

LINCOLN NATIONAL CORP  
Form 10-Q  
May 01, 2014

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended March 31, 2014

OR

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

For the transition period from            to

Commission File Number: 1-6028

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LINCOLN NATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

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

(484) 583-1400

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

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

Smaller reporting company

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

As of April 28, 2014, there were 263,746,176 shares of the registrant’s common stock outstanding.

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Lincoln National Corporation

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See accompanying Notes to Consolidated Financial Statements

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

## LINCOLN NATIONAL CORPORATION

## CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

|  | As of<br>March 31,<br>2014<br>(Unaudited) | As of<br>December 31,<br>2013 |
|--|---|-------------------------------|
| <b>ASSETS</b>  |   |                               |
| Investments:   |   |                               |
| Available-for-sale securities, at fair value:  |   |                               |
| Fixed maturity securities (amortized cost: 2014 – \$77,263; 2013 – \$76,353)                       | \$ 82,988                                 | \$ 80,078                     |
| Variable interest entities' fixed maturity securities (amortized cost: 2014 – \$583; 2013 – \$682) | 597                                       | 697                           |
| Equity securities (cost: 2014 – \$186; 2013 – \$182)   | 207                                       | 201                           |
| Trading securities   | 2,316                                     | 2,282                         |
| Mortgage loans on real estate  | 7,089                                     | 7,210                         |
| Real estate  | 42  | 47                            |
| Policy loans   | 2,687                                     | 2,677                         |
| Derivative investments   | 1,044                                     | 881                           |
| Other investments  | 1,237                                     | 1,218                         |
| Total investments  | 98,207                                    | 95,291                        |
| Cash and invested cash   | 1,849                                     | 2,364                         |
| Deferred acquisition costs and value of business acquired  | 8,454                                     | 8,886                         |
| Premiums and fees receivable   | 504                                       | 420                           |
| Accrued investment income  | 1,116                                     | 1,029                         |
| Reinsurance recoverables   | 5,984                                     | 6,041                         |
| Funds withheld reinsurance assets  | 772                                       | 776                           |
| Goodwill   | 2,273                                     | 2,273                         |
| Other assets   | 3,822                                     | 2,730                         |
| Separate account assets  | 118,968                                   | 117,135                       |
| Total assets   | \$ 241,949                                | \$ 236,945                    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |   |                               |
| Liabilities  |   |                               |
| Future contract benefits   | \$ 18,997                                 | \$ 17,251                     |
| Other contract holder funds  | 74,507                                    | 74,548                        |
| Short-term debt  | -   | 501                           |
| Long-term debt   | 5,380                                     | 5,320                         |
| Reinsurance related embedded derivatives   | 135                                       | 108                           |
| Funds withheld reinsurance liabilities   | 843                                       | 867                           |
| Deferred gain on business sold through reinsurance   | 226                                       | 245                           |

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|   |         |         |
|---|---------|---------|
| Payables for collateral on investments  | 3,519   | 3,238   |
| Variable interest entities' liabilities | 22      | 27      |
| Other liabilities                       | 4,866   | 4,253   |
| Separate account liabilities            | 118,968 | 117,135 |
| Total liabilities                       | 227,463 | 223,493 |

Contingencies and Commitments (See Note 8)

|   |            |            |
|---|------------|------------|
| Stockholders' Equity  |            |            |
| Preferred stock – 10,000,000 shares authorized  | -          | -          |
| Common stock – 800,000,000 shares authorized; 263,682,162 and 262,896,701 shares issued and outstanding as of March 31, 2014, and December 31, 2013, respectively | 6,805      | 6,876      |
| Retained earnings   | 5,228      | 5,013      |
| Accumulated other comprehensive income (loss)   | 2,453      | 1,563      |
| Total stockholders' equity  | 14,486     | 13,452     |
| Total liabilities and stockholders' equity  | \$ 241,949 | \$ 236,945 |

See accompanying Notes to Consolidated Financial Statements



## LINCOLN NATIONAL CORPORATION

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited, in millions, except per share data)

|  | For the Three<br>Months Ended<br>March 31, |         |
|--|--|---------|
|  | 2014                                       | 2013    |
| Revenues   |  |         |
| Insurance premiums   | \$ 739                                     | \$ 654  |
| Fee income   | 1,098                                      | 958     |
| Net investment income  | 1,208                                      | 1,150   |
| Realized gain (loss):  |  |         |
| Total other-than-temporary impairment losses on securities                           | (10 )                                      | (20 )   |
| Portion of loss recognized in other comprehensive income                             | 7  | 6       |
| Net other-than-temporary impairment losses on securities recognized in earnings      | (3 )                                       | (14 )   |
| Realized gain (loss), excluding other-than-temporary impairment losses on securities | (15 )                                      | (45 )   |
| Total realized gain (loss)   | (18 )                                      | (59 )   |
| Amortization of deferred gain on business sold through reinsurance                   | 19   | 19      |
| Other revenues   | 130  | 117     |
| Total revenues   | 3,176                                      | 2,839   |
| Expenses   |  |         |
| Interest credited  | 633  | 617     |
| Benefits   | 1,078                                      | 958     |
| Commissions and other expenses   | 971  | 895     |
| Interest and debt expense  | 67   | 64      |
| Total expenses   | 2,749                                      | 2,534   |
| Income (loss) before taxes   | 427  | 305     |
| Federal income tax expense (benefit)   | 98   | 66      |
| Net income (loss)  | 329  | 239     |
| Other comprehensive income (loss), net of tax  | 890  | (227 )  |
| Comprehensive income (loss)  | \$ 1,219                                   | \$ 12   |
| Net Income (Loss) Per Common Share   |  |         |
| Basic  | \$ 1.25                                    | \$ 0.89 |
| Diluted  | 1.21                                       | 0.86    |

