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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and thank you for joining Lincoln Financial Group Third Quarter 2023 Earnings Webcast. At this time, all lines are in a listen-only mode. Later, we will announce the opportunity for questions and instructions will be given at that time. [Operator instructions]

Now I will turn the conference over to the Chief Accounting Officer and Interim Chief Head of Investor Relations, Adam Cohen. Please go ahead, sir.

Adam Cohen
Chief Accounting Officer, Lincoln National Corp.

Thank you. Good morning and welcome to Lincoln Financial's third quarter earnings call. Before we begin, I have an important reminder. Any comments made during the call regarding future expectations, including those regarding deposits, expenses, income from operations, share repurchases and liquidity and capital resources are forward-looking statements under the Private Securities Litigation Reform Act of 1995.

These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from current expectations. These risks and uncertainties include those described in the cautionary statement disclosures in our earnings release issued yesterday as well as those detailed in our 2022 annual report on Form 10-K, most recent quarterly reports on Form 10-Q and from time to time in our other filings with the SEC. These forward-looking statements are made only as of today and we undertake no obligation to update or revise any of them to reflect events or circumstances that occur after this date.

We appreciate your participation today and invite you to visit Lincoln's website, www.lincolnfinancial.com, where you can find our press release and statistical supplement which include full reconciliations of the non-GAAP measures used on the call, including adjusted income from operations or adjusted operating income and adjusted income from operations available to common stockholders to their most comparable GAAP measures. Presenting on today's call are Ellen Cooper, Chairman, President and CEO; and Chris Neczypor, Chief Financial Officer. After their prepared remarks, we will move to the question-and-answer portion of the call.

I would now like to turn the call over to Ellen.

Ellen Gail Cooper

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

Thank you, Adam, and good morning, everyone. Before I turn my attention to this quarter's results, I first want to provide you with an update on the reinsurance transaction we announced with Fortitude Re in the second quarter of this year.

We are very pleased to announce today that both our regulators, the Indiana Department of Insurance, and our partner's regulator, the Bermuda Monetary Authority, have approved the transaction. With these approvals, we expect the transaction to close this month with economic benefits in line with what we originally communicated with an effective date of October 1 of this year. This significant milestone is the culmination of months of hard work on behalf of our teams and marks a big step forward in our efforts to derisk, strengthen the company's balance sheet and improve ongoing free cash flow.

Now turning to this quarter's remarks. We entered 2023 with a clear focus on taking actions to support rebuilding our capital position and delivering long-term profitable growth. We have a powerful franchise, trusted brand, distribution leadership and broad diversified product solutions across our four businesses. These elements serve as a solid foundation as we reposition the company to deliver increasing value to our shareholders.

While our third quarter results fell short of our expectations; I firmly believe we are continuing to make good progress on improving the underlying strength of the business, taking the necessary steps to repair the balance sheet and evaluating additional actions to further accelerate our path to recovery.

It is worth mentioning that the advancements we are making and the evolution taking place inside the walls of the company to reset and rebuild will not always be apparent in our quarterly financial results and this quarter is a clear example of that. We have more work to do to deliver strong results consistently and it will take some time.

Over the past year, we have taken swift and targeted actions with a strategic focus in three key areas: rebuild and protect capital; preserve the franchise and grow profitably; and invest in our infrastructure and talent.

Our actions have been aligned to these areas and include, first, shifting new business to a more capital-efficient mix while maintaining a robust level of sales. While a shift like this takes time, we are on track in all four of our businesses to achieve sales growth that utilizes less capital while meeting or exceeding target returns. Broadly speaking, as we look forward to the fourth quarter and into 2024, we expect continued sequential growth in sales, and we have a number of product enhancements and distribution initiatives planned that will further support this objective.

Second, executing on Spark, our enterprise-wide expense and technology modernization initiative, where we are on track with the incremental savings we have discussed with you previously.

Third, improving the profitability of our Group Protection business, which continues to be critically important to our long-term strategy. We have spoken with you about our goal of reaching and then sustaining the high end of our target margin for Group, which is 7%, and we are progressing toward that goal.

Fourth, we are continuing to evaluate additional internal and external solutions to unlock the value of our in-force.

And finally, strong execution is all about people. Over the past year or so, we have assembled a leadership team that has the right people in the right roles to drive results-driven outcomes and lead the organization forward. We are benefiting from fresh perspectives across every aspect of our business, which includes taking a hard look at every facet of our strategy, execution, processes and infrastructure. Overall, we are executing on our capital rebuild and capital generation efforts and have modestly improved our RBC year-to-date, despite some headwinds, while positioning the businesses to support long-term growth.

Turning to a few comments on third quarter results. We recorded a $144 million charge to operating income related to this year's assumption review, which was primarily driven by the Life business and relates to updated policyholder behavior and mortality assumptions. We have a rigorous process in place and feel confident in our updated assumptions.

