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PRESENTATION

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Good morning, everybody. Thanks for joining us for our second interim session of the day. I'm Yaron Kinar, the Insurance Analyst at Goldman joined today by Dennis Glass, President and CEO of Lincoln Financial.

Just one housekeeping item. If you have any questions, there is a submit question box at the bottom of your screen that you can use.

Dennis, thanks so much for joining us this morning.

QUESTIONS AND ANSWERS

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

So maybe we can start off with a high-level question. The macro environment, can you maybe talk about the challenges and opportunities that presents?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yaron, happy to do that, and thank you for having us here. My time is 6:30 in the morning. So I'm glad to be with all of you East coasters and others around the country early today.

Yes, on macro, overall, I think it's pretty optimistic for the life industry. And let me start with the most important issue right now. And the most positive issue we're seeing in the United States and across the world is the potential for very quick vaccine distribution and effectiveness, which, as we all know, is terrific from a health perspective. It's also an opportunity to see some growth in the economy. I think between now and when the vaccine becomes widely distributed, we'll need some intermediate government support. But combining those 2 things, I think we have an opportunity in 2021 for both some economic growth and a little more buoyancy in the equity markets.

So from our industry perspective, 2 immediate consequences of that: one, investment results should be better. And we all thought that the bond downgrades and investment losses might be bigger this year, but they weren't. They're pretty benign. So that is a good continuation into 2021, again, with the effectiveness of the vaccine and intermediate government support.

The other positive for the industry coming out of that, of course, will be uplift in assets under management and fees on assets under management are pretty important earnings component for the industry. So hopefully, good economy in 2021, continued good equity market results and the consequences of less investment, challenge and more fees on assets under management.

Now long term, the bigger issue for the industry, and we all know this, is low interest rates. And even with a rising economy, I don't think many people, certainly, we at Lincoln, don't expect any explosive upward trend in interest rates, maybe a modest trend up in the next couple of years.

So what does that mean for the industry? And what are the attributes of companies that can prosper in a low interest rate environment? I think Lincoln is one of those companies that can prosper in a low interest rate environment. And I'd point to a couple of things. First, interest rates are affecting product design quite a bit. Historically, a lot of the guaranteed products relied on strong general account investment returns and that provided stronger guarantees for a given premium. Well, with low interest rates, we have to change our perspective on how to get good consumer value. And so with that comment, companies that have broad existing portfolios and have demonstrated an ability to pivot with new products that resonate with consumers are in good position, even though rates are low, and there will be some value proposition changes. If you have innovative product and experience, you're going to do fine.

The second thing is, of course, as you (technical difficulty), you need very strong distribution, and companies that have a strength in distribution, and again, Lincoln would be one of those, I think, have an opportunity to excel in bringing new market -- new products to the market and even better deliver on the products that are already in the marketplace.

The second issue associated with interest rates is spread compression and all of us are going to see some spread compression over the next couple of years. So again, a trait of companies that can prosper even with that earnings drag from spread compression are those companies who have demonstrated ability to lower their cost on an ongoing basis. And so that would be another trait.

The final thing is if you have a strong balance sheet, that's helpful. Again, a good solid quality investment portfolio. That's another trait that will be important. So bottom line, I think that what we've seen over the last 9 months that we're seeing some evidence already. Is that the products that the industry brings to market to provide a financial peace of mind and financial protection for everyday Americans. That's going to continue to be positive. And actually, I think, probably an uplift in demand as consumers have a keener view of risk and how our products can protect them. So overall, some challenges, but I think good companies will continue to prosper.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Right. Thank you for that. Maybe we can continue down the path of low interest rates and their impact and maybe more specific in near-term ways. So I think the company has talked about expecting roughly 4% impact to EPS from spread compression in the near term and in the current rate environment. So I guess the first question that comes to mind for me is how confident is the company that it will be able to achieve its 8% to 10% EPS growth target even in the face of this elevated spread headwind?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes. Yaron, again, for the reasons I've just mentioned, I'm pretty optimistic long term about our industry and its prospects, again, not without challenge. But specifically, on our business model's ability to generate 8% to 10% EPS growth over the long term, I'm quite confident.

