and are a function of the rates priced into the product and the level of insurance in force. Insurance in force, in turn, is driven by sales, persistency and mortality experience.

*Comparison of the Three and Six Months Ended June 30, 2008 to 2007*

Traditional in-force face amount and thus premiums remained relatively flat.

**Insurance Fees**

Details underlying insurance fees, sales, net flows, account values and in-force face amount (in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Insurance Fees</b>						
Mortality assessments	\$ 321	\$ 282	14%	\$ 633	\$ 575	10%
Expense assessments	164	148	11%	330	301	10%
Surrender charges	15	16	-6%	31	31	0%
<b>DFEL:</b>						
Deferrals	(89)	(112)	21%	(177)	(178)	1%
Amortization, excluding unlocking	38	41	-7%	73	68	7%
Retrospective unlocking	11	(7)	257%	15	(10)	250%

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Total insurance fees	\$ 460	\$ 368	25%	\$ 905	\$ 787	15%
----------------------	--------	--------	-----	--------	--------	-----

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Sales by Product</b>						
UL:						
Excluding <i>MoneyGuard</i> ®	\$ 124	\$ 145	-14%	\$ 237	\$ 311	-24%
<i>MoneyGuard</i> ®	12	10	20%	23	17	35%
Total UL	136	155	-12%	260	328	-21%
VUL	12	17	-29%	27	38	-29%
Term/whole life	5	8	-38%	11	17	-35%
Total sales	\$ 153	\$ 180	-15%	\$ 298	\$ 383	-22%
<b>Net Flows</b>						
Deposits	\$ 952	\$ 1,005	-5%	\$ 1,919	\$ 2,044	-6%
Withdrawals and deaths	(325)	(419)	22%	(712)	(761)	6%
Net flows	\$ 627	\$ 586	7%	\$ 1,207	\$ 1,283	-6%
Contract holder assessments	\$ 675	\$ 586	15%	\$ 1,318	\$ 1,188	11%

	As of June 30,		Change
	2008	2007	
<b>Account Values</b>			
UL	\$ 21,321	\$ 20,261	5%
VUL	4,473	4,948	-10%
Interest-sensitive whole life	2,283	2,256	1%
Total account values	\$ 28,077	\$ 27,465	2%
<b>In-Force Face Amount</b>			
UL and other	\$ 288,668	\$ 276,040	5%
Term insurance	234,109	236,155	-1%
Total in-force face amount	\$ 522,777	\$ 512,195	2%

Insurance fees relate only to interest-sensitive products and include mortality assessments, expense assessments (net of deferrals and amortization related to DFEL) and surrender charges. Mortality and expense assessments are deducted from our contract holders' account values. These amounts are a function of the rates priced into the product and premiums received, face amount in force and account values. Insurance in force, in turn, is driven by sales, persistency and mortality experience. In-force growth should be considered independently with respect to term products versus UL and other products, as term products have a lower profitability relative to face amount compared to whole life and interest-sensitive products.

Sales in the table above and as discussed below were reported as follows:

UL, VUL, *MoneyGuard*® 100% of annualized expected target premiums plus 5% of paid excess premiums, including an adjustment for internal replacements at approximately 50% of target; and

Whole life and term 100% of first year paid premiums.

## Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Sales are not recorded as a component of revenues (other than for traditional products) and do not have a significant impact on current quarter income from operations but are indicators of future profitability.

We have screening procedures to identify sales that we believe have characteristics associated with stranger-originated life insurance in order to prevent policies with these characteristics from being issued. However, accurate identification of these policies can be difficult, and we continue to modify our screening procedures. We believe that our sales of UL products include some sales with stranger-originated life insurance characteristics. We expect no significant impact to our profitability; however, returns on UL business sold as part of stranger-originated designs are believed to be lower than traditional estate planning UL sales due in part to no expected lapses.

UL and VUL products with secondary guarantees represented approximately 33% of interest-sensitive life insurance in force as of June 30, 2008, and approximately 77% and 76% of sales for the three and six months ended June 30, 2008. AG38 imposes additional statutory reserve requirements for these products. See [Review of Consolidated Financial Condition](#) [Liquidity and Capital Resources](#) [Sources of Liquidity and Cash Flow](#) for further information on the manner in which we reinsure our AG38 reserves.

*Comparison of the Three and Six Months Ended June 30, 2008 to 2007*

The growth in mortality and expense assessments was attributable primarily to the impact of a \$41 million reduction in insurance fees, net of DFEL amortization, related to the impact of the correction to account values and modification of accounting related to certain insurance contracts during the second quarter of 2007. In addition, mortality and expense assessments grew as a result of increased life insurance in force and account values from new sales since June 30, 2007, an increase in the average attained age of the in-force block (which also led to increases in benefits as discussed below) and favorable persistency.

The second quarter of 2008 had favorable retrospective unlocking (increase to DFEL amortization) due primarily to lower premiums received and higher death claims, partially offset by higher investment income on alternative investments and prepayment and bond makewhole premiums and lower maintenance expenses than estimated in our model projections.

The second quarter of 2007 had unfavorable retrospective unlocking (decrease to DFEL amortization) due primarily to higher investment income on alternative investments and prepayment and bond makewhole premiums, higher premiums received and lower maintenance expenses than estimated in our model projections, partially offset by the impact of the correction to account values in the second quarter of 2007 mentioned above.

The first six months of 2008 had favorable retrospective unlocking (increase to DFEL amortization) due primarily to lower premiums received and higher death claims than estimated in our model projections and model adjustments on certain life insurance policies, partially offset by lower maintenance expenses than estimated in our model projections.

The first six months of 2007 had unfavorable retrospective unlocking (decrease to DFEL amortization) due primarily to higher investment income on alternative investments and prepayment and bond makewhole premiums, higher premiums received and lower maintenance expenses than estimated in our model projections, partially offset by the impact of the correction to account values in the second quarter of 2007 mentioned above.

**Net Investment Income and Interest Credited**

Details underlying net investment income, interest credited (in millions) and our interest rate spread were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Net Investment Income</b>						
Fixed maturity securities, mortgage loans on real estate and other, net of investment expenses	\$ 423	\$ 413	2%	\$ 846	\$ 825	3%
Commercial mortgage loan prepayment and bond makewhole premiums <sup>(1)</sup>	9	10	-10%	12	21	-43%
Alternative investments <sup>(2)</sup>	14	43	-67%	14	50	-72%
Surplus investments <sup>(3)</sup>	21	27	-22%	42	51	-18%
Total net investment income	\$ 467	\$ 493	-5%	\$ 914	\$ 947	-3%
<b>Interest Credited</b>						
	\$ 262	\$ 254	3%	\$ 520	\$ 506	3%

<sup>(1)</sup> See [Consolidated Investments](#) [Commercial Mortgage Loan Prepayment and Bond Makewhole Premiums](#) below for additional information.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

- (2) See Consolidated Investments Alternative Investments below for additional information.
- (3) Represents net investment income on the required statutory surplus for this segment.