Group, which produced notably strong performance in the first half of the year, delivered results below our expectations in the third quarter. Chris will provide further context on the results. But I want to remind you that we have been taking deliberate actions to support our longer-term margin expansion initiatives. And we have been successful in driving year-over-year margin improvement. These include: executing on our repricing strategy, which is enabling us to meet profitability targets while maintaining strong retention; progressing well with wins in our higher-margin supplemental health products which are a growing area of our business; and seeing success in the overall repositioning of our business through our new market segment strategies. As we've previously stated, we expect Group to be a larger part of our business mix and a key contributor over time.

I also want to address expenses. We are seeing elevated expense pressure across the enterprise, which has been a contributing factor to the pressure on our earnings year-to-date. From my perspective, this is a critical area of focus and opportunity as we look forward, and we are currently examining our expense base across the organization.

Now, turning to sales highlights for each of our businesses, starting with our two Retail Solutions businesses, annuities and life insurance, where we serve 2.6 million individuals in the US. We saw sequential sales growth in both businesses and we expect this momentum to carry into the fourth quarter.

In annuities, while third quarter sales declined 16% year-over-year, we saw sequential growth of 6%, as we launched a range of product enhancements and actions with our distribution partners. The largest driver of this growth was our fixed annuities business, where we saw sales increase 23%, as we took actions to strategically position ourselves across fixed product categories and with select distribution partners.

In life insurance, our third quarter sales were down 16% year-over-year, while we saw sequential growth of 17%, driven by a strong quarter in our MoneyGuard suite of products and executive benefits. Sales in these products can be lumpy from period to period. As we evolve our business with a sharper focus on capital efficiency, we continue to expect sales in certain term and variable universal life product segments to decline, and both term and VUL sales were down meaningfully year-over-year and sequentially.

In summary, in our two retail businesses, we are benefiting from a diversified product mix that enables us to be a solutions provider to our customers, while meeting or exceeding our capital efficiency and new business return targets.

Next, I'd like to turn to Workplace Solutions, which is comprised of our Group Protection and Retirement Plan Services businesses. We serve more than 50,000 employers and close to 14 million employees with our differentiated product offerings and service capabilities. With Group and Retirement together, delivering workplace benefits and services that support employers, financial professionals and employees, we have a unique position in the market.

In Group Protection, premiums grew 4% versus the prior year quarter, a direct result of the strong relationships and positive customer experience we deliver across each of our focused market segments. This has enabled us to achieve strong persistency while executing on the pricing actions that are a core part of our margin expansion strategy. In what is typically our lowest sales volume quarter of the year, sales were down approximately 19% year-over-year.

On a year-to-date basis, we've seen strong momentum in employee-paid sales, representing 60% of total group sales and up 8 percentage points year-over-year. We are seeing continued strength in supplemental health where sales more than doubled year-to-date. Looking ahead, the fourth quarter is our highest sales volume quarter. And based on our strong pipeline, we are expecting robust sales, enabling us to head into 2024 with solid momentum.

Lastly, in Retirement Plan Services, while first year sales were down more than 50% year-over-year, we see significant momentum heading into the close of the year and have a healthy pipeline of cases that will be implemented in 2024. Recurring deposits rose 6% year-over-year as our service model supports our customers in helping to drive higher contribution rates and an increasing number of participants. In addition, we are experiencing another year of nearly 100% client retention as our existing clients favor our digitally enabled high-touch customer approach.

To sum up, our Workplace Solutions businesses continue to meet or exceed capital efficiency and new business return targets. We are enhancing our customer-focused strategies and expect these actions to lead to long-term sustainable growth in these businesses going forward.

Before I turn the call over to Chris, I want to leave you with three key takeaways. First, we are laser-focused on profitable growth across all segments. We saw sequential sales growth in our two retail businesses in the third quarter. And as we head into 2024, we have a strong pipeline across all four businesses to support growing our best-in-class annuities business, executing the pivot in our Life business and delivering higher profitability in Workplace Solutions.

Second, we have a clear path in place and we have significant resources across the enterprise committed to achieving our financial objectives, strengthening our balance sheet, including rebuilding our capital levels, reducing the volatility of that capital and increasing ongoing free cash flow. This includes our transaction with Fortitude Re, which I spoke about upfront. And we will continue to evaluate additional internal and external solutions to unlock the value of our in-force.

And finally, I will continue to be as transparent as possible with our stakeholders. As I mentioned earlier, we're benefiting from having fresh eyes and perspectives across the organization evaluating all aspects and facets of our business. We have a lot to accomplish and hold ourselves fully accountable to delivering on our objectives.

We've been making significant progress which will support strengthening and repositioning of the company for long-term value creation.

Given the substantial amount of in-depth analysis that is underway, we anticipate providing you with more specifics early next year on our outlook for key financial objectives and the drivers that will get us there. Our path forward is not going to be linear. But we're taking the necessary steps and working through the near-term challenges while also making significant progress under the surface to strengthen the company. I want to reiterate my confidence in the team and our ability to deliver.

