S&P Global
Market Intelligence

Lincoln National Corporation NYSE:LNC

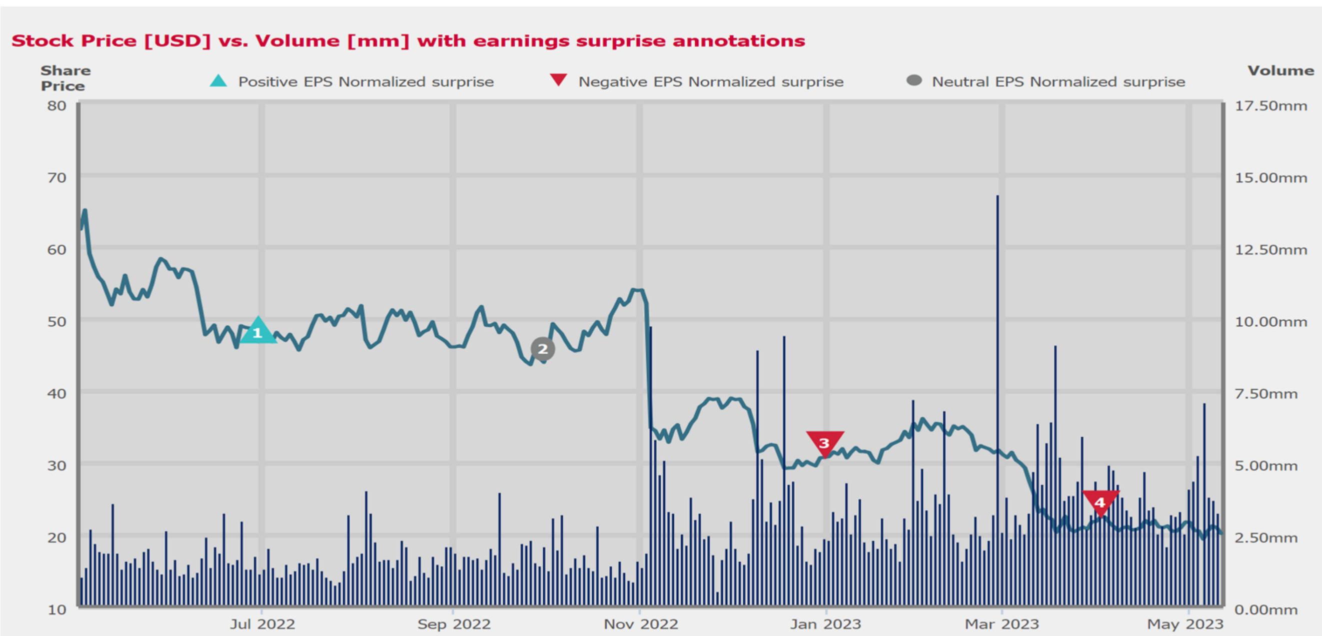
FQ1 2023 Earnings Call Transcripts

Wednesday, May 10, 2023 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2023-			-FQ2 2023-	-FY 2023-	-FY 2024-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.53	1.52	(0.65 %)	1.95	7.44	NA
Revenue (mm)	4586.82	4657.00	1.53	4516.47	18352.36	NA

Currency: USD
Consensus as of May-11-2023 12:00 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2022	2.21	2.23	0.90 %
FQ3 2022	1.79	(10.23)	NM
FQ4 2022	1.78	0.97	(45.51 %)
FQ1 2023	1.53	1.52	(0.65 %)

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EXECUTIVES

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Presentation

Operator

Good morning, and thank you for joining Lincoln Financial Group's First Quarter 2023 Earnings Conference Call. [Operator Instructions]

Now I'd like to turn the conference over to Vice President of Investor Relations, Al Copersino. Please go ahead, sir.

Al Copersino
VP & Head of Investor Relations

Thank you. Good morning, and welcome to Lincoln Financial’s first 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 this call including adjusted income from operations or adjusted operating income and adjusted income from operations available to common stockholders to the most comparable GAAP measures.

A slide presentation containing supplemental first quarter 2023 investment portfolio information is also posted on our website in the Investor Relations section.

Presenting on today's call are Ellen Cooper, 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
President, CEO & Director

Thank you, Al, and good morning, everyone. During the first quarter, we continued to take the necessary steps and have made substantial progress to strengthen the balance sheet, improve our free cash flow and position the business for long-term sustainable growth. We have a differentiated business model, including a powerful distribution franchise, broad product offerings and a diversified, high-quality investment portfolio. These strengths have the foundation for successful execution of our enterprise priorities, and we will continue to focus on actions that deliver on our objectives.