Now in the short term, let me talk about a couple of things. First, the need to redesign products, probably in the short run, the growth for Lincoln coming out of new business, which we typically talk in terms of being 2% to 4% of the total of 8% to 10%. That 2% to 4% might be a little bit lower as new products take hold, and we begin to regain our top line sales growth. That should take place over a reasonably short intermediate period. So a little bit less of our 8% to 10% in the near term coming from new business.

On the other hand, we can put more emphasis on cost control. And we typically talk cost of margin. We typically speak in terms of maybe 1% of our 8% to 10% coming from that. I think in the intermediate term, that's going to be more like 1% to 3%. And so the combination of a little slower growth from new business will be offset by cost control and further reduction in cost.

And then the interplay of spread compression and equity market growth, we'll have to see how that turns out. But typically, that's plus 2% for us of the 8% to 10%. And then finally, share buybacks. And I think share buybacks, we're in a strong position to continue our program of share repurchases. And again, in our 8% to 10%, that's usually been 1% to 2%, 2% to 3% at this lower share price. Maybe it'd be a little stronger than it's been in the past.

So long term, 8% to 10%, I think our strategy and business model can produce. In the short run, some of the levers that we have to get there will have to change, but we've demonstrated an ability to execute, particularly on cost over the last decade. So I'm confident that we will continue to execute.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Got it. And then another question that comes to mind is when will yields on the rolling off maturities be low enough that we would start to see the spread headwind abating even if new money rates remain where they are today?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes. We have seen a significant reduction in spread compression over the last year or 2. I expect, over the next 3 years, that it will begin to creep down incrementally every year, but I think we've got some level of spread compression reducing our run rate for the next several years.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Okay. And then one item, I think you have one trigger, you can pull to offset some of that would be lowering crediting rates. So how much room do you have to do that?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes. That's a business-by-business answer. Let me just -- in-force management, which includes lowering credit rates, includes other strategies, taken together that can help mitigate spread compression. But even with that, I still see some spread compression occurring for the next couple of years.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

And then also connected to the low interest rate environment. I think the company lowered the long-term interest rate assumption by 50 basis points this year at 3% in the third quarter. What should investors expect as we look into kind of year-end statutory cash flow testing with regards to the impact of the low interest rate environment?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes. We've talked about a $100 million to $200 million reserve increase may happen or may be needed in the event that the 10-year is consistently at 50 basis points. The way the subtest work, the answer to 2020 is baked in pretty much with respect to cash flow testing. And so at the end of 2020, we don't see any pressure on statutory reserves. And again, this $100 million, $200 million may develop towards the end of 2021. But in addition to interest rates, sort of the curve of the reserve increase is going to start coming down. So let's just stick with $100 million to $200 million, maybe in 2021, maybe not if the 10-year is at 50 basis points.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Okay. And is that curve of reserve increases that you mentioned? Is that the reason that, that $100 million or $200 million actually came down quite a bit last year from -- I think it was well above that prior to that?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes. We have been talking about $600 million to $700 million, Yaron. And yes, that's exactly what happened is the reserve build began to shift, and we're going to continue to see that.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Okay.

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

There may be another dimension of that -- to that answer, but I think that's the majority of it.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Okay. And then maybe shifting gears a little bit. I think on the last earnings call, you talked about expecting sales to accelerate throughout the organization over the course of 2021. Is there a way to parse how much of the sales pressure that comes from the -- that we're currently seeing in 2020, how much of that comes from the absence of the face-to-face meetings versus the lower interest rate environment?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes. Let me take the last question first. It was the last point, lower interest rates. Almost all of the sales decline that we've seen in the individual lines, Annuity and Life relate to us -- we have this threepronged top line program called Reprice, Shift and Add. So in 2020, most of what we're doing is repricing all of our products, most of the big changes are in the individual businesses. And we were a step ahead of the industry. And so a combination of increasing the cost to the consumer by increased premiums, lowering benefits, along with being a step ahead of the competition on those changes are what principally in individual life annuity business caused a slowdown in sales. I will tell you that as we leave 2020, all of our repricing has been completed and the marketplace from a competitive position is mostly caught up with us.