I will now turn the call over to Chris to take you through the financials in more detail.

Christopher M. Neczypor

Executive Vice President & Chief Financial Officer, Lincoln National Corp.

Thank you, Ellen, and good morning, everyone. We appreciate you dialing in and listening to our call. I'm going to discuss three things this morning. First, we'll provide a recap of the quarter. Second, we'll go through the segment level financials including an update on our annual review of reserve assumptions. And lastly, we'll finish up with an update on our investment portfolio.

So let's start with a recap of the quarter. Last night, we reported third quarter adjusted operating income available to common stockholders of $39 million or $0.23 per share. This includes the impact from this year's assumption review, which lowered earnings by $144 million or $0.84 per share. Also included in the quarter are $48 million of unfavorable items that are nonrecurring. This consists of $40 million impacting our Life business and $8 million impacting other operations. I will discuss the impacts on Life in greater detail when I discuss our segment results.

Additionally, alternative returns for the quarter were $23 million lower than implied by our long-term expectation of an annualized 10% return. These items combined impacted the quarter by $215 million. However, even after adjusting for these items, the quarterly results still fell short of our expectations and we are taking the necessary steps to address the issues.

Now turning to net income. Net income available to common stockholders was $819 million or $4.79 per diluted share. The difference between net and adjusted operating income for the quarter was predominantly driven by two factors. First, there was a favorable impact to net income within non-operating income driven by positive movement in market risk benefits as the benefit of higher interest rates more than offset the impacts from lower equity markets.

Second, as Ellen mentioned, we expect the transaction with Fortitude to close. And as a result, we impaired securities down to fair market value as of September 30, resulting in an after-tax realized loss of $369 million. As I mentioned last quarter, the amount of the quarterly impairment only included assets that were in an unrealized loss position. Any gains in the portfolio and any market movement after September 30 will be realized upon closing the transaction. This impairment has no impact to statutory capital.

Before turning to the segments, I thought it would be useful to highlight three general themes we see impacting the businesses. The first is what we view as a number of short-term pressures. Some examples here include the lingering excess mortality in life from the endemic, slightly weaker alternatives performance and spread pressures in annuity. We expect some of these headwinds to abate or normalize over the next few quarters. The second big theme we're seeing is higher expenses. This is a large driver of earnings pressure year-to-date and a key area of focus.

And lastly, while overall, the reported numbers this quarter fell short of our expectations, we see significant progress being made under the surface to reposition the company for longer-term value creation. And as we go through the segments, we will discuss each of these themes.

So now let's turn to the segment results starting with Group. Taking a step back, this was a business in 2022 that had a reported margin under 1% for the full year. And while the pandemic certainly contributed to this, the results underscored the need for ongoing enhancements. Through the first three quarters this year, the Group margin has improved substantially in part due to strategic actions we've taken. But this is also a reflection of a favorable macro environment coupled with favorable seasonality in the first half of the year. And while we began to see the very favorable incidents we experienced in the first half of the year normalize in the third quarter, we are seeing significant improvement in the underlying fundamentals of our business compared to where we were a year ago.

Now turning to the numbers. This quarter, excluding the $24 million net favorable impact from the assumption review, Group reported operating income of $44 million compared to $109 million in the prior quarter. Results from both disability and life drove the sequential decline.

Starting with disability, excluding annual assumption review, loss ratio was 76% in the third quarter, an increase of 5 percentage points versus the prior quarter. The sequential increase reflects higher incidents, which is consistent with seasonal patterns we've experienced in past years and in line with our expectations. However, compared to the prior year quarter, the loss ratio was favorable by roughly 7 percentage points, excluding the impacts of the assumption review. This improvement reflects the continued execution of our repricing efforts and continued operational investments to support our claimants in their return-to-work journey.

Turning to Group Life. The loss ratio of 81% increased roughly 9 percentage points sequentially when removing impacts from the annual assumption review. Results in the second quarter benefited from very favorable mortality. However, this quarter, we experienced volatility due to elevated severity driven by increased mortality in younger age bands who typically have higher claim amounts. This dynamic also drove the increase in the life loss ratio versus the prior year quarter. But when removing this, the underlying mortality and morbidity results present a favorable trend.

Overall, group results were below expectations in the third quarter. Despite this, we continue to see progress under the surface given pricing actions and operational improvements in our claims function and expect our margin to be roughly 5% for the full year. Looking beyond 2023, we remain focused on achieving a long-term margin of 7%. It will take time and the path towards that target will not always follow a straight line. But we are confident that the work we are doing today will lead to sustained improvement.

Turning to Annuities. Annuities reported operating income of $248 million, which includes a $12 million unfavorable impact from our assumption review, compared to $275 million in the prior year quarter, which included a $1 million favorable impact from that assumption review. This decrease was primarily due to higher expenses and variable annuity outflows partially offset by higher equity markets.