Our first quarter financial results were within the range we disclosed on last week's call. Our earnings for the quarter reflect the 2023 headwinds we have discussed previously, such as higher expenses, lower prepayment income and the pressures highlighted in our Life Insurance business that we expect to begin to dissipate or be offset by larger positives in 2024 and beyond. Chris will go through the details of the headwinds in Life and where we see opportunity for improvement in its financial performance over time.

Before discussing our business unit highlights, I will spend some time discussing our progress in executing our strategy. We are continuing to make headway in improving our capital position and our long-term cash flow profile with 3 of our businesses delivering solid free cash flow for the company. And the fourth, our Life business, which will be improved post the close of the recently announced reinsurance transaction.

We estimate the RBC ratio at the end of the first quarter to be approximately 380% and following the close of the reinsurance transaction, we expect to be closer to our near-term target of 400%. We also continue to expect to generate $300 million to $500 million of free cash flow this year before the impact of the reinsurance transaction and to execute on initiatives to further improve ongoing free cash flow in 2024 and beyond.

One of the key initiatives underway is our focus on new business capital efficiency across retail and workplace solutions, where we are delivering a robust level of sales with a more capital-efficient product mix by leveraging our distribution leadership and broad diversified product portfolios.

Other key initiatives to drive ongoing free cash flow include continuing to implement our Spark Initiative, enhancing the profitability of our group business, fully repositioning our VA hedge program, completing our recently announced reinsurance transaction, which is expected to reduce balance sheet risk, improve our capital position and lessen the drag on the Life Insurance distributable earnings' profile and taking additional actions to improve the capital generation of our in-force book.

This quarter is a clear demonstration of the swift progress we are making, and I am pleased with our results as we continue to execute to improve our long-term free cash flow profile. As we look ahead, we have also highlighted our goal of reducing financial leverage and will provide a longer-term view of targeted capital levels later this year that is aligned with a prudent approach to capital return and maintains our financial flexibility, creating long-term sustainable value for shareholders.

Turning to the business units and starting with our Annuities business. Sales of $3.2 billion were up 17% versus the prior year quarter. Within the Fixed Product category, sales rose sequentially for the fourth consecutive quarter and net inflows were again strong. In Index Variable Annuities, sales were up 9% as we drive new and multi-ticket producer growth. In Life Insurance, sales were down 16% as our shift towards a more capital-efficient product mix takes hold. Indexed Universal Life sales were up 34% marking a record first quarter for IUL sales, while as expected, sales of term products declined.

Furthermore, we continue to expand our products into new geographies and channels, such as the recent launch of MoneyGuard Market Advantage in the State of California. Executive Benefit sales can be lumpy and were down in the quarter. In our 2 retail businesses, Annuities and Life Insurance, we are pleased with our overall level of sales and diversified product mix which are meeting our capital efficiency targets and exceeding our new business return targets.

We expect the new business from our retail businesses, both Annuities and Life to be important drivers of future cash generation and profitable growth. In our 2 Workplace Solutions businesses, Group Protection and Retirement Plan Services where we serve more than 50,000 employers and close to 14 million employees, our differentiated product offerings and service capabilities have generated high customer satisfaction scores and strong retention.

We continue to invest in our technology, claims organization and distribution franchise to position ourselves for continued growth and long-term success. These investments are supporting the year-over-year expansion in our group margin, and we expect our Workplace Solutions businesses to be key cash flow and earnings growth engines for the company going forward.

In Group Protection, overall sales were up 22% with strength across all size segments and more than 50% growth in employee paid sales where we are seeing significant momentum in supplemental health products. Premiums were up 7% from higher sales, ongoing price increases and strong persistency. And finally, in Retirement Plan Services, net flows were strong at $535 million, helped by our digitally enabled high-touch customer experience that has led to excellent retention.

First year sales were down following a strong prior year quarter in the large-case market where sales can be lumpy. First year sales in the small-case market, a key focus area were up 78%, speaking to our product innovation and distribution strength. We expect RPS first year sales to be higher over the balance of the year. We are very happy with the performance of our Workplace Solutions businesses as sales continue to meet or exceed capital efficiency and new business return targets. We continue to execute and to enhance our customer-focused strategies, and we expect that will be into long-term sustainable growth.

Turning to our investment portfolio. Our high quality and broadly diversified investment portfolio is tightly aligned with our liabilities' profile and positioned to perform well under multiple economic scenarios. Our real estate and banking exposures are well positioned and we have a long track record of excellent commercial mortgage loan underwriting discipline and a rigorous credit-monitoring process. Our team regularly stress test the portfolio by asset class and sector name by name and we remain highly confident in our ability to navigate various economic environments.