So the good news is as we enter 2021, the products that we're selling in the marketplace are, for the most part, achieving the return on capital necessary to back those products. So I find that to be a very powerful entry point, if you will, into 2021. There's a little in the 2 workplace businesses, RPS and Group. There's a little bit of sort of COVID-induced delay of decision-making, but not to really any great extent. So mostly from a Lincoln perspective, for most companies in the industry, the repricing is underway. And again, back to Lincoln, we see new products in 2021, plus a more competitive position for our current products as the lift that we're talking about.

Let me come back to the question of distribution effectiveness and I'm speaking, across our businesses, but I'm going to most -- I'm going to use the individual businesses, the examples. But in distribution, we've shifted from in-person meetings to virtual and the effectiveness of virtual in 2020 in our distribution channels has been tremendous. And so we're getting more people attending content meetings. The wholesalers aren't traveling around as much. And so they have more time to have one-on-ones with the financial advisers. So that's all working very well.

I'll add to that, that we initiated a strategic review based on what we saw in the first couple of months of the pandemic and virtual and how effective it was being to take what we've learned and transferred into a strategic advantage going forward. So we just completed a 3-month study with the help of an outside consultant. And I think coming out of that, strategy, our advantage in the marketplace, which has been good all the time from a distribution standpoint is going to get better. And the use of virtual selling is going to be a real substantive addition to productivity across all industries, I think.

But moving forward, historically, we probably did 30% of our aggregate distribution efforts was virtual, 70% was -- this is sort of average across all the channels, 70% was in person. And we think that's going to flip, maybe not completely, but 60% virtual, 40% in person, but much more effectiveness for our financial -- our consumers, our partners and our own distribution organizations. So I'm very excited about what we're doing on distribution in the virtual environment, the digital environment to make it more productive and effective.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Got it. And with these initiatives and the changes to come, are there particular businesses and products that you expect to lead the growth into 2021?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes. So reprice, I've talked about that shift. Let me spend a couple of minutes on that, Yaron. And again, I'm going to -- if I could just sort of say to set the table, the products that have been driven by the general account investment engine. So let's -- historically, guaranteed universal life. The ability to pay a premium and get a good defined guaranteed death benefit. That's been changing for the last 5 years, and it doesn't work as well today. So -- and other products that have longer duration characteristics, in our case, MoneyGuard, so the same issue, which is the value proposition of a fixed deposit and a guaranteed long-term care bucket of benefits. That isn't going to be as strong of a value proposition any longer, because we're not getting the kind of returns in that product on a general account basis that we have in the past.

So what countries -- companies around the world are doing and in the United States is they are taking products that were general account investment engines, keeping those and then adding upside potential by building the investment engine on a separate account basis. So now when we go into the market with MoneyGuard, we'll have 2 choices for the consumer. One, give us x dollars of deposit, we'll guarantee x dollars of long-term care benefit and some amount of death benefit, but that will be a lower guarantee. But then move over to this other product driven by separate accounts, equities, some debt and the upside potential for the long-term care benefit will be bigger than even it was before interest rate drop. So how fast the market will adopt that product to the new one, the MoneyGuard with the equity engine, we'll see all the market research that we've done with consumers demonstrated it's a very valuable consumer value proposition. And that gets back to my opening remarks.

So we're doing a lot of innovative product design that MoneyGuard being an example. And then we have a tremendously strong distribution system to get that in front of customers, financial advisers. However, you may forget you're on because you follow so many companies, but we have 100,000 financial advisers or brokers that choose a Lincoln product every 24 months. So with our wholesale platforms, selling new ideas into that strong financial adviser and broker basis is what gives us confidence that we'll be able to get products like that into the marketplace and successfully.