Sequentially, excluding the impact of the assumption review, earnings declined $11 million primarily due to the spread pressures we noted last quarter. While we expect these pressures to persist into the fourth quarter, the drivers behind this short-term headwind are behind us and we expect will abate starting next year.

Lastly, turning to account balances. VAs with living benefit guarantees now represent 44% of total account balances, a decrease of 3 percentage points from the prior year. Additionally, RILA account balances now represent 17% of total account balances, up from 13% in the prior year. So overall, while spread pressure and increased expenses are expected to continue through the fourth quarter, underlying earnings continue to be strong. And we see growth in this business heading into 2024.

Next, focusing on Retirement Plan Services. Retirement reported operating income of $43 million compared to $47 million in the prior year quarter. The decline was primarily driven by higher expenses and increased stable value outflows partially offset by an increase in base spreads. Base spreads expanded 5 basis points over the prior year quarter though sequentially faced some modest pressure.

Average account balances for the quarter increased over 9% versus the prior year quarter driven by positive net flows for the trailing 12 months combined with favorable equity markets. Looking ahead, we expect to end 2023 with positive net flows for the year and have a strong pipeline heading into 2024.

Spread expansion for 2023 should be mid-single digits. And the rate environment will influence the outlook heading into 2024. Expenses are a headwind and we are focused on addressing this issue both for retirement and the company. Overall, we continue to expect consistent underlying long-term earnings growth and steady free cash flow from the retirement business.

Lastly, turning to Life Insurance. As a result of this year's assumption unlocking, Life had a negative impact of $156 million driven by updates to our policyholder behavior and mortality assumptions. Importantly, there is no negative impact to statutory capital or free cash flow related to the annual review of reserve assumptions.

Turning to this quarter's results. Excluding the assumption review impacts, Life reported an operating loss of $17 million compared to an operating loss of $64 million in the prior year quarter. The year-over-year improvement was driven by alternative investment income and underlying mortality partially offset by the run rate impact from the assumption review and two additional nonrecurring items.

First, there was an unfavorable mortality impact of $25 million related to unclaimed property identified by process enhancement. Excluding this impact, mortality was in line with our expectations. Second, there was an unfavorable impact of $15 million as a result of a surrender benefit program that concluded this quarter for GUL products. Lastly, on spreads, we continue to anticipate spreads to bottom in the fourth quarter before beginning to expand in 2024.

Overall, while the headwinds we've discussed throughout the first half of the year remain, we continue to make progress on strengthening the foundation of the life business. We are confident in our assumptions and continue to make progress on repositioning our in-force block of business and shifting new business to a more capital-efficient mix.

Turning briefly to company-wide expenses. Expenses in the quarter remained elevated and are one of the key pressures to earnings and free cash flow for the company. As such, expenses are an important area of focus and opportunity for us as a management team. And we are actively engaged in a comprehensive review in which we are closely examining our expense base across the organization in order to mitigate expense growth and identify opportunities for further cost reduction.

There are three primary drivers behind our increased expenses. First, there are both onetime and short-term expense headwinds that will decrease over time. Examples here include certain advisory and consultant costs or expenses related to strategic projects like the reinsurance transaction. These expenses will lessen naturally over time as we execute on our strategic initiatives.

The second driver is recent inflationary headwinds which are impacting Lincoln as well as the rest of the industry. And third, there are expenses that are associated with some deferred maintenance. These are costs that we need to incur to best position Lincoln as a stronger and more profitable company down the road. These expenses will live with us thanks to new systems and new people needed in certain areas.

But for both the inflationary headwinds and the cost of the deferred maintenance, it's incumbent on us to find offsetting savings elsewhere in the organization. And this is a project we're currently shaping. Put simply, there is opportunity to continue to rightsize the expense base of the company. We look forward to discussing more on this topic early next year as part of our broader outlook.

Moving to investments where we again reported solid credit results. We continue to maintain a high-quality portfolio, which is currently 97% investment grade. Our conservative positioning reflects disciplined portfolio construction, regular stress testing and proactive credit risk management.

Now turning to a brief update on our commercial mortgage loan portfolio which continues to perform very well with no material loan modifications, no delinquencies and no forced extensions. A key area of focus in office remains near-term maturities. Given our conservatively positioned office portfolio, we have had 100% of our loans pay off in full and have less than $1 million of remaining maturities in 2023. We have future maturities of $135 million and $186 million coming due in 2024 and 2025, respectively, which represents less than 2% of our CML portfolio.

Office loans with near-term maturities continue to perform well with an average debt-to-service coverage ratio of 3.5 times. Lastly, our alternative investment performance generated a return of 1.6% this quarter, below our long-term quarterly targeted return of 2.5%. However, the portfolio is well diversified and we expect it to continue to deliver strong results over the long term. As we look forward to the fourth quarter, I want to highlight the fact that we report our private equity returns on a three-month lag. And given broader public equity market weakness last quarter, we expect that our alternatives returns will likely be below our long-term target in the fourth quarter.