In closing, we are pleased with our swift progress as we execute against our priorities and deliver on our commitments. We are strengthening our balance sheet, our capital generation is improving, we are generating capital-efficient sales with returns at or above targeted levels and our investment portfolio is positioned well, all of which gives me great confidence as we move forward.

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

Christopher Michael Neczypor
Executive VP & CFO

Thank you, Ellen, and good morning, everyone. We appreciate everyone dialing in and listening to our call. I'm going to discuss 3 things this morning. First, we'll go through the financial results for the quarter, then I'll touch on capital and then we'll finish up with details around our investment portfolio. So let's start with the financial results. Last night, we reported first quarter adjusted operating income available to common stockholders of $260 million or $1.52 per diluted share.

There are 2 items to call out as it relates to these results. The first is that alternative investments were $19 million below target or $0.11 per share. Second, our Annuities business had a favorable tax item of $11 million or $0.06 per share. Additionally, with this being the first quarter under the new accounting framework of LDTI, we reported a net loss available to common shareholders of $909 million or $5.37 per diluted share.

The main difference between the net and adjusted operating income is the change in the market risk benefits and hedge instrument valuations. Offsetting this loss was a favorable MRB related item that flows through AOCI. As we've discussed, with the adoption of LDTI, we expect GAAP net income volatility to increase partly due to noneconomic drivers.

Now turning to the segment results. Let's start with the highlight, which was Group Protection. This quarter, Group Protection reported $71 million in operating income compared to a loss of $46 million in the prior year quarter. This significant improvement was primarily due to improved disability results driven by strategic investments in our business. In addition, as the pandemic turns to endemic, similar to what you've heard from peers, the impact on our earnings has declined.

The loss ratio for Group Life was 80.4%, an improvement of 11 points from a year ago as COVID claims have continued to decline. The disability loss ratio was 71.4%, an improvement of over 17 points from a year ago, driven by lower disability claims and strong recoveries as we provided solid return-to-work outcomes for our claimants. The expense ratio is up 110 basis points from a year ago, which, as I noted earlier, is primarily the result of strategic investments in our business and is translating to increased overall profitability.

These strategic investments will continue to generate value in the marketplace and improve the customer experience for both employers and claimants. The result of these outcomes was a 5.6% operating margin for the quarter, up from a negative 3.9% margin a year ago. Importantly, while these results are clear signs of progress, we continue to see upside over the next couple of years and a path to reaching and sustaining our 7% margin target. Profitable growth in the Group business will continue to be critical as we execute against our strategic objectives, specifically as we look to grow and diversify Lincoln's long-term earnings' profile and to help decrease our capital sensitivity to market volatility.

Now let's turn to Annuities. Annuities delivered another solid quarter with reported operating income of $274 million compared to $317 million in the prior year quarter. The decrease was due primarily to lower account values driven by the decline in the capital markets in 2022. Lower prepayment income and higher expenses also were headwinds.

Lastly, our repositioned hedge program is working as intended, protecting capital and maximizing the present value of distributable earnings. And while it's early in the program's tenure, we continue to see excess capital in LNBAR as a result. Looking ahead, we see continued upside to our Annuities business. Our diverse product portfolio gives us opportunity to grow with capital efficiency in various market environments. Our hedge program is now explicitly prioritizing capital and the earnings power from our high-quality in-force blocks continue to generate capital and significant cash flow for the company.

Let's now turn to Retirement Plan Services. Retirement reported operating income of $43 million compared to $58 million in the prior year quarter. The decline was largely due to lower prepayment income, the impact of lower equity markets on fee income and higher expenses. Somewhat offsetting these headwinds were higher base spreads, which expanded by 25 basis points relative to a year ago. We expect to see spread expansion for the full year, though given the volatile rate environment, spread changes won't be linear, and we expect full year expansion in the low single digits.

Stepping back, despite lower prepayment income and higher expenses, which we expect to continue through 2023, the Retirement business continues to deliver solid underlying results, and importantly, positive net flows, which should continue to help grow the business over the long term.

Lastly, let's discuss Life Insurance. Life reported an operating loss of $13 million compared to operating income of $23 million in the prior year quarter. This was a business that pre-COVID generated $500 million to $600 million of earnings a year. And so I think it's worth walking through 2 things. First, what are the drivers to the decline? And then second, how do we think about which of these headwinds will get better over the next few years?