	For the Three Months Ended June 30, 2008		Basis Point Change	For the Six Months Ended June 30, 2008		Basis Point Change
<b>Interest Rate Yields and Spread</b>						
<u>Attributable to interest-sensitive products:</u>						
Fixed maturity securities, mortgage loans on real estate and other, net of investment expenses	5.88%	6.10%	(22)	5.95%	6.13%	(18)
Commercial mortgage loan prepayment and bond makewhole premiums	0.15%	0.14%	1	0.09%	0.17%	(8)
Alternative investments	0.24%	0.75%	(51)	0.12%	0.44%	(32)
Net investment income yield on reserves	6.27%	6.99%	(72)	6.16%	6.74%	(58)
Interest rate credited to contract holders	4.33%	4.45%	(12)	4.33%	4.46%	(13)
Interest rate spread	1.94%	2.54%	(60)	1.83%	2.28%	(45)
<u>Attributable to traditional products:</u>						
Fixed maturity securities, mortgage loans on real estate and other, net of investment expenses	6.23%	6.29%	(6)	6.17%	6.33%	(16)
Commercial mortgage loan prepayment and bond makewhole premiums	0.00%	0.14%	(14)	0.06%	0.08%	(2)
Alternative investments	-0.02%	0.05%	(7)	-0.02%	0.04%	(6)
Net investment income yield on reserves	6.21%	6.48%	(27)	6.21%	6.45%	(24)

Note: The yields, rates and spreads above are calculated using whole dollars instead of dollars rounded to millions.

	For the Three Months Ended June 30, 2008			For the Six Months Ended June 30, 2008		
	2007	Change	2007	Change		
<b>Averages</b>						
<u>Attributable to interest-sensitive products:</u>						
Invested assets on reserves	\$ 23,245	\$ 22,155	5%	\$ 23,081	\$ 21,925	5%
Account values universal and whole life	23,480	22,372	5%	23,369	22,215	5%
<u>Attributable to traditional products:</u>						
Invested assets on reserves	5,291	5,012	6%	5,298	5,015	6%

A portion of the investment income earned for this segment is credited to contract holder accounts. Invested assets will typically grow at a faster rate than account values because of the AG38 reserve requirements. Invested assets are also affected by various reserve adjustments, primarily the result of the merger of several of our insurance subsidiaries, the modification of accounting for certain of our life insurance policies, and by capital transactions providing relief from AG38 reserve requirements, which leads to a transfer of invested assets for other corporate purposes. We expect to earn a spread between what we earn on the underlying general account investments and what we credit to our contract holders accounts. The interest rate spread for this segment represents the excess of the yield on invested assets on reserves over the average crediting rate on interest sensitive products. The yield on invested assets on reserves is calculated as net investment income, excluding amounts attributable to our surplus investments and reverse repurchase agreement interest expense, divided by average invested assets on reserves. In addition, we exclude the impact of earnings from affordable housing tax credit securities, which is reflected as a reduction to federal income tax expense, from our spread calculations. Traditional products use interest income to build the policy reserves. Commercial mortgage loan prepayments and bond makewhole premiums and investment income on alternative investments can vary significantly from period to period due to a number of factors, and, therefore, may contribute to investment income results that are not indicative of the underlying trends.

*Comparison of the Three Months Ended June 30, 2008 to 2007*

The increase in fixed maturity securities, mortgage loans on real estate and other net investment income was due to continued growth of business in force partially offset by the impact of reductions in statutory reserves. The decrease in investment income on alternative investments was driven primarily by less favorable results from limited partnership investments. Higher AG38 statutory reserve liabilities on UL policies with secondary guarantees contributed to invested asset growth. At June 30, 2007, we reduced statutory reserves related to our secondary guarantee UL products by approximately \$150 million, which has reduced the amount of net investment income allocated to this segment by \$2 million per quarter. This statutory reserve reduction related to modifying the accounting for certain of our life insurance policies. In October 2007, we released approximately \$300 million of capital that had previously supported our UL products with secondary guarantees as a result of executing on a capital transaction to provide AG38 relief. This release of capital lowered the level of assets supporting this business and has reduced net investment income by approximately \$5 million per quarter. As of December 31, 2007, we reduced statutory reserves related primarily to legal entity consolidation by \$344 million, which has reduced the amount of net investment income allocated to this segment by approximately \$5 million in the first quarter of 2008. This reduction in statutory reserves was primarily a result of the merger of several of our insurance subsidiaries.

The increase in interest credited was attributable primarily to growth in UL account values. On June 1, 2007, we implemented a 10 basis point decrease in crediting rates on most interest-sensitive products not already at contractual guarantees, which has increased spreads approximately 5 basis points. On June 1, 2008, we implemented a 10 basis point decrease in crediting rates on most interest-sensitive products not already at contractual guarantees, which is expected to increase future spreads by approximately 5 basis points.

At the end of the second quarter of 2008, new money rates exceeded the portfolio rate by roughly 16 basis points. At the end of the second quarter of 2007, new money rates exceeded the portfolio rate by roughly 10 basis points. As of June 30, 2008, 54% of interest-sensitive account values have crediting rates at contract guaranteed levels, and 36% have crediting rates within 50 basis points of contractual guarantees. Going forward, we expect to be able to manage the effects of spreads on near-term income from operations through a combination of rate actions and portfolio management, which assumes no significant changes in net flows into or out of our fixed accounts or other changes that may cause interest rate spreads to differ from our expectations. For information on interest rate spreads and the interest rate risk due to falling interest rates, see Item 3. Quantitative and Qualitative Disclosures About Market Risk.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

The increase in fixed maturity securities, mortgage loans on real estate and other net investment income was due to continued growth of business in force partially offset by the impact of reductions in statutory reserves. The decrease in investment income on alternative investments was driven primarily by less favorable results from limited partnership investments.

**Benefits**

Details underlying benefits (dollars in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Benefits</b>						
Death claims direct and assumed	\$ 509	\$ 428	19%	\$ 1,054	\$ 912	16%
Death claims ceded	(229)	(166)	-38%	(466)	(354)	-32%
Reserves released on death	(81)	(80)	-1%	(179)	(172)	-4%
Net death benefits	199	182	9%	409	386	6%
Change in reserves for products with secondary guarantees	28	18	56%	54	18	200%
Other benefits <sup>(1)</sup>	73	63	16%	134	105	28%
Total benefits	\$ 300	\$ 263	14%	\$ 597	\$ 509	17%
Death claims per \$1,000 of inforce	1.48	1.34	10%	1.48	1.40	6%

<sup>(1)</sup> Other benefits includes primarily traditional product changes in reserves and dividends.

Benefits for this segment include death claims incurred during the period in excess of the associated reserves for its interest-sensitive and traditional products. In addition, benefits include the change in reserves for our products with secondary guarantees. The reserve for secondary guarantees is impacted by changes in expected future trends of claims and assessments causing unlocking adjustments to this liability similar to DAC, VOBA and DFEL.

*Comparison of the Three Months Ended June 30, 2008 to 2007*

The increase in benefits was due primarily to growth in business in force, higher mortality due to an increase in the average attained age of the in-force block (which also led to increases in insurance fees as discussed above) and an increase in reserves for products with secondary guarantees.

An adjustment to account values and modification of accounting related to certain life insurance policies in the second quarter of 2007 increased reserves for products with secondary guarantees. In the third quarter of 2007, we had an unfavorable prospective unlocking that also resulted in an increase in reserves for products with secondary guarantees. As a result of these changes, we have experienced an increase in reserves of approximately \$4 million.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

The increase in benefits was due primarily to growth in business in force, higher mortality due to an increase in the average attained age of the in-force block (which also led to increases in insurance fees as discussed above) and an increase in reserves for products with secondary guarantees, partially offset by a \$14 million increase to benefits in the first quarter of 2007 related to a purchase accounting adjustment to the opening balance sheet of Jefferson-Pilot.