Before we close, I'd like to step back and make a few comments. To reiterate, the results this quarter were below our expectations. Some of the pressures are temporary and will normalize over the next few quarters while others are more structural but are within our control such as expenses. I also think it is important to reiterate the progress we're making as we work to position Lincoln for sustainable value creation.

First, the work done to structure the reinsurance deal in the first half of the year was significant and will result in a big step forward for the company, both from a capital and a free cash flow perspective. Additionally, we've discussed a new VA hedge program and are very pleased that three quarters of the way through the year, through a variety of different market environments, the performance has been better than expected, allowing us to take a modest dividend out of LNBAR this quarter. And while it is still early in the program's tenure, the success so far has us increasingly confident in the long-term implications for free cash flow from that block.

It is also important to note that we've been able to modestly improve RBC this year, despite the headwinds we discussed and several other unexpected onetime earnings or credit headwinds throughout. And as a reminder, the fourth quarter tends to have unfavorable seasonality impacts. Rebuilding capital is a top priority for the company and we will be in position to discuss incremental steps forward early next year.

Most recently, the annual assumption review was a major undertaking for the organization and a big step forward. Over the past year, we have assembled a new team of leaders across finance, risk and within the business units. This included a new Chief Risk Officer and new Chief Actuary, who are charged with leading the assumption review process, and brought additional deep industry knowledge into our existing strong governance framework.

We feel good about our holistic and comprehensive review. Validation of our assumptions allows us to move forward strategically as we work to position the company for sustainable value creation.

Ultimately, the actions we are taking today will benefit the franchise over the long term and are foundational to delivering higher earnings and free cash flow, which will be a true measure of our progress.

And then lastly, I'd like to reiterate that we plan to provide increased specifics to help the investment community better understand the outlook for our business. We have invested substantial time and energy in doing a deep dive on each of our business lines as well as on our financials and operations, including significant enhancements to data, infrastructure and analytics needed to manage and measure our business effectively, the work we've been discussing over the last several quarters. Expenses will be a focus, as will ensuring we're optimizing our capital allocation. As a result of these reviews, we anticipate that we will be able to share more details early next year.

With that, let me turn the call back to Adam.

Adam Cohen
Chief Accounting Officer, Lincoln National Corp.

Thank you, Ellen and Chris. We will now being the question-and-answer portion of the call. As a reminder, we ask that you please limit yourself to one question and one follow-up, and then re-queue if you have additional questions. With that, let me turn the call over to the operator to begin Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question is from Alex Scott of Goldman Sachs. Please go ahead. Your line is open.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Hi, good morning. First one I have is on free cash flow. I just wanted to see if you could opine a bit on where we are year-to-date, how we're running relative to, I guess, the $300 million to $500 million range. And if we should still think about Fortitude being $100 million-plus in sort of that run rate headed into next year. I know you mentioned you're going to go into more detail early next year. But I just wanted to make sure we have sort of where we're running right now and the baseline sort of clear, ahead of thinking through the components that can move it up over time.

Ellen Gail Cooper
Chairman, President & Chief Executive Officer, Lincoln National Corp.

A

So good morning, Alex. I will start with Fortitude and then I'll hand it over to Chris to talk about free cash flow and where we are for the year. So again, we're really pleased to be able to announce that we received the regulatory approval. There are no changes to the economics of the deal that we had previously communicated to all of you. So, we expect upon close of the transaction, about 15 basis points of additional risk-based capital. And we do still expect about $100 million on an annual improvement as it relates to ongoing free cash flow.

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.
A

And then, Alex, to the question more broadly, I would say probably something similar as to last quarter where you can see RBC is up modestly, let's say. And given the dividend for the year, we're tracking at that $300 million range. We did take a $50 million dividend out of LNBAR this quarter. But obviously, we also had the higher preferred on a quarterly basis from the HoldCo.

So to answer the question, I think we're tracking similar to what we described last quarter. To Ellen's point, Fortitude should add $100 million to the run rate. And then when we're with you all early next year, we hope to be able to provide more of an outlook. I think we started to talk this quarter about a number of other things that we're looking at, expenses as an example. So, I'll just say stay tuned.

Alex Scott
Analyst, Goldman Sachs & Co. LLC
Q

Got it. One nuanced follow-up I had. I know you got rid of some of the SGUL through this, or you're going to upon closing with the Fortitude transaction. But for the portion of the SGUL that remains, there was a statutory impact from the cash flow testing last year. Rates are much higher. I know that that rate does get updated. Is there any relief that you expect to get on the remaining SGUL reserves that are incremental above sort of the standard statutory reserves that we should be contemplating around year-end?

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.
A

So Alex, I think what we've said in the past is – well, and if we haven't, I'll just say it now. But the majority of the SGUL reserves that had the 8D impact last year are part of the Nova transaction. So all of the reserve that is attached to that would be part of that and I wouldn't expect anything incremental. Said differently there, it's contemplated in the way we've structured the deal.