So stepping back, the major headwinds to this business that have emerged over the last few years to GAAP earnings are as follows: first, 2021's reinsurance transaction involving executive benefits and universal life blocks reduced annual earnings by $65 million;

second, last year's assumption reset had a $180 million annual run rate impact to earnings; third, prepaid income was historically $30 million a year, which in this rate environment has mostly become de minimis; fourth, reinsurance costs, which we've pointed to over the past few quarters have been a $40 million to $45 million incremental headwind. And then similar to the other business units, we've seen expenses increase over the last few years, some of which is nonrecurring, but some is a reflection of the business environment that we're in, and we are managing through that.

So in total, these 5 things equate to roughly half the decline from the pre-COVID run rate. Most of the other half is largely due to 3 items, each of which should get better over the next few years. First, we target a 10% annual return in our Alt portfolio over time. And this quarter, we returned just under 7% annualized. Also a large contributor to the Life segment, given the long-duration nature of the reserves, and so this can be a meaningful swing quarter-to-quarter.

Second, COVID has had a negative impact on Life earnings over the trailing 4 quarters of approximately $90 million. We're seeing some declining mortality headwinds as the pandemic turns to endemic, but elevated mortality relative to pre-COVID time periods is still a headwind for now. And third, as we've discussed, LDTI has a negative impact on Life GAAP earnings. Amortization of deferred revenue is currently occurring more slowly under LDTI, which is the main driver of the expected $100 million to $120 million negative impact on full year 2023 Life earnings. This is a timing issue.

And in the future, deferred revenue amortization will continue to grow each year going forward, and so this will become less of a headwind. Lastly, the transaction we announced last week, while accretive to free cash flow is expected to be dilutive to Life GAAP earnings by roughly $120 million to $140 million annually. And so while most of these headwinds will persist, a portion will begin to normalize next year. Importantly, we feel confident about the business we are putting on the books today and our ability to generate profitable growth in this segment over time.

Let's now turn to capital. We ended the quarter with an estimated RBC ratio at approximately 380%. The sequential increase in RBC comes despite turmoil in the credit markets and typical first quarter seasonality and is the result of continued management actions to increase capital efficiency. We remain on track to deliver $300 million to $500 million of free cash flow this year, assuming a normal market environment and before the impact of the block reinsurance transaction we discussed last week.

As a reminder, the deal is expected to increase RBC by about 15 points at close and grow ongoing free cash flow by over $100 million a year. Moving to investments. Despite credit market turbulence, we reported solid credit results. As you'll see in the supplement that we provided, our portfolio is currently 97% investment grade, and we experienced a seventh consecutive quarter of positive net rating migrations. Our conservative positioning reflects disciplined portfolio construction, regular stress testing and proactive credit risk management.

Now turning to our banking and commercial real estate exposure. Our total bank holdings represent just 5% of invested assets and are diversified across global systemically important banks, trust and custody banks and high-quality regional banks.

Let's now talk about commercial mortgage loans. And here, I would make 3 points. First, we have an extremely high-quality CML portfolio, representing 12% of the total invested assets. Our CML strategy is focused on 100% fixed rate senior loans to stabilized properties with low loan-to-value and high debt service coverage ratios. We maintained disciplined underwriting and rigorous ongoing monitoring processes with virtually no credit losses since 2019 and no current loan modifications.

Our CML portfolio is currently comprised 80% of CM1 mortgages, approximately 20% of CM2 mortgages and only 0.4% of CM3 or below mortgages. The average loan-to-value is 46% and the debt service coverage ratio is 2.4x, and we have no direct real estate equity or transitional loan exposure.

Second, let's talk a bit about office exposure. Office for us represents 21% of the CML portfolio, and that number is down 400 basis points from 3 years ago. Since 2020, we have proactively shifted our portfolio away from office exposure, and that's both from a mix perspective and on an absolute basis.

Our office portfolio is also conservatively positioned with similar metrics as the broader CML portfolio I mentioned a moment ago. However, what is even more important is our near-term maturities. In 2023, we have only $34 million of remaining maturities from office mortgages and only $164 million in 2024 or 5% of our total office portfolio and 1% of our total commercial loan portfolio. Additionally, it's worth noting that loans with near-term maturities are performing extremely well, with nearly half of those loans being on high-demand medical office buildings.

The third and last point I want to make about office and other commercial mortgage loans, in particular, is that it's important to understand where we participate in the market. While we have a broadly diversified footprint and the capability to lend across all markets, our emphasis historically has been in the middle market. So from a size perspective, this resulted in our average office loan being around $16 million. And from a mix perspective, we will tend to have a highly diversified portfolio with lower-than-average office exposure and a greater allocation to apartments or industrial properties within our CML portfolio.