Let me also give an example. In the Annuity business, for a long time, guaranteed lifetime income sort of led the industry as a consumer value. Consumers in the last 18 months are shifting to more asset protection products inside the Annuity business, so index variable annuity is an example. And here's another demonstration of the value proposition. The consumer on an indexed VA can say, "I want to take 10% downside market risk, and then I'm happy to get, let's say, 60% of the S&P 500 as upside potential," or they can say, look, "I'll take 30% downside risk, and then instead of 60%, maybe 80% of the participation in the S&P 500." So consumer is going to have a lot more opportunity at Lincoln in the industry to make choices about risk and reward. And I think that will work out fine over time for us and the industry.

We've seen that, Yaron, in -- we did a study of products and growth -- industry growth rates in regions of the world where the interest rates were actually negative. And what we saw was that the growth rates for the life industries in those regions, a little bit, but not significantly lower than what we saw in the United States, but the shift in product mix is what drove the growth to keep it similar to what it was in the United States.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Got it. And as we see sales accelerate again and maybe we even see a bit of a catch-up of sales momentum in 2021, does that impact the cash conversion rate because you're deploying more capital potentially into organic growth? Will we see that conversion rate coming in at maybe the lower end of the 50% to 60% range that you've talked about in the past?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yaron, let me just sort of talk about that. The -- in 2019 -- or excuse me, in 2020, you had the repricing, and you also had some pretty significant increased reserve requirements because of PBR that hit us hardest in the life line on our VUL ONE product and on our MoneyGuard product. So when we repriced, we had to take that into consideration. But what I'm driving at, though, is set that aside, the amount of business that we're doing in shorter guaranteed liabilities and the statistics that we talked about in the call, was about 82% of our business is nonguaranteed business and about 18% is guaranteed business. That compares to a couple of years ago where 70% was -- where it was more like 30% guaranteed. So just what we're selling in the marketplace has lower capital requirements because of the nature of the product than when we were selling a great deal of more of long-term liabilities. And again, the exception to that would be the 2 products in the life business that were affected by PBR.

So as we go forward, we don't see much more capital being consumed than what we've had in the last couple of years from new business, slightly lower levels. On balance, slightly less capital strain per dollar of new business and so that will be a positive for cash flow conversion. So tracking out of that, of course, in the near term, is continued higher COVID claims, and that will run off.

So all these things will shake out, and I guess the bottom line from my perspective would be that we will have sufficient capital to both drive top line sales and excess capital available to continue our share repurchase program, but there's a lot of moving parts.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Right. Right. Well, yes, that's our job to try and figure those out, I guess.

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes. Yes.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

So I only launched coverage less than a week ago. And 2 themes that I've got a lot of questions on, specifically with regards to Lincoln or around potential regulatory changes and around risk transfers. So why don't we start with the regulatory -- potential regulatory changes first. So we're going to have a new administration coming to office in January. Do you see any potential initiatives that would limit compensation practices or implement stricter, best interest standards that would be revived under the new administration? And if so, what do you expect the ratifications of those initiatives to be to Lincoln?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes. Great question, Yaron. Let's just start with the fact that the SEC has a very solid, best interest standard that they introduced, I think, last year, and that's the rule of the land right now. And the DOL has been following the SEC, I noticed that something came out in the last couple of days that was sort of compatible DOL list of regulations to what the SEC has -- already has the standard. So the SEC's best interest standard is a great compromise to permit the industry to provide good financial advice and good products, while protecting the consumer. So I think the SEC rules are very good. When we were providing our own comments to the SEC, we couldn't actually improve too much on what they had come forward with.