**Underwriting, Acquisition, Insurance and Other Expenses**

Details underlying underwriting, acquisition, insurance and other expenses (in millions) were as follows:

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Underwriting, Acquisition, Insurance and Other Expenses</b>						
Commissions	\$ 174	\$ 212	-18%	\$ 357	\$ 439	-19%
General and administrative expenses	98	114	-14%	201	225	-11%
Taxes, licenses and fees	26	26	0%	55	58	-5%
Total expenses incurred	298	352	-15%	613	722	-15%
DAC and VOBA deferrals	(231)	(272)	15%	(465)	(561)	17%
Total expenses recognized before amortization	67	80	-16%	148	161	-8%
DAC and VOBA amortization, net of interest:						
Retrospective unlocking	18	(21)	186%	28	(33)	185%
Other amortization	142	111	28%	262	262	0%
Other intangible amortization	1	1	0%	2	2	0%
Total underwriting, acquisition, insurance and other expenses	\$ 228	\$ 171	33%	\$ 440	\$ 392	12%

**DAC and VOBA deferrals**

As a percentage of sales 151.0% 151.1% 156.0% 146.5%

Commissions and other general and administrative expenses that vary with and are related primarily to the production of new business are deferred to the extent recoverable and for our interest-sensitive products are generally amortized over the lives of the contracts in relation to EGPs. For our traditional products, DAC and VOBA are amortized on either a straight-line basis or as a level percent of premium of the related contracts, depending on the block of business.



*Comparison of the Three Months Ended June 30, 2008 to 2007*

The decrease in expenses incurred was primarily a result of lower sales. The increase in DAC and VOBA amortization, excluding unlocking, was due partially to business growth and the impact from the rise in the ratio of deferrable expenses to EGPs from unfavorable unlocking.

The second quarter of 2008 had unfavorable retrospective unlocking (increase to DAC and VOBA amortization) due primarily to lower premiums received and higher death claims, partially offset by higher investment income on alternative investments and prepayment and bond makewhole premiums and lower maintenance expenses than estimated in our model projections.

The second quarter of 2007 had favorable retrospective unlocking (decrease to DAC and VOBA amortization) due primarily to higher investment income on alternative investments and prepayment and bond makewhole premiums, higher premiums received and lower maintenance expenses than estimated in our model projections, partially offset by the impact of the correction to account values in the second quarter of 2007 mentioned above.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

The decrease in expenses incurred was primarily a result of lower sales. The increase in DAC and VOBA amortization, excluding unlocking, for the three months ended June 30, 2008, as compared to the corresponding period in 2007 as discussed above was offset by lower DAC and VOBA amortization due to less favorable investment income during the six months ended June 30, 2008, as compared to the corresponding period in 2007 and the impact of an adjustment to the opening balance sheet of Jefferson-Pilot, which increased DAC and VOBA amortization for the three months ended March 31, 2007, by \$10 million.

The first six months of 2008 had unfavorable retrospective unlocking (increase to DAC and VOBA amortization) due primarily to lower premiums received and higher death claims than estimated in our model projections and model adjustments on certain life insurance policies, partially offset by lower maintenance expenses than estimated in our model projections.

The first six months of 2007 had favorable retrospective unlocking (decrease to DAC and VOBA amortization) due primarily to higher investment income on alternative investments and prepayment and bond makewhole premiums, higher premiums received and lower maintenance expenses than estimated in our model projections, partially offset by the impact of the correction to account values in the second quarter of 2007 mentioned above.

## RESULTS OF EMPLOYER MARKETS

The Employer Markets business provides its products through two segments: Retirement Products and Group Protection. The Retirement Products segment operates through two lines of business – Defined Contribution, which provides employer-sponsored variable and fixed annuities, and mutual-fund based programs in the 401(k), 403(b) and 457 marketplaces, and Executive Benefits, which provides corporate-owned life insurance ( COLI ) and bank-owned life insurance ( BOLI ). Our Institutional Pension business, which was previously reported as part of the Retirement Products segment, is now being reported in Other Operations. The Group Protection segment of Employer Markets offers group life, disability and dental insurance to employers.

### Employer Markets – Retirement Products

#### Income from Operations

Details underlying the results for Employer Markets – Retirement Products (in millions) were as follows:

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Operating Revenues</b>						
Insurance fees	\$ 74	\$ 78	-5%	\$ 148	\$ 153	-3%
Net investment income	227	235	-3%	451	472	-4%
Other revenues and fees	3	5	-40%	9	9	0%
<b>Total operating revenues</b>	<b>304</b>	<b>318</b>	<b>-4%</b>	<b>608</b>	<b>634</b>	<b>-4%</b>
<b>Operating Expenses</b>						
Interest credited	145	141	3%	290	285	2%
Benefits	4	3	33%	6	5	20%
Underwriting, acquisition, insurance and other expenses	81	90	-10%	165	171	-4%
<b>Total operating expenses</b>	<b>230</b>	<b>234</b>	<b>-2%</b>	<b>461</b>	<b>461</b>	<b>0%</b>
<b>Income from operations before taxes</b>	<b>74</b>	<b>84</b>	<b>-12%</b>	<b>147</b>	<b>173</b>	<b>-15%</b>
Federal income taxes	22	26	-15%	43	53	-19%
<b>Income from operations</b>	<b>\$ 52</b>	<b>\$ 58</b>	<b>-10%</b>	<b>\$ 104</b>	<b>\$ 120</b>	<b>-13%</b>

The discussion of Employer Markets – Retirement Products is provided in *Retirement Products – Defined Contribution* and *Retirement Products – Executive Benefits* below.

*Retirement Products Defined Contribution***Income from Operations**

Details underlying the results for Employer Markets Retirement Products Defined Contribution (in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Operating Revenues</b>						
Insurance fees	\$ 61	\$ 65	-6%	\$ 122	\$ 127	-4%
Net investment income	175	182	-4%	346	363	-5%
Other revenues and fees	3	5	-40%	9	9	
<b>Total operating revenues</b>	<b>239</b>	<b>252</b>	<b>-5%</b>	<b>477</b>	<b>499</b>	<b>-4%</b>
<b>Operating Expenses</b>						
Interest credited	107	104	3%	213	209	2%
Underwriting, acquisition, insurance and other expenses	75	81	-7%	152	152	
<b>Total operating expenses</b>	<b>182</b>	<b>185</b>	<b>-2%</b>	<b>365</b>	<b>361</b>	<b>1%</b>
Income from operations before taxes	57	67	-15%	112	138	-19%
Federal income taxes	16	20	-20%	31	41	-24%
<b>Income from operations</b>	<b>\$ 41</b>	<b>\$ 47</b>	<b>-13%</b>	<b>\$ 81</b>	<b>\$ 97</b>	<b>-16%</b>

*Comparison of the Three and Six Months Ended June 30, 2008 to 2007*

Income from operations for this line of business decreased due primarily to the following:

Lower net investment income driven by less favorable results from our investment income on alternative investments and prepayment and bond makewhole premiums; and

Unfavorable impact of lower average daily account values due to unfavorable equity markets. A substantial increase in new deposit production in other products is necessary to maintain earnings at current levels, and increased uncertainty in the market has weakened the overall outlook.