So to summarize the 3 key takeaways on CMLs. First, we have a high-quality portfolio with negligible exposure to CM3 or below. Second, we have proactively reduced our office exposure by 400 basis points and have very limited near-term maturities. And third, our strategy is focused primarily on middle market lending, resulting in a higher percentage of apartment and industrial properties.

Lastly, on our investment portfolio more generally and to reiterate a point I made on our call last week, the asset listings in our statutory filings include assets both for Lincoln as well as those in our funds withheld reinsurance agreements where we do not have the economic exposure, and it's worth highlighting this statement is true for the CML portfolio as well.

In closing, let me reiterate 3 points. First, from an earnings perspective, we are encouraged by the quarter but we know we have more work to do with addressing the headwinds in our Life business. Second, we continue to make progress on improving our capital position and our long-term free cash flow profile, with the results this quarter showing signs of progress and last week's transaction announcement being another step forward. And third, our investment portfolio is very high quality, and our exposure to recent areas of market concern are more than manageable.

We appreciate everyone taking the time to listen today, and now we look forward to taking your questions. With that, let me turn the call back to Al.

Al Copersino
VP & Head of Investor Relations

Thank you, Ellen and Chris. We will now begin the question-and-answer portion of the call. [Operator Instructions]
With that, let me turn the call over to the operator to begin Q&A.

Question and Answer

Operator

[Operator Instructions] We'll take our first question from Erik Bass with Autonomous Research.

Erik James Bass
Autonomous Research US LP

I was hoping you could talk more about your intermediate to longer-term strategic view on the individual Life business? And are there further things you can do to improve returns on the in-force block? And then bigger picture, do you still want to be one of the biggest sellers of Life Insurance? Or do you want to narrow the focus of the product set of either what you sell or what you're retaining on your balance sheet?

Ellen Gail Cooper
President, CEO & Director

So thank you for the question. And let me just start by saying that as we discussed in our upfront remarks, we were really, really pleased with the announcement of the transaction last week, and that really goes, first of all, to our focus on really trying to maximize the value of the in-force business. And we recognize that we have an in-force business that has -- that is legacy, and we have also communicated to all of you that it has a fair amount of pressure as it relates to free cash flow and also as it relates to our GAAP earnings.

And at the same time, we feel really good about all of the business that we're putting on the books. And so from an overall Life Insurance business, we feel good about the fact that we are in process right now of very much a capital-efficient product mix tilt that has us in this particular quarter with overall Life sales that are down year-over-year, but targeted, for example, in higher indexed universal life and lower term.

And so we're going to continue to execute on all of that as we go forward. And we're also going to continue to look for ways to optimize the in-force. And as we mentioned last week, and we'll say it again, we know we're not done. So we've got more work to do there. I think importantly, the headwinds and, in particular, some of the potential for upside and normalization that Chris highlighted in his remarks, those will serve both in terms of improving the GAAP earnings' profile as well as our free cash flow profile as we move forward.

Erik James Bass
Autonomous Research US LP

And then you mentioned doing regular investment portfolio stress testing and appreciate the additional disclosure you gave. I was just hoping you could share some detail on maybe what are the outcomes from those stress tests and the estimated potential credit loss and ratings migration impacts on capital and stress scenario?

Ellen Gail Cooper
President, CEO & Director

Sure. So I'll take that question as well. So we have been talking for some time, first of all, about the fact that our investment portfolio, overall credit quality has been improving. And we saw, as Chris mentioned, the seventh consecutive quarter now of net positive ratings migration. We also have talked about the fact that we utilized a multi-manager framework across the entire portfolio. And so we leverage our external managers and their very professional advice in terms of how we think about potential scenarios and stress testing for particular economic scenarios.

And so in those particular cases, we will go sector by sector, we will go name by name, and we will stress test, and we will then evaluate potential names and potential credits that may experience significant credit deterioration in the event of a credit cycle. And as a result of that, over the last 5 to 6 years, we've done some very significant derisking and also shifts in terms of the overall portfolio. So one of the things that we highlighted this morning was within our commercial mortgage loans. And I'll come back to how we're stressed to do that in a moment.

But just to give you a sense of how this has worked in terms of the overall shift. So over the last couple of years, we have been shifting, first of all, away from public corporates. We have increased the overall credit quality. So if you look year-over-year, our single A and above has increased by about 200 basis points, and the decrease has come from -- we have a lower allocation now to overall BBBs.