So then it gets back to the question of what those -- the Department of Labor overlay on those qualified products that they have some say over as we go forward. I would guess they would try to strengthen that from their perspective, the protections for the consumer a little bit beyond what's in the SEC standard, but we'll have to see. Again, I think everybody believes the SEC standards are pretty good starting point. If at the margin, there's some protection on compensation or things like that in the narrow range of products that DOL says grace over. I think the industry will be able to deal with it.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

And then I think we are running out of time, but one item that I really do want to touch on because I'm looking at my screen here and already getting several questions on it, is the potential for risk transfers. We've seen some of those. There's a question around Lincoln's appetite for those deals. I was thinking about variable annuities, but clearly have other blocks of business, whether fixed annuities or even life where there may be appetite or willingness to transact? What can you say around that?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes. I can say that I'm 100% with all the people who are asking the questions, which is that there's more capital in the marketplace, particularly on the VA risk transfer side than there has been in the past. Every time a deal is done, it makes it easier for the next deal to get done, because there's more technology, there's more comfort, people understand the issues. So because there's more capital in the risk transfer marketplace across the board, and we're seeing deals that have features that would have prevented us from getting to something economic before, maybe we can get to something economic because of what we've seen in the marketplace.

So to answer the question, Lincoln is putting more energy in to try and find risk transfer opportunities in 2021. The principal objective, which is to use that capital to buy our shares back at what we think is a generational opportunity to buy Lincoln shares.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

So essentially, it would be a pull forward of capital through such a transaction and using that capital towards share buybacks?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes. It's -- the easiest way to think about it is you sell a block of business, the way we did with Athene a couple of years ago, release capital associated with that business, purchase price. And take the released capital, the purchase price, and buy our shares back. Let me hasten to say that we do these risk transfer deals on economics. And so we're going to have minimum economics associated with any risk transfer deal. And at the margin, we can tinker with those economics to make sure we get accretion if we buy our shares back but we're not going to do a deal that doesn't have the right economics for the basic transaction just to do a deal or just to get a little bit of earnings per share accretion. We start with, we need to get a decent return on the fundamentals of the transaction and then use that money in the best way possible for our shareholders.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Got it. And a couple of questions coming in from the audience. If you were to venture a guess here, do you think that such a deal would be more likely on the annuity side or the life side? Can you offer any comments around that?

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes, I can, Yaron. Let me just make the high level statement that what -- particularly on the VA side, but in general, in these deals, the most important dimension or characteristics is that the buyer has to have a pretty good understanding of the liability or the benefit payment schedule. So let's take the equitable transaction. The business that was sold and I only have a high -- I don't have all the details, but the business that's sold was deep in the money. So it was pretty obvious what the benefit stream of payments would be that the buyer would have to make on a go-forward basis. The second characteristic of the -- that transaction was, because of the nature of the liability and because of deepness of the in-money position of the customer, was that much of the reserves were general account reserves. And so asset management people love a predictable benefit payment and reserves that have a lot of general account assets backing that liability, so they can do their magic with their willingness to take a little bit more credit risk because of their skills.

So to the extent across our portfolio, we can demonstrate clear benefit streams with a lot of variability and to the extent that there's general account assets in play for the reserves and the capital. Those would be the best liabilities. That could happen -- we could see that in small parts of our guaranteed living benefit annuity in-force. We can see more of it in our life insurance in-force business. But right now, what we sort of see coming across in Transam is sort of a mix of those two. And let me hasten to say, Yaron, particularly on the annuity side, even though the markets has more capital in it, it's not a deep transactional market where things are happening on an everyday basis. I guess there's a term, it's a make an appointment kind of marketplace. But still, we're seeing a flow of opportunities. We're putting more resources and energy around it because of all the reasons I've just discussed, and we'll see what happens.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Got it. Well, I think we're just out of time. So thank you very much for this very early morning start for the...

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

I hope people quote and tell it was 6:30 here. Have a good day, and thank you for inviting us and much success.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Hopefully, next year in person. All right.

Dennis Robert Glass - *Lincoln National Corporation - President, CEO & Director*

Yes.

Yaron Joseph Kinar - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Take care.