Alex Scott
Analyst, Goldman Sachs & Co. LLC
Q

Okay. Thank you.

Operator: Your next question is from Tom Gallagher of Evercore ISI. Please go ahead. Your line is open.

Thomas Gallagher
Analyst, Evercore ISI
Q

Good morning. Ellen, yeah, it's good to hear that you still expect the same benefits on the deal. Has anything changed on the terms of the deal, the mix of the reserves and the risks that are being transacted on? So any change in the terms of the deal? And can you provide a little bit of insight as to why it took longer?

Ellen Gail Cooper
Chairman, President & Chief Executive Officer, Lincoln National Corp.
A

Sure, Tom. So thanks again for the question. So in addition to no changes to the economics of the deal, there's no change to the structuring of the deal as well. So we had previously communicated $28 billion, the same amount of GUL. So no changes at all to the economics or to the overall structure.

Yes, it did take longer than we had expected. Obviously, when we announced the transaction earlier in the year, we had announced a close date. We went beyond that. What I would say there is that this is a very complex transaction. We had regulators that, as you would imagine, did a very thorough review and analysis, working with us and also our partner. And we really believe that in particular, that the overall attention that we received and the focus and hard work of the regulators, it just very much substantiates the overall value of the transaction and the work that was done.

So it took longer than we – but we got there. We're very, very pleased. And again, just want to reinforce the fact that upon close of this deal, that we really do think of this as a major milestone for the company and an important step as we continue to move forward to rebuild our capital position and to improve the ongoing free cash flow of the company.

Thomas Gallagher
Analyst, Evercore ISI

Q

Got it. Thank you. And then just for my follow-up. Ellen, when you mentioned what comes next and the things you're contemplating, internal, external reinsurance. My question is on the external reinsurance. Would you say another in-force deal is more likely? Is flow reinsurance a stronger consideration? And finally, would you consider entering into a strategic partnership with an investment manager like we've seen some of your peers in the industry do? Is that something you're considering?

Ellen Gail Cooper
Chairman, President & Chief Executive Officer, Lincoln National Corp.

A

Yeah. So Tom, to address this, I want to say a couple of things. First of all, we recognize the importance around clarity not just around our outlook and our key metrics – and we plan to update you on that in the beginning of next year – but also around the drivers and the strategic actions that will really enable us to be able to reposition and rebuild the company.

So obviously, the Fortitude transaction is a step in that direction. At the moment, we're focused on the close of that. We identified in our overall remarks that there are a number of places that we are evaluating, that's internal, external solutions as it relates to the in-force. We have been active. I also want to mention that while we have been focusing on the rebuild of our capital position, we also have been focused on profitable growth. And that profitable growth as it relates to new business and sales, we've been focused very much on capital efficiency there. And one of the ways that we've been able to maintain a robust level of sales there while being capital efficient has been through flow agreements. So that's been an active part of the strategy this year and we'll continue that going forward.

As it relates to additional actions as it relates to the in-force and new business, just stay tuned. Again, we'll be able to update you more as it relates to all of this in the beginning of next year. And I just want to reiterate again that we recognize the importance of keeping you updated and being fully transparent.

Thomas Gallagher
Analyst, Evercore ISI

Q

Okay, thanks.

Operator: Your next question is from Ryan Krueger of KBW. Please go ahead. Your line is open.

Ryan Krueger
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hey, thanks. Good morning. I had a question on expenses. So you had the Spark Initiative in place, which you previously detailed the potential benefits from. Sounded like you didn't directly reference that when you were talking about evaluating expenses. So my question is, are you looking at expense actions that would be different and over and above the Spark Initiative? Or are you kind of doing a full new analysis on how to think about expenses?

Ellen Gail Cooper
Chairman, President & Chief Executive Officer, Lincoln National Corp.

A

So Ryan, thank you for this question. So first of all, as it relates to Spark, which we have talked about previously and is an enterprise-wide expense initiative, we are on track. And we are going to continue to execute on everything that we've talked about previously. And so the expectation here is that we will get to an expense save run rate benefit by late 2024 of about $260 million to $300 million. And just as a reminder, for this year, that net save is more in the range of about $60 million to $100 million. So incremental improvement along the way.

Now the Spark Initiative has really been focused on the modernization of technology, of putting legacy applications onto the cloud, of reengineering processes and improving automation. And so it's definitely giving us a lift. We see an opportunity to your exact question that is bigger and broader and in addition to incremental to Spark that we are examining right now. And we'll be able to update you further in the beginning of the year. So the expense pressures, obviously, go above and beyond the scope of the Spark Initiative. And we have every plan to take action to address them and identify the opportunities and be back to you as soon as we can with more on that early next year.