And within there, the lowest allocation that we've ever had to BBB- and BBB minuses on negative outlook, and our below investment grade has also decreased by about another 100 basis points. And we've shifted out of cyclical sectors that tend to not hold up well during an economic cycle. In the mortgage portfolio, in particular, there, some of what we have done is that we have been shifting into industrial, in particular, and we've increased our overall industrial exposure inside of the commercial mortgage loan portfolio by about 600 basis points and a negative 400 basis points, as Chris highlighted, away from office and another about minus 200 as it relates to retail.

As it relates to overall credit stress testing in the commercial mortgage loan portfolio, here as well, we stress test this portfolio on a loan-level basis. And what we do is we evaluate the most recent financial statements. We look at the rent rolls for each of the properties. We stress net operating income by property type and for office, in particular, we used actual rent rolls, actual lease renewal assumptions that were derived from our overall portfolio surveillance activities, and we add that all up together, and we are extremely comfortable and believe that any particular credit stress as it relates to the overall portfolio to CML or to office is extremely manageable and will keep us in line with our overall financial plan and all of the expectations that we have previously communicated to you.

Operator

Next, we'll go to Tom Gallagher with Evercore ISI.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Just a few questions. I just want to confirm the $300 million to $500 million of cash flow for 2023. Is that after interest expense or before interest expense?

Christopher Michael Neczypor
Executive VP & CFO

No, that's after, Tom. So we create distributable earnings in the Life Insurance companies and LNBAR and so forth. And then we pay the interest expense as well as the preferred dividend as a use of that and what flexes what we think of as the free cash flow. So $300 million to $500 million is after all of the expenses at the holdco.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. And then the other -- so pro forma, this deal, it would be $400 million to $600 million on an annualized basis?

Christopher Michael Neczypor
Executive VP & CFO

Yes. I think that's right. I mean I understand the math. Keep in mind that the deal itself creates about 15 points at close, right? But on a run rate basis, yes, we're saying this year, $300 million to $500 million. And then for the deal itself, that will add $100 million going forward. We'll talk more about 2024 and beyond later this year, but that's the $100 million from the deal on a run rate basis is incremental free cash flow.

Operator

Next, we'll go to Michael Ward with Citigroup.

Michael Augustus Ward
Citigroup Inc. Exchange Research

I was just wondering if you could share any views on the S&P capital model changes. I know the new ones just came out yesterday, but just curious overall thoughts prior to yesterday.

Ellen Gail Cooper
President, CEO & Director

So Michael, the S&P capital just came out, the revision just came out, I believe, yesterday as you noted. Our team, obviously, will go through that. I don't -- we don't have any specific comments for you today. What we can tell you is that we know that when the original updates came out, we were working very closely with S&P as well as with all of our peers. And at the end of the day, we work across the industry to really ensure that there are good models and that they are adequately capturing the potential risks and that we're holding capital relative to that. And we believe that S&P in partnership with us and the rest of the industry wants to have a good model as well. And that's one of the reasons why about a year ago, they took all of our comments and they came back with a revision. So more to come as we have the opportunity to go through it and speak to our peers, speak to S&P and see what the implications are.

Michael Augustus Ward
Citigroup Inc. Exchange Research

Okay. Great. And then on the -- I guess, post the recent deal, just curious if that changes your outlook for capital deployment ability or timing. And then are there certain product lines that you have earmarked that you definitely want to stay in versus product lines from here that you would look to be doing more reinsurance deals?

Ellen Gail Cooper
President, CEO & Director

So Mike, I'll take this and then I'll hand it over to Chris to add anything else. So I want to make clear that, first of all, we have been at really advancing relative to the strategic objectives that we communicated here for about 2 quarters. And we are very much focused on as, number one, the rebuild of capital; and number two is the improving of our ongoing capital generation. And we've talked to you about a number of initiatives that are underway, some of which we're seeing immediate impacts such as the capital efficiency as it relates to our sales.

And some of these are initiatives that are underway now where we're seeing some level of improvement such as the Spark Initiative and our Group Protection margins, but some of this we're going to see more as we go forward. Importantly, as we think about beyond 2023, we're not yet going to prove experience doing a comprehensive review and will be back later this year with additional thoughts around a clear range and how to think about '24 and beyond.

Operator

Next, we'll go to Jimmy Bhullar with JPMorgan Chase.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

So first, just a question for Chris or maybe Ellen. The inclusion of the fixed annuity block in your deal that you did with Fortitude, was that just to improve the overall sort of attractiveness of what you were trying to transact for Fortitude or is there a strategic reason for deemphasizing fixed annuities?