The foregoing items are discussed further below.

**Insurance Fees**

Details underlying insurance fees, account values and net flows (in millions) were as follows:

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Insurance Fees</b>						
Annuity expense assessments	\$ 55	\$ 59	-7%	\$ 110	\$ 115	-4%
Mutual fund fees	5	4	25%	9	8	13%
Total expense assessments	60	63	-5%	119	123	-3%
Surrender charges	1	2	-50%	3	4	-25%
Total insurance fees	\$ 61	\$ 65	-6%	\$ 122	\$ 127	-4%
<b>Average Daily Variable Account Values</b>	\$ 16,892	\$ 18,377	-8%	\$ 16,766	\$ 17,982	-7%
<b>Average Daily S&amp;P 500 Index®</b>	1,371.26	1,496.87	-8%	1,360.21	1,461.02	-7%

	As of June 30,		
	2008	2007	Change
<b>Account Values</b>			
Variable portion of variable annuities	\$ 16,195	\$ 18,480	-12%
Fixed portion of variable annuities	6,073	6,023	1%
Total variable annuities	22,268	24,503	-9%
Fixed annuities	5,221	4,917	6%
Total annuities	27,489	29,420	-7%
Mutual funds	7,553	6,543	15%
Total annuities and mutual funds	\$ 35,042	\$ 35,963	-3%

Account Value Roll Forward By Product	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Total Micro Small Segment:</b>						
Balance at beginning-of-period	\$ 7,218	\$ 7,689	-6%	\$ 7,798	\$ 7,535	3%
Gross deposits	389	378	3%	887	838	6%
Withdrawals and deaths	(395)	(434)	9%	(964)	(885)	-9%
Net flows	(6)	(56)	89%	(77)	(47)	-64%
Transfers between fixed and variable accounts			NM	(12)	(5)	NM
Investment increase and change in market value	74	379	-80%	(423)	529	NM
Balance at end-of-period	\$ 7,286	\$ 8,012	-9%	\$ 7,286	\$ 8,012	-9%
<b>Total Mid Large Segment:</b>						
Balance at beginning-of-period	\$ 9,621	\$ 7,734	24%	\$ 9,463	\$ 6,975	36%
Gross deposits	748	589	27%	1,517	1,302	17%
Withdrawals and deaths	(299)	(132)	NM	(458)	(250)	-83%
Net flows	449	457	-2%	1,059	1,052	1%
Transfers between fixed and variable accounts	(11)	36	NM	(40)	37	NM
Investment increase and change in market value	(74)	328	NM	(497)	491	NM
Balance at end-of-period	\$ 9,985	\$ 8,555	17%	\$ 9,985	\$ 8,555	17%
<b>Total Multi-Fund® and Other Variable Annuities:</b>						
Balance at beginning-of-period	\$ 17,925	\$ 19,053	-6%	\$ 18,797	\$ 19,146	-2%
Gross deposits	284	306	-7%	568	620	-8%
Withdrawals and deaths	(490)	(634)	23%	(1,033)	(1,331)	22%
Net flows	(206)	(328)	37%	(465)	(711)	35%
Transfers between fixed and variable accounts		(1)	100%		(4)	100%
Inter-segment transfer			NM	295		NM
Investment increase and change in market value	52	672	-92%	(856)	965	NM
Balance at end-of-period	\$ 17,771	\$ 19,396	-8%	\$ 17,771	\$ 19,396	-8%
<b>Total Annuities and Mutual Funds:</b>						
Balance at beginning-of-period	\$ 34,764	\$ 34,476	1%	\$ 36,058	\$ 33,656	7%
Gross deposits	1,421	1,273	12%	2,972	2,760	8%
Withdrawals and deaths	(1,184)	(1,200)	1%	(2,455)	(2,466)	0%
Net flows	237	73	225%	517	294	76%
Transfers between fixed and variable accounts	(11)	35	NM	(52)	28	NM
Inter-segment transfer			NM	295		NM
Investment increase and change in market value	52	1,379	-96%	(1,776)	1,985	NM
Balance at end-of-period <sup>(1)</sup>	\$ 35,042	\$ 35,963	-3%	\$ 35,042	\$ 35,963	-3%

<sup>(1)</sup> Includes mutual fund account values. Mutual funds are not included in the separate accounts.



	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Net Flows</b>						
Variable portion of variable annuity deposits	\$ 561	\$ 577	-3%	\$ 1,235	\$ 1,232	0%
Variable portion of variable annuity withdrawals	(646)	(747)	14%	(1,479)	(1,560)	5%
Variable portion of variable annuity net flows	(85)	(170)	50%	(244)	(328)	26%
Fixed portion of variable annuity deposits	93	87	7%	185	187	-1%
Fixed portion of variable annuity withdrawals	(182)	(236)	23%	(392)	(470)	17%
Fixed portion of variable annuity net flows	(89)	(149)	40%	(207)	(283)	27%
Total variable annuity deposits	654	664	-2%	1,420	1,419	0%
Total variable annuity withdrawals	(828)	(983)	16%	(1,871)	(2,030)	8%
Total variable annuity net flows	(174)	(319)	45%	(451)	(611)	26%
Fixed annuity deposits	187	146	28%	427	344	24%
Fixed annuity withdrawals	(198)	(140)	-41%	(358)	(305)	-17%
Fixed annuity net flows	(11)	6	NM	69	39	77%
Total annuity deposits	841	810	4%	1,847	1,763	5%
Total annuity withdrawals	(1,026)	(1,123)	9%	(2,229)	(2,335)	5%
Total annuity net flows	(185)	(313)	41%	(382)	(572)	33%
Mutual fund deposits	580	463	25%	1,125	997	13%
Mutual fund withdrawals	(158)	(77)	NM	(226)	(131)	-73%
Mutual fund net flows	422	386	9%	899	866	4%
Total annuity and mutual fund deposits	1,421	1,273	12%	2,972	2,760	8%
Total annuity and mutual fund withdrawals	(1,184)	(1,200)	1%	(2,455)	(2,466)	0%
Total annuity and mutual fund net flows	\$ 237	\$ 73	225%	\$ 517	\$ 294	76%

We charge expense assessments to cover insurance and administrative expenses. Expense assessments are generally equal to a percentage of the daily variable account values. Our expense assessments include fees we earn for the services that we provide to our mutual fund programs. In addition, we collect surrender charges when contract holders surrender their contracts during the surrender charge periods to protect us from premature withdrawals.

New deposits are an important component of our effort to grow our business. Although deposits do not significantly impact current period income from operations, they are an important indicator of future profitability. The other component of net flows relates to the retention of our business as demonstrated by our lapse rates.

We serve the mid-large case 401(k) and 403(b) markets with our mutual fund programs. Our programs bundle our fixed annuity products with mutual funds, along with record keeping and employee education components. The amounts associated with the mutual fund programs are not included in the assets or liabilities reported on our Consolidated Balance Sheets.

The distribution model for the micro-small case 401(k) market is focused on driving growth through financial intermediaries. As of June 30, 2008, we had 68 wholesalers in place to support this business and plan for additional growth in the second half of 2008. We are beginning to experience an increase in new business activity as a result of building our own wholesaling force for this market.

## Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

*Comparison of the Three Months Ended June 30, 2008 to 2007*

The decrease in expense assessments was driven by lower average daily variable annuity account values due to unfavorable equity markets.

Deposits in our mid-large segment (including mutual fund program fixed annuity deposits) increased due to an increase in the number of mutual fund program accounts, which resulted in both an increase in initial deposits and an increase in ongoing periodic deposits.

The overall lapse rate for our annuity products was 13% for the second quarter of 2008 compared to 15% for the same period in 2007. The return on assets, calculated as income divided by average assets under management, for *Multi-Fund*<sup>®</sup> and Other Variable Annuities, our oldest block of annuity business, is more than two times that of new deposits. Therefore, a substantial increase in new deposit production in other products is necessary to maintain earnings at current levels.

As of June 30, 2008, approximately \$13.2 billion, or 59%, of variable annuity contract account values contained a return of premium death benefit feature, and the net amount at risk related to these contracts was \$27 million. The remaining variable annuity contract account values contain no GDB feature.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

The decrease in expense assessments was driven by lower average daily variable annuity account values due to unfavorable equity markets.

Deposits in our mid-large segment (including mutual fund program fixed annuity deposits) increased due to an increase in the number of mutual fund program accounts, which resulted in both an increase in initial deposits and an increase in ongoing periodic deposits.

The overall lapse rate for our annuity products remained flat at 15%.

**Net Investment Income and Interest Credited**

Details underlying net investment income, interest credited (in millions) and our interest rate spread were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Net Investment Income</b>						
Fixed maturity securities, mortgage loans on real estate and other, net of investment expenses	\$ 164	\$ 159	3%	\$ 324	\$ 325	0%
Commercial mortgage loan prepayment and bond makewhole premiums <sup>(1)</sup>	1	2	-50%	2	3	-33%
Alternative investments <sup>(2)</sup>	(1)	3	NM	(2)	5	NM
Surplus investments <sup>(3)</sup>	11	18	-39%	22	30	-27%
Total net investment income	\$ 175	\$ 182	-4%	\$ 346	\$ 363	-5%
<b>Interest Credited</b>						
	\$ 107	\$ 104	3%	\$ 213	\$ 209	2%

<sup>(1)</sup> See Consolidated Investments Commercial Mortgage Loan Prepayment and Bond Makewhole Premiums below for additional information.

<sup>(2)</sup> See Consolidated Investments Alternative Investments below for additional information.

<sup>(3)</sup> Represents net investment income on the required statutory surplus for this segment.

	For the Three Months Ended June 30, 2008		Basis Point Change	For the Six Months Ended June 30, 2008		Basis Point Change
	2007	2007		2007	2007	
<b>Interest Rate Spread</b>						
Fixed maturity securities, mortgage loans on real estate and other, net of investment expenses	5.89%	5.95%	(6)	5.90%	6.03%	(13)
Commercial mortgage loan prepayment and bond makewhole premiums	0.05%	0.09%	(4)	0.04%	0.06%	(2)
Alternative investments	-0.03%	0.10%	(13)	-0.03%	0.09%	(12)
Net investment income yield on reserves	5.91%	6.14%	(23)	5.91%	6.18%	(27)
Interest rate credited to contract holders	3.80%	3.82%	(2)	3.80%	3.81%	(1)
Interest rate spread	2.11%	2.32%	(21)	2.11%	2.37%	(26)

Note: The yields, rates and spreads above are calculated using whole dollars instead of dollars rounded to millions.

	For the Three Months Ended June 30, 2008			For the Six Months Ended June 30, 2008		
	2007	2007	Change	2007	2007	Change
Average invested assets on reserves	\$ 11,067	\$ 10,719	3%	\$ 10,978	\$ 10,748	2%
Average fixed account values, including the fixed portion of variable	11,266	10,957	3%	11,191	10,966	2%
Net flows for fixed annuities, including the fixed portion of variable	(100)	(143)	30%	(138)	(244)	43%

A portion of our investment income earned is credited to the contract holders of our fixed annuity products, including the fixed portion of variable annuity contracts. We expect to earn a spread between what we earn on the underlying general account investments supporting the fixed annuity product line, including the fixed portion of variable annuity contracts, and what we credit to our fixed annuity contract holders' accounts, including the fixed portion of variable annuity contracts. The interest rate spread for this segment represents the excess of the yield on invested assets on reserves over the average crediting rate. The yield on invested assets on reserves is calculated as net investment income, excluding the amounts attributable to our surplus investments, reverse repurchase agreement interest expense, inter-segment cash management account interest expense and interest on collateral, divided by average invested assets on reserves. The average invested assets on reserves are calculated based upon total invested assets, excluding hedge derivatives. The average crediting rate is calculated as interest credited before DSI amortization, plus the immediate annuity reserve change (included within benefits), divided by the average fixed account values, including the fixed portion of variable annuities. Commercial mortgage loan prepayments and bond makewhole premiums, investment income on alternative investments and surplus investment income can vary significantly from period to period due to a number of factors and, therefore, may contribute to investment income results that are not indicative of the underlying trends.

#### *Comparison of the Three Months Ended June 30, 2008 to 2007*

The decline in surplus investment income was attributable to less favorable investment income on alternative investments.

The modest increase in fixed maturity securities, mortgage loans on real estate and other net investment income was attributable to the growth in the average fixed account values, including the fixed portion of variable, driven by transfers from variable annuities partially offset by the yield decline due to lower reinvestment rates. During the second quarter of 2008, in response to the competitive environment, we held credit rates constant and reduced new money rates by 25 basis points for Multi-Fund<sup>®</sup> and mutual fund products. We have taken further crediting rate actions in the third quarter of 2008, with the expectation of maintaining stable spreads over the near term, excluding the effects of prepayment and makewhole premiums. For information on interest rate spreads and the interest rate risk due to falling interest rates, see Item 3. Quantitative and Qualitative Disclosures About Market Risk.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

The decline in surplus investment income was attributable to less favorable investment income on alternative investments.

While fixed maturity securities, mortgage loans on real estate and other net investment income remained flat, the yield declined due to lower reinvestment rates, which was offset by the increase in average fixed account values, including the fixed portion of variable, driven by transfers from variable annuities.

**Underwriting, Acquisition, Insurance and Other Expenses**

Details underlying underwriting, acquisition, insurance and other expenses (in millions) were as follows:

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Underwriting, Acquisition, Insurance and Other Expenses</b>						
Commissions	\$ 19	\$ 21	-10%	\$ 39	\$ 41	-5%
General and administrative expenses	52	55	-5%	104	105	-1%
Taxes, licenses and fees	3	4	-25%	7	9	-22%
Total expenses incurred	74	80	-8%	150	155	-3%
DAC deferrals	(22)	(21)	-5%	(45)	(45)	0%
Total expenses recognized before amortization	52	59	-12%	105	110	-5%
DAC and VOBA amortization, net of interest:						
Retrospective unlocking		2	-100%	3	2	50%
Other amortization	23	20	15%	44	40	10%
Total underwriting, acquisition, insurance and other expenses	\$ 75	\$ 81	-7%	\$ 152	\$ 152	0%

**DAC deferrals**

As a percentage of sales/deposits	1.5%	1.6%	1.5%	1.6%
-----------------------------------	------	------	------	------

Commissions and other costs, that vary with and are related primarily to the production of new business, excluding those associated with our mutual fund products, are deferred to the extent recoverable and are amortized over the lives of the contracts in relation to EGPs. We do not pay commissions on sales of our mutual fund products, and distribution expenses associated with the sale of these mutual fund products are not deferred and amortized, as is the case for our insurance products.