Ryan Krueger
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Great, thanks. That's helpful. And then just on LNBAR, the $50 million dividend. Just any sense of how you used to take, I guess, $100 million, $125 million a year; do you think that's kind of the right way to think about what the eventual run rate could be again? Or is it too soon following the changes to the hedging program?

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.

A

Ryan, thanks for the question. I think that it's early. We're nine months into the year. I would say we feel comfortable given that third quarter, we saw some volatility and some downward moves in the markets. And so you got to see how the hedge program did with a little bit more choppy waters. Fourth quarter looks to be a little bit of a continuation of the same. So I think we felt good taking $50 million out in the quarter. We obviously didn't take anything out in the previous quarter. As it relates to what the long-term run rate is, I think it's a little bit too early. So we feel good about the program. It's doing better than expected. But we'd like to get a little bit more time under the belt before we make any long-term decisions.

Ryan Krueger
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Got it. Thank you.

Operator: Your next question is from Mike Ward of Citi. Please go ahead. Your line is open.

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Hey, guys. Thank you. I was just curious about the assumption review. If you could help us sort of characterize the changes in assumptions as whether – is it more just prescriptive under LDTI or is it more new behavior information or just a rightsizing of prior assumptions?

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.

A

Sure, Mike. Thanks for the question. So look, just to step back, it's a significant process that we undertake every year. We look at over $100 billion of reserves. We review the key assumptions around mortality, policyholder behavior, capital markets across all our major business lines. So it is a comprehensive review, LDTI, non-LDTI, of all four businesses. And so for this quarter, I would say we had a number of pluses and minuses. I'll just walk you through maybe at the segment level.

So Life had $156 million of unfavorable and that was a mix of adjustments across a number of different assumptions and really looking at the entirety of the UL block. So $145 million of that was from policyholder behavior. And there, really, we just had another year of experience as well as another year of modeling improvements. $20 million was due to mortality where we've seen some weaker older age mortality, I think, similar to the rest of the industry. Annuity had $12 million of unfavorable there that was also mostly around mortality, although $12 million relative to the size of that block is somewhat immaterial. Group actually had a positive unlocking driven by a more favorable view around our LTD claim termination rate.

And look, so net-net, there wasn't one large assumption change that drove the aggregate charge. I do think that when you take into account that we had new leadership basically across the board as it relates to this process, we feel really good about where we landed in the validation of the assumptions. So there's always going to be some probability of pluses and minuses as you move forward when you're throwing up experience. But we feel pretty good where we landed.

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Got it, okay. So then is there any change in the run rate sort of earnings profile go forward for Life or Group?

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.

A

Not for Group. For Life, there will be about a $5 million per quarter run rate impact negative. Although one of the things to look at when you see the queue, post the Fortitude deal, the run rate from a GAAP perspective – so no change to the economics. But from a GAAP perspective, the run rate would actually get a little bit less onerous, a little bit less of a negative as basically we've had to write down some of the assets over the past two quarters. And then you basically have less of a loss to amortize in over time.

So the net of those two things will probably be about a wash from a run rate perspective. But to answer your question specifically, as it relates to the unlocking for Life, it will be about a $5 million run rate impact largely offset by slightly better expectations from a GAAP perspective as it relates to the deal.

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

Operator: Your next question is from John Barnidge of Piper Sandler. Please go ahead. Your line is open.

John Barnidge
Analyst, Piper Sandler & Co.
Q

Thank you very much. Appreciate the opportunity. Can you talk about the legal accrual? Other companies with retirement businesses have reported accruals for electronic communications. Thank you.

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.
A

So John, what I would say is we're not going to comment on legal accruals. I would refer you back to the language in the 10-K where we put in disclosures what we can. So I wouldn't – I mean, we're not going to comment on legal accruals.

John Barnidge
Analyst, Piper Sandler & Co.
Q

Okay, I appreciate that. And then as we think about the opportunities for expense reductions above and beyond the Spark initiatives, is there an opportunity to create an offshore captive for parts of that? Thank you.

Ellen Gail Cooper
Chairman, President & Chief Executive Officer, Lincoln National Corp.
A

So John, as we mentioned, as it relates to the broader expense initiative, we are in the process of evaluating. And we view very much, not only is this a top priority but a real opportunity for us as we move forward. So, just stay tuned. We will be back to you in the beginning of the year. And we'll be able to provide you additional detail on where we're headed, on the strategy around it, and how we also believe that an expense reduction program will support our future goals as it relates to improving ongoing earnings, free cash flow, capital, et cetera, but also the efficiency and effectiveness of the Group and expansion of talent as well.

John Barnidge
Analyst, Piper Sandler & Co.
Q

Appreciate that, thank you.

Operator: Your next question is from Jimmy Bhullar of JPMorgan. Please go ahead. Your line is open.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC
Q

Hi, the first for Chris or Ellen maybe. On the expense program that you're talking about, is it fair to assume that initially it'll absorb cash flows and be dilutive then? But obviously, you're hoping that over time, that'll be more than offset by the incremental savings.