Christopher Michael Neczypor
Executive VP & CFO

Jimmy, it's a good question. No. So look, stepping back, right, you can think about what we were trying to accomplish last year and into this year, as we were thinking about our strategic objectives, right? The goal was really how do we derisk the balance sheet. How do we create capital day 1? And how do we improve the free cash flow, right? So we focused with the GUL block as a starting point and then said, what is the right mix of liabilities to include with that to increase the attractiveness of the deal overall.

And so where we landed was the optimal mix for us and the transaction was a combination of MoneyGuard, fixed annuities and GUL and that's what ended up making the most sense for us. So nothing specific about the annuity block itself. But when you look at these transactions, you're always trying to think about what is the maximum economics that you can create relative to the risk that you're seeing.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

That makes sense. And then on -- can you talk about your long-term RBC target? And I'm assuming it's higher than 400%, given the business mix. But I think at one point from the outside in, it seems like you had to do deals to get to even 400%, but now you're getting pretty close to that. But do you feel that you can get to whatever your target is longer term through just normal income and cash flow? Or do you feel that it's reasonable to expect additional transactions over the next 1 to 2 to 3 years?

Christopher Michael Neczypor
Executive VP & CFO

So Jimmy, that's a great question. Let me step back and just talk to you about a couple of different ways to think about our free cash flow improving over time. And obviously, that would lead to growth in RBC. And as it relates to what we think the long-term target is, I would say that it will be over 400%, but we're not -- we're focused on getting back to 400% in the near term. But if you step back, right, and think about the free cash flow profile, I wouldn't really say that there's 3 things that would be drivers to improvement over time, right?

So the first is that there's a timing issue, right? And we've spoken to this in the past. If you think about the pre PBR Life products, right, the capital profile of them is not linear year-to-year, right? And so what we're dealing with today is some of the increased reserves and capital associated with that block of business. But over time, that will lessen as a headwind. At the same time, as it relates to the GUL block, which we've talked about extensively, right, we're dealing with some of the headwinds there. And so you're building reserves and holding capital, but that also gets better over time as you naturally build to the level that you need to get to. So part of it is just timing.

The second thing I would say is that we are, as Ellen mentioned, and we've talked about on multiple times, we're being more efficient with the capital that we're deploying, right? And so we've mentioned the fact that we're deploying $300 million less new business capital a year and still trying to generate a similar level of sales and importantly, a similar level, if not more, of expected aggregate DE on those sales. So philosophically, if you move to a focus on capital deployment and return on that capital, you will begin to compound over time. And so when you look out a few years after we've gotten through the trough that we have right now on cash flow, we end up being a much more capital-efficient company.

And then the last driver is really what you would think of as management actions, right? And we can break that down into 3 categories. So the first is simply improving the real economics of the business. So increasing premiums, increasing revenues, reducing expenses, right, and really improving the fundamental economics of the business, that's going to give you the best source of upside given the run rate nature of it. And so you're already starting to see this in our Workplace business, right?

Our group margin this quarter is a perfect example of that. The second area in terms of management actions, and this is really what I would call balance sheet optimization, we have a relatively straightforward structure. We do have the Barbados entity. But other than that, we're relatively simple in our structure relative to the peers in the industry. So are there ways to optimize our business that create efficiencies and improve the cash flow there?

And then the last area within the management actions is obviously inorganic solutions. And an example there is what we discussed last week with the reinsurance transaction. So we're not going to walk you through all the different math behind each of those things. But hopefully, that gives you a sense as to when you think out over the next couple of years where -- what the drivers to the higher free cash flow are, you can start to understand the path.

Operator

Next, we'll go to John Barnidge with Piper Sandler.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

My question is about the commentary about Retail and Group Protection. Employee pay Group Protection sales was 70% from 57% a year ago, that quarter-to-quarter volatility with composition of products? Or kind of what level are you trying to get there?

Ellen Gail Cooper
President, CEO & Director

Sure. So John, I'll take that. So first of all, as we look in particular at Group Protection, and we're clearly seeing a very strong overall supportive macro environment for the growth in terms of topline and also in terms of overall margin and profitability. So just when you think about, for example, the fact that we've been in a period of higher wage inflation, number one; number two, tighter labor market where it's that much more important for employers to be providing strong benefits to their overall employees. So that's one thing that's very important.

Secondly, as it relates to that wage inflation and additional dollars in the pockets of the employees, we are seeing an increase, and we saw it again in the first quarter of more employee direct participation in overall benefits. So the experience that we had in the first quarter and be mindful also that for us, first quarter represents about 16% of the overall sales for Group Protection for the year. But in the first quarter, we saw our overall sales were up year-over-year by 22%. And within that 22%, about a 50% overall increase in employee pay, so employees electing their own voluntary benefits.