*Comparison of the Three Months Ended June 30, 2008 to 2007*

The decrease in underwriting, acquisition, insurance and other expenses was due in part to the implementation of several expense management controls and practices that are focused on aggressively managing expenses and lower incentive compensation accruals as a result of lower earnings and production performance relative to planned goals.

The second quarter of 2007 had unfavorable retrospective unlocking (increase to DAC and VOBA amortization) due primarily to higher lapses than estimated in our model projections.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

The first six months of 2008 and 2007 had unfavorable retrospective unlocking (increase to DAC and VOBA amortization) due primarily to higher lapses than estimated in our model projections.

*Retirement Products Executive Benefits***Income from Operations**

Details underlying the results for Retirement Products Executive Benefits (in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Operating Revenues</b>						
Insurance fees	\$ 13	\$ 13	0%	\$ 26	\$ 26	0%
Net investment income	52	53	-2%	105	109	-4%
Total operating revenues	65	66	-2%	131	135	-3%
<b>Operating Expenses</b>						
Interest credited	38	37	3%	77	76	1%
Benefits	4	3	33%	6	5	20%
Underwriting, acquisition, insurance and other expenses	6	9	-33%	13	19	-32%
Total operating expenses	48	49	-2%	96	100	-4%
Income from operations before taxes	17	17	0%	35	35	0%
Federal income taxes	6	6	0%	12	12	0%
Income from operations	\$ 11	\$ 11	0%	\$ 23	\$ 23	0%

*Comparison of the Three Months Ended June 30, 2008 to 2007*

Income from operations remained flat as lower earnings on surplus investments due to unfavorable equity markets and increased interest credited driven by modest fixed account fund value growth were offset by lower DAC and VOBA amortization expense due to unfavorable retrospective unlocking in the second quarter of 2007.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

Income from operations remained flat as lower earnings on surplus investments due to unfavorable equity markets and lower consent fees were offset by lower DAC and VOBA amortization expense due to unfavorable retrospective unlocking in the first six months of 2007.

The foregoing items are discussed further below.

**Insurance Fees**

Details underlying insurance fees, sales, net flows, account values and in-force face amount (in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Insurance Fees</b>						
Mortality assessments	\$ 8	\$ 8	0%	\$ 17	\$ 17	0%
Expense assessments	6	5	20%	11	9	22%

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

DFEL:

Deferrals	(1)	(1)	0%	(2)	(2)	0%
Amortization			NM		1	-100%
Retrospective unlocking		1	-100%		1	-100%
Total insurance fees	\$ 13	\$ 13	0%	\$ 26	\$ 26	0%

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Sales</b>	\$ 13	\$ 14	-7%	\$ 41	\$ 34	21%
<b>Account Values</b>						
Balance at beginning-of-period	\$ 4,460	\$ 4,264	5%	\$ 4,436	\$ 4,305	3%
Deposits <sup>(1)</sup>	110	79	39%	275	144	91%
Withdrawals and deaths <sup>(1)</sup>	(60)	(53)	-13%	(154)	(193)	20%
Net flows	50	26	92%	121	(49)	NM
Policyholder assessments	(17)	(17)	0%	(37)	(35)	-6%
Interest credited and change in market value	33	80	-59%	6	132	-95%
Balance at end-of-period	\$ 4,526	\$ 4,353	4%	\$ 4,526	\$ 4,353	4%
<b>In Force</b>	\$ 14,939	\$ 14,809	1%	\$ 14,939	\$ 14,809	1%

<sup>(1)</sup> Deposits and withdrawals and deaths include \$23 million and \$67 million for the three and six months ended June 30, 2008, related to the exchange of legacy Jefferson-Pilot products with new Lincoln products.

Our mortality and expense assessments are deducted from our contract holders' account values and reported as insurance fees. For this business, the mortality and expense assessments amounts are a function of the rates priced into the product and face amount of our insurance in force. Insurance in force, in turn, is driven by sales, persistency and mortality experience.

Included in the business acquired with the Jefferson-Pilot companies are BOLI products, which accounted for \$1.7 billion in contract holder fund balances as of June 30, 2008. VOBA balances, net of unearned revenue reserves, related to these blocks were approximately \$113 million as of June 30, 2008. These contracts, which are generally not subject to surrender charges, are owned by several thousand contract holders. These contracts were primarily originated through, and continue to be serviced by, two marketing organizations. The surrender rate for this product may increase beyond current experience due to the absence of surrender charges and rising interest rates that may result in returns available to contract holders on competitors' products being more attractive than on our policies in force. The following factors may influence contract holders to continue these coverages: our ability to adjust crediting rates; relatively high minimum rate guarantees; the difficulty of re-underwriting existing and additional covered lives; and unfavorable tax attributes of certain surrenders. Our assumptions for amortizing VOBA and unearned revenue for these policies reflect a higher long-term expected lapse rate than other blocks of business due to the factors noted above. Lapse experience for this block in a particular period could vary significantly from our long-term lapse assumptions.

Consistent with the way we report UL sales, we report COLI and BOLI sales as 100% of annualized expected target premium plus 5% of paid excess premium, including an adjustment for internal replacements at approximately 50% of target. Sales in this business tend to be of large case nature and can fluctuate significantly from quarter to quarter.

#### *Comparison of the Three Months Ended June 30, 2008 to 2007*

Mortality and expense assessments for this business increased as client deposits were primarily in variable products partially offset by declines in variable account values from unfavorable equity markets.

#### *Comparison of the Six Months Ended June 30, 2008 to 2007*

Mortality and expense assessments for this business were favorably impacted by higher variable fees resulting from a customer transferring \$55 million of fixed account value to variable account value in the second quarter of 2007 partially offset by declines in variable account values from unfavorable equity markets. This transfer had an offsetting impact on investment income and interest credited as discussed below. Expense assessments also increased as client deposits were primarily in variable products.

Insurance in force increased modestly as growth over the prior year due to sales was partially offset by term rider face reductions in the second quarter of 2008.



**Net Investment Income and Interest Credited**

Details underlying net investment income and interest credited (in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Net Investment Income</b>						
Fixed maturity securities, mortgage loans on real estate and other, net of investment expenses	\$ 51	\$ 51	0%	\$ 101	\$ 104	-3%
Commercial mortgage loan prepayment and bond makewhole premiums <sup>(1)</sup>			NM	1	1	0%
Surplus investments <sup>(2)</sup>	1	2	-50%	3	4	-25%
<b>Total net investment income</b>	<b>\$ 52</b>	<b>\$ 53</b>	<b>-2%</b>	<b>\$ 105</b>	<b>\$ 109</b>	<b>-4%</b>
<b>Interest Credited</b>	<b>\$ 38</b>	<b>\$ 37</b>	<b>3%</b>	<b>\$ 77</b>	<b>\$ 76</b>	<b>1%</b>

(1) See Consolidated Investments Commercial Mortgage Loan Prepayment and Bond Makewhole Premiums below for additional information.

(2) Represents net investment income on the required statutory surplus for this segment.