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.
A

Jimmy, I think it's too early to get into the details. I think any time you're talking about a expense program or an efficiency program, there's the upfront cost and then there's the ongoing savings. I think we thoughtful as to whatever it is that we do. So, let's just stay tuned. We're looking at all that right now.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC
Q

And then, how do you think about the RBC level that you'd like to be at eventually a few years out given your business mix? And do you feel that you can get there through normal statutory income? Or is it necessary for you to do more transactions to get there?

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.
A

So Jimmy, what we've said is that the near-term target is to get back to the 400% RBC. I think we've also mentioned that longer term, we'll expect to hold a buffer to that 400%. I think the goal is to not have a repeat of 2022. And so to have that – holding excess capital above the target makes sense. To specifically your question, we can certainly get there via natural organic capital generation over the next couple of years just thinking about the growth in free cash flow. And then to the degree that there's anything strategic we can do to accelerate that, we would look at that.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC
Q

Okay, thank you.

Operator: Your next question is from Wes Carmichael of Wells Fargo. Please go ahead. Your line is open.

Wes Carmichael
Analyst, Wells Fargo Securities LLC
Q

Hey, good morning. I had a question on holding company liquidity. And with the debt maturity, I think that's now around $450 million. And I'm just curious what you're kind of comfortable operating with there, and if there's any potential levers that you have, if there are any near-term kind of statutory earnings headwinds.

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.
A

So, Wes, thanks for the question. I think the level that we're operating at now is the target level. And I think you can hold excess capital at the HoldCo or you can hold excess capital at your insurance company. To me, they're relatively similar in terms of the way that you think about goals over time. You're right, we had a $500 million debt maturity during the quarter, paid that down. I think we have a long-term goal of delevering more broadly. But we feel comfortable with the amount of liquidity that we have at the holding company.

Wes Carmichael
Analyst, Wells Fargo Securities LLC
Q

Got it, thanks. And maybe would you just – can you comment on the statutory earnings generation in the quarter within LNL, and kind of how you're thinking about overall earnings generation in the quarter?

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.
A

So, Wes, I think it's the same idea as to the RBC comment that we made before. Whether you're looking at it from an earnings perspective or an RBC, it's the same math. We improved modestly. And I think if you look at some of the items we talked about, on a GAAP basis, a lot of those port over to stat as well. You referenced LNL. We have one main insurance company. And so fair to think that for a lot of the items that we discussed, GAAP should look relatively similar to the stat for some of the one-timers. So despite some noise in the quarter, we were able to modestly grow RBC. We feel good about that. And we look forward to updating you as it relates to the longer-term outlook early next year.

Wes Carmichael
Analyst, Wells Fargo Securities LLC

Q

Thank you.

Operator: Your next question is from Wilma Burdis of Raymond James. Please go ahead. Your line is open.

Wilma Burdis
Analyst, Raymond James & Associates, Inc.

Q

Hey, good morning. Could you discuss if you freed up any RBC via the enhanced cash value surrender program in the quarter? And are there any other opportunities for Lincoln to buy back its own GUL policies in larger volumes from third parties?

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.

A

Wilma, thanks for the question. I think we're not going to comment on future programs. Fair to say, we look at these from time to time. This quarter is a good example of some success there. As it relates specifically to stat, what I would say is the net impact was basically de minimis. And we had the one-time item, but then you would imagine there would be capital freed up behind that. So, no major plus or minus as it relates to RBC.

Wilma Burdis
Analyst, Raymond James & Associates, Inc.

Q

Should I take from that comment that the RBC freed up sort of offset mostly the cost of the program? Or is that how I should think about it?

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.

A

Yeah. I think there's always going to be some pluses and minuses. It'll, in theory, improve over time. But we're talking about a relatively small portion of the overall program.

Wilma Burdis
Analyst, Raymond James & Associates, Inc.

Q

And how would you think about that going forward once you reinsure the business? Do you stop doing those types of programs? Or how should I think about that?

Christopher M. Neczypor
Executive Vice President & Chief Financial Officer, Lincoln National Corp.

A

So Wilma, we had as part of the deal, 40% of our GUL. We have a lot to go. So I think that this will be something that we continue to look at the way that the rest of the industry does and to the degree it makes sense for us, we'll continue to execute.

Wilma Burdis
Analyst, Raymond James & Associates, Inc.

Q

Good. Thank you.

Operator: We have completed the allotted time for questions. Lincoln Financial Group will follow up later this afternoon with those remaining in the queue. I will now turn the call over to Adam Cohen for closing remarks.

Adam Cohen
Chief Accounting Officer, Lincoln National Corp.

Thank you for joining us this morning. We're happy to take any follow-up questions that you have. You can e-mail us at investorrelations@lfg.com. Thank you and have a good day.

Operator: This concludes today's conference call. Thank you for your participation. You may now disconnect.