And then within the overall sales, about 25% of those overall sales were in supplemental health. And so we have been very much focused on growing supplemental health. Not only are they important benefits for overall employees and really they also, from an overall margin perspective, they will be very supportive of our long-term goals of sustaining our margins at around the 7% range. So we feel really, really good about that. And just overall, in general, as it relates to the overall Group Protection business and what we're seeing there, I'll make a couple of other comments.

We are very focused -- while we talked about the fact that overall premium grew 7% year-over-year. We are very focused on premium growth that meets our overall objectives, capital efficient, driving profitable growth, and we recognize also that the value proposition within group is not solely about price. It's also about the overall customer experience, customer satisfaction.

And so we're doing an awful lot to invest in the business. We're investing in the claims organization. We're investing in the technology to really improve the overall experience and differentiate ourselves. And so we really believe that this, at the end of the day, is a real opportunity for us going forward to continue to really focus on the overall growth of this business, and we're excited to be reporting back to you as we continue to grow the business.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

My follow-up. Can you talk about maybe how Annuity and Life Insurance surrender activity trended as the quarter progressed? Was there a step function higher in March, given some of the volatility in the market that emerged?

Christopher Michael Neczypor
Executive VP & CFO

John, it's Chris. Sure. It's a good question. And you can see in the stats up increased surrender rates in the annuity block. What I would tell you is a couple of things. One, surrenders were in line with expectations, right? And so given the rate environment, the surrender profile looks as we would expect.

The second thing is, just keep in mind, we aren't a giant fixed annuity rider historically. We love the product, and we have decent sales there and so forth. But relative to our peers, in some cases and just thinking about the overall mix of our business, fixed annuities has not been as big of a sales driver for us going back a long way.

And so when you look at our portfolio, we do have elevated surrenders relative to the past couple of quarters, but that's to be expected with a higher interest rate environment. And then the last thing I would say is when you look at our numbers, they're on a gross basis, right? And so we have some relatively large fixed annuity reinsurance deals. And so there will be an offset as it relates to the ceded surrenders that flows through in the net aggregated line. So hope that helps.

Operator

Next, we'll go to Ryan Krueger with KBW.

Ryan Joel Krueger
Keefe, Bruyette, & Woods, Inc., Research Division

I had a question on the reinsurance transaction. Is there any residual exposure from experience on the block over time? Or was 100% of the risk on those ceded blocks fully co-insured?

Christopher Michael Neczypor
Executive VP & CFO

So Ryan, that's a good question. I mean you're always retaining some risk, right? So in the case of this transaction, we are retaining the risk of future YRT increases on GUL as an example, but we think the risk is manageable. We've recently renegotiated rates on the majority of that. I think the number was close to 80%. So it's a complex deal. There will be risk that we retain as part of any transaction. But if you're asking about the YRT, that's how I would answer that.

Ryan Joel Krueger
Keefe, Bruyette, & Woods, Inc., Research Division

Makes sense. And then you mentioned that you feel like you have -- you're in an excess capital position at LNBAR at this point. Would you anticipate being in a position to reducing dividends out of LNBAR in 2024?

Christopher Michael Neczypor
Executive VP & CFO

So great question, Ryan. A couple of things. One, so we are seeing excess capital there, but I would say markets were up 7% in the quarter. So we want a little bit of time to see how the year progresses. I would say that we would feel comfortable taking the excess capital out later this year as we watch the hedge program perform.

As I mentioned in the script, our hedge program performed really well in the first quarter, but we want to see a couple more quarters before we think about taking excess capital out.

The other thing I would mention is just from a dividend perspective, going forward, you will see dividends coming out of LNBAR on a more regular basis. And so this quarter, we took $100 million out, but I wouldn't characterize that as all free cash flow.

So starting this year, there's a holding company expense related to the hedge program in LNBAR that's paid out of the holding company, but it has an offsetting interest income stream in LNBAR. So you'll see dividends on a more regular basis to some degree, but it's really covering some of the holding company expense. So as it relates to the excess capital behind the VA block, the hedge program is performing well, but we want to see a couple more quarters before we start to think about taking some of that up to the holding company.

Operator

And that concludes today's question-and-answer session. That's all the time we have for today. I'll now turn the call back over to Al Copersino for any additional or closing remarks.

Al Copersino
VP & Head of Investor Relations

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

Operator
And that does conclude today's conference. We thank you for your participation. You may now disconnect.