When analyzing the impact of net investment income for this segment, it is important to understand that a portion of the investment income earned is credited to the contract holders of our fixed products, including the fixed portion of variable. We expect to earn a spread between what we earn on the underlying general account investments supporting the fixed product line and what we credit to our fixed contract holders accounts.

Commercial mortgage loan prepayments and bond makewhole premiums, investment income on alternative investments and surplus investment income can vary significantly from period to period due to a number of factors and, therefore, can provide results that are not indicative of the underlying trends.

*Comparison of the Three Months Ended June 30, 2008 to 2007*

Earnings on surplus investments were negatively impacted by unfavorable equity markets.

On January 1, 2008, we implemented a 25 basis point increase in crediting rates on a small block of policies that have approximately \$150 million of fixed account value. Despite this crediting rate action, interest credited remained relatively flat as fixed account values have only modestly increased as client deposits were primarily in variable products.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

Fixed maturity securities, mortgage loans on real estate and other net investment income decreased due to the unfavorable impact of a customer transferring \$55 million from fixed account value to variable account value in the second quarter of 2007, reducing the interest margin, and higher consent fees in 2007. Additionally, earnings on surplus investments were negatively impacted by unfavorable equity markets.

Interest credited remained relatively flat as modest fixed account value growth and the crediting rate action discussed above were partially offset by the impact of a customer transferring \$55 million from fixed account value to variable account value in the second quarter of 2007.

**Benefits**

Benefits for this segment include claims incurred during the period in excess of the associated account balance for its interest-sensitive products.

*Comparison of the Three Months Ended June 30, 2008 to 2007*

Benefits increased modestly due to slightly less favorable mortality yet remained in line with growth in business in force.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

Benefits increased modestly due to slightly less favorable mortality yet remained in line with growth in business in force. Additionally, benefits were favorably impacted by a recovery on a reinsurance agreement in the first quarter of 2007.

**Underwriting, Acquisition, Insurance and Other Expenses**

Details underlying underwriting, acquisition, insurance and other expenses (in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Underwriting, Acquisition, Insurance and Other Expenses</b>						
Commissions	\$ 6	\$ 7	-14%	\$ 18	\$ 13	38%
General and administrative expenses	3	2	50%	6	5	20%
Taxes, licenses and fees	1	1	0%	3	2	50%
Total expenses incurred	10	10	0%	27	20	35%
DAC and VOBA deferrals	(6)	(7)	14%	(18)	(14)	-29%
Total expenses recognized before amortization	4	3	33%	9	6	50%
DAC and VOBA amortization, net of interest:						
Retrospective unlocking		2	-100%	(1)	5	NM
Other amortization	2	4	-50%	5	8	-38%
Total underwriting, acquisition, insurance and other expenses	\$ 6	\$ 9	-33%	\$ 13	\$ 19	-32%

**DAC and VOBA deferrals**

As a percentage of sales	46.2%	50.0%	43.9%	41.2%
--------------------------	-------	-------	-------	-------

Commissions and other costs that vary with and are related primarily to the production of new business are deferred to the extent recoverable and, for our interest-sensitive products, are amortized over the lives of the contracts in relation to EGPs.

*Comparison of the Three Months Ended June 30, 2008 to 2007*

Expenses incurred remained flat as decreased sales and lower incentive compensation expense were offset by a change in expense allocation methodology within Employer Markets that did not affect consolidated expenses.

The unfavorable retrospective unlocking (increase to DAC and VOBA amortization) in the second quarter of 2007 was due to actual gross profits being lower than EGPs due to the impact of a customer transferring \$55 million of fixed account value to variable account value, partially offset by favorable retrospective unlocking from market conditions.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

The increase in expenses incurred was primarily a result of increased sales and the change in expense allocation discussed above.

The favorable retrospective unlocking (decrease to DAC and VOBA amortization) in the first six months of 2008 was due primarily to higher premiums received and lower death claims than estimated in our model projections. The unfavorable retrospective unlocking (increase to DAC and VOBA amortization) in the first six months 2007 was due to the impact of a customer transferring \$55 million in fixed account value to variable account value discussed above and higher surrender activity than estimated in our model projections. The surrender activity occurred for a variety of reasons, and no systemic issues, such as service or product competitiveness, contributed to this surrender activity.

**Employer Markets Group Protection**

The Group Protection segment offers group life, disability and dental insurance to employers. The segment's products are marketed primarily through a national distribution system of regional group offices. These offices develop business through employee benefit brokers, third-party administrators and other employee benefit firms.

**Income from Operations**

Details underlying the results for Employer Markets Group Protection (in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Operating Revenues</b>						
Insurance premiums	\$ 393	\$ 361	9%	\$ 763	\$ 693	10%
Net investment income	31	29	7%	58	56	4%
Other revenues and fees	1	1	0%	3	2	50%
<b>Total operating revenues</b>	<b>425</b>	<b>391</b>	<b>9%</b>	<b>824</b>	<b>751</b>	<b>10%</b>
<b>Operating Expenses</b>						
Benefits	287	266	8%	555	512	8%
Underwriting, acquisition, insurance and other expenses	89	80	11%	179	159	13%
<b>Total operating expenses</b>	<b>376</b>	<b>346</b>	<b>9%</b>	<b>734</b>	<b>671</b>	<b>9%</b>
Income from operations before taxes	49	45	9%	90	80	13%
Federal income taxes	17	16	6%	32	28	14%
<b>Income from operations</b>	<b>\$ 32</b>	<b>\$ 29</b>	<b>10%</b>	<b>\$ 58</b>	<b>\$ 52</b>	<b>12%</b>
<b>Income from Operations by Product Line</b>						
Life	\$ 11	\$ 10	10%	\$ 21	\$ 19	11%
Disability	20	18	11%	36	31	16%
Dental			NM	(1)		NM
<b>Total non-medical</b>	<b>31</b>	<b>28</b>	<b>11%</b>	<b>56</b>	<b>50</b>	<b>12%</b>
Medical	1	1	0%	2	2	0%
<b>Total income from operations</b>	<b>\$ 32</b>	<b>\$ 29</b>	<b>10%</b>	<b>\$ 58</b>	<b>\$ 52</b>	<b>12%</b>

*Comparison of the Three Months Ended June 30, 2008 to 2007*

Income from operations for this segment increased due to the following:

## Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Growth in insurance premiums driven by normal, organic business growth in our non-medical products and better than expected persistency;  
and

Combined total non-medical loss ratio experience below the lower end of our expected range.

The increase in income from operations was partially offset by an increase to underwriting, acquisition, insurance and other expenses due to growth in our business in force, elevated costs associated with investments in strategic initiatives and an increase in the allocation of expenses to this segment.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

Income from operations for this segment increased due to the following:

Growth in insurance premiums driven by normal, organic business growth in our non-medical products and better than expected persistency; and

Combined total non-medical loss ratio experience at the lower end of our expected range. The increase in income from operations was partially offset by an increase to underwriting, acquisition, insurance and other expenses due to growth in our business in force, higher 401(k) expenses, elevated costs associated with investments in strategic initiatives and an increase in the allocation of expenses to this segment.

The foregoing items are discussed further below.

**Insurance Premiums**

Details underlying insurance premiums (in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Insurance Premiums by Product Line</b>						
Life	\$ 134	\$ 125	7%	\$ 267	\$ 244	9%
Disability	167	150	11%	330	295	12%
Dental	37	34	9%	74	66	12%
Total non-medical	338	309	9%	671	605	11%
Medical	55	52	6%	92	88	5%
Total insurance premiums	\$ 393	\$ 361	9%	\$ 763	\$ 693	10%
<b>Sales</b>	\$ 65	\$ 62	5%	\$ 119	\$ 123	-3%

Our cost of insurance and policy administration charges are embedded in the premiums charged to our customers. The premiums are a function of the rates priced into the product and our business in force. Business in force, in turn, is driven by sales and persistency experience.

Sales in the table above and as discussed below are the combined annualized premiums for our life, disability and dental products. Sales relate to long-duration contracts sold to new contract holders and new programs sold to existing contract holders. The trend in sales is an important indicator of development of business in force over time.

*Comparison of the Three and Six Months Ended June 30, 2008 to 2007*

The increase in insurance premiums in our non-medical business reflects normal business growth and favorable persistency experience.

**Net Investment Income**

We use our interest income to build the associated policy reserves, which is a function of our insurance premiums and the yields on our invested assets.

*Comparison of the Three and Six Months Ended June 30, 2008 to 2007*

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Net investment income remained relatively flat as continued growth of business in force was offset by lower yields on required statutory surplus due to weaker results from our alternative investments.

**Benefits**

Details underlying benefits (in millions) were as follows:

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Benefits by Product Line</b>						
Life	\$ 97	\$ 92	5%	\$ 192	\$ 181	6%
Disability	111	100	11%	221	200	11%
Dental	30	27	11%	60	53	13%
Total non-medical	238	219	9%	473	434	9%
Medical	49	47	4%	82	78	5%
Total benefits	\$ 287	\$ 266	8%	\$ 555	\$ 512	8%

**Loss Ratios by Product Line**

Life	72.3%	73.9%	72.1%	74.5%
Disability	66.1%	66.4%	67.1%	67.9%
Dental	81.1%	79.3%	81.0%	79.2%
Total non-medical	70.2%	70.8%	70.6%	71.8%
Medical	88.6%	89.3%	88.2%	89.0%

Note: Loss ratios presented above are calculated using whole dollars instead of dollars rounded to millions.

Management has chosen to focus on trends in loss ratios to compare actual experience with pricing expectations because group-underwriting risks change over time. We believe that loss ratios in the 71-74% range are more representative of longer-term expectations for the composite non-medical portion of this segment. We expect normal fluctuations in this range, as claim experience is inherently uncertain, and there can be no assurance that experience will fall inside this expected range.

*Comparison of the Three and Six Months Ended June 30, 2008 to 2007*

We experienced favorable claim experience on all of our non-medical and medical products, except for dental. Our improved total non-medical loss ratio was driven by exceptional life and disability results. Our life loss ratio benefited from favorable waiver claims experience. Our disability loss ratio benefited from favorable termination and incidence experience. The termination experience was only relevant for the six months ended June 30, 2008, as compared to the corresponding period in the prior year.

**Underwriting, Acquisition, Insurance and Other Expenses**

Details underlying underwriting, acquisition, insurance and other expenses (in millions) were as follows:

	For the Three Months Ended			For the Six Months Ended		
	June 30, 2008	June 30, 2007	Change	June 30, 2008	June 30, 2007	Change
<b>Underwriting, Acquisition, Insurance and Other Expenses</b>						
Commissions	\$ 43	\$ 41	5%	\$ 87	\$ 81	7%
General and administrative expenses	41	37	11%	83	70	19%
Taxes, licenses and fees	9	10	-10%	19	19	0%
Total expenses incurred	93	88	6%	189	170	11%
DAC and VOBA deferrals	(13)	(14)	7%	(27)	(25)	-8%
Total expenses recognized before amortization	80	74	8%	162	145	12%
DAC and VOBA amortization, net of interest	9	6	50%	17	14	21%
Total underwriting, acquisition, insurance and other expenses	\$ 89	\$ 80	11%	\$ 179	\$ 159	13%

**DAC and VOBA Deferrals**

As a percentage of insurance premiums	3.3%	3.9%	3.5%	3.6%
---------------------------------------	------	------	------	------

Expenses, excluding commissions, that vary with and are related primarily to the production of new business are deferred to the extent recoverable and are amortized on either a straight-line basis or as a level percent of premium of the related contracts depending on the block of business. Commissions, which vary with and are related to paid premiums, are expensed as incurred. The level of expenses is an important driver of profitability for this segment as group insurance contracts are offered within an environment that competes on the basis of price and service.

*Comparison of the Three Months Ended June 30, 2008 to 2007*

The increase in underwriting, acquisition, insurance and other expenses was in line with the increase in insurance premiums and is attributable to growth in our business in force, elevated costs associated with investments in strategic initiatives and an increase in the allocation of expenses to this segment.

*Comparison of the Six Months Ended June 30, 2008 to 2007*

The increase in underwriting, acquisition, insurance and other expenses was in line with the increase in insurance premiums and is attributable to higher 401(k) expenses, elevated costs associated with investments in strategic initiatives and an increase in the allocation of expenses to this segment. Partially offsetting the increase in expenses were higher deferrals, driven by strategic sales expenses.

## RESULTS OF INVESTMENT MANAGEMENT

The Investment Management segment, through Delaware Investments, provides a broad range of managed account portfolios, mutual funds, sub-advised funds and other investment products to individual investors and to institutional investors such as private and public pension funds, foundations and endowment funds. Delaware Investments is the marketing name for Delaware Management Holdings, Inc. and its subsidiaries.

### Income from Operations

Details underlying the results for Investment Management (in millions) were as follows:

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
<b>Operating Revenues</b>						
Investment advisory fees external	\$ 76	\$ 93	-18%	\$ 152	\$ 183	-17%
Investment advisory fees inter-segment	21	19	11%	41	44	-7%
Other revenues and fees	28	39	-28%	52	74	-30%
<b>Total operating revenues</b>	<b>125</b>	<b>151</b>	<b>-17%</b>	<b>245</b>	<b>301</b>	<b>-19%</b>
<b>Operating Expenses</b>						
Underwriting, acquisition, insurance and other expenses	101	133	-24%	202	258	-22%
Income from operations before taxes	24	18	33%	43	43	0%
Federal income taxes	9	7	29%	16	15	7%
Income from operations	\$ 15	\$ 11	36%	\$ 27	\$ 28	-4%
Pre-tax operating margin <sup>(1)</sup>	19%	12%		17%	14%	

<sup>(1)</sup> The pre-tax operating margin is determined by dividing pre-tax income from operations by operating revenues.  
*Comparison of the Three Months Ended June 30, 2008 to 2007*

Income from operations increased due primarily to the following:

Expenses incurred in the second quarter of 2007 for the launch of a closed-end fund as well as additions to a reserve for legal matters in that quarter; and

Lower incentive compensation accruals as a result of lower earnings and production performance relative to planned goals.  
The increase in income from operations was partially offset by:

Lower investment advisory fees due to lower assets under management driven by the sale of certain institutional fixed income business and less favorable equity markets; and

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-Q

Negative returns on seed capital driven by the unfavorable equity markets in the second quarter of 2008.  
*Comparison of the Six Months Ended June 30, 2008 to 2007*

Income from operations decreased slightly due primarily to the following:

Lower investment advisory fees due to lower assets under management driven by the sale of certain institutional fixed income business and less favorable equity markets; and