See accompanying Notes to Consolidated Financial Statements

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## LINCOLN NATIONAL CORPORATION

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited, in millions, except per share data)

|  | For the Three<br>Months Ended<br>March 31, |           |
|--|--|-----------|
|  | 2014                                       | 2013      |
| <b>Common Stock</b>  |  |           |
| Balance as of beginning-of-year                                | \$ 6,876                                   | \$ 7,121  |
| Stock compensation/issued for benefit plans                    | 7  | 10        |
| Retirement of common stock/cancellation of shares              | (78 )                                      | (88 )     |
| Balance as of end-of-period                                    | 6,805                                      | 7,043     |
| <b>Retained Earnings</b>                                       |  |           |
| Balance as of beginning-of-year                                | 5,013                                      | 4,044     |
| Net income (loss)  | 329  | 239       |
| Retirement of common stock                                     | (72 )                                      | (12 )     |
| Common stock dividends declared (2014 – \$0.16; 2013 – \$0.12) | (42 )                                      | (33 )     |
| Balance as of end-of-period                                    | 5,228                                      | 4,238     |
| <b>Accumulated Other Comprehensive Income (Loss)</b>           |  |           |
| Balance as of beginning-of-year                                | 1,563                                      | 3,808     |
| Other comprehensive income (loss), net of tax                  | 890  | (227 )    |
| Balance as of end-of-period                                    | 2,453                                      | 3,581     |
| Total stockholders' equity as of end-of-period                 | \$ 14,486                                  | \$ 14,862 |

See accompanying Notes to Consolidated Financial Statements

## LINCOLN NATIONAL CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in millions)

|   | For the Three<br>Months Ended<br>March 31, |         |
|---|--|---------|
|   | 2014                                       | 2013    |
| <b>Cash Flows from Operating Activities</b>   |  |         |
| Net income (loss)   | \$ 329                                     | \$ 239  |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:  |  |         |
| Deferred acquisition costs, value of business acquired, deferred sales inducements and deferred front-end loads deferrals and interest, net of amortization | (95 )                                      | (77 )   |
| Trading securities purchases, sales and maturities, net   | 11   | 12      |
| Change in premiums and fees receivable  | (84 )                                      | (60 )   |
| Change in accrued investment income   | (87 )                                      | (63 )   |
| Change in future contract benefits and other contract holder funds  | 233  | (208 )  |
| Change in reinsurance related assets and liabilities  | 21   | (112 )  |
| Change in federal income tax accruals   | 48   | 66      |
| Realized (gain) loss  | 18   | 59      |
| Amortization of deferred gain on business sold through reinsurance  | (19 )                                      | (19 )   |
| Other   | (112 )                                     | (88 )   |
| Net cash provided by (used in) operating activities   | 263  | (251 )  |
| <b>Cash Flows from Investing Activities</b>   |  |         |
| Purchases of available-for-sale securities  | (2,061)                                    | (3,194) |
| Sales of available-for-sale securities  | 160  | 189     |
| Maturities of available-for-sale securities   | 1,158                                      | 1,882   |
| Purchases of other investments  | (538 )                                     | (629 )  |
| Sales or maturities of other investments  | 645  | 573     |
| Increase (decrease) in payables for collateral on investments   | 281  | (74 )   |
| Other   | (22 )                                      | (36 )   |
| Net cash provided by (used in) investing activities   | (377 )                                     | (1,289) |
| <b>Cash Flows from Financing Activities</b>   |  |         |
| Payment of long-term debt, including current maturities   | (500 )                                     | -       |
| Deposits of fixed account values, including the fixed portion of variable   | 2,481                                      | 2,517   |
| Withdrawals of fixed account values, including the fixed portion of variable  | (1,443)                                    | (1,281) |
| Transfers to and from separate accounts, net  | (743 )                                     | (684 )  |
| Common stock issued for benefit plans and excess tax benefits   | (4 )                                       | (2 )    |
| Repurchase of common stock  | (150 )                                     | (100 )  |
| Dividends paid to common and preferred stockholders   | (42 )                                      | (33 )   |
| Net cash provided by (used in) financing activities   | (401 )                                     | 417     |

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|   |          |          |
|---|----------|----------|
| Net increase (decrease) in cash and invested cash | (515 )   | (1,123)  |
| Cash and invested cash as of beginning-of-year    | 2,364    | 4,230    |
| Cash and invested cash as of end-of-period        | \$ 1,849 | \$ 3,107 |

See accompanying Notes to Consolidated Financial Statements

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LINCOLN NATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Operations and Basis of Presentation

Nature of Operations

Lincoln National Corporation and its majority-owned subsidiaries (“LNC” or the “Company,” which also may be referred to as “we,” “our” or “us”) operate multiple insurance businesses through four business segments. See Note 13 for additional details. The collective group of businesses uses “Lincoln Financial Group” as its marketing identity. Through our business segments, we sell a wide range of wealth protection, accumulation and retirement income products and solutions. These products include fixed and indexed annuities, variable annuities, universal life insurance (“UL”), variable universal life insurance (“VUL”), linked-benefit UL, indexed UL, term life insurance, employer-sponsored retirement plans and services, and group life, disability and dental.

Basis of Presentation

The accompanying unaudited consolidated financial statements are prepared in accordance with United States of America generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions for the Securities and Exchange Commission (“SEC”) Quarterly Report on Form 10-Q, including Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Therefore, the information contained in the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013 (“2013 Form 10-K”), should be read in connection with the reading of these interim unaudited consolidated financial statements.

Certain GAAP policies, which significantly affect the determination of financial position, results of operations and cash flows, are summarized in our 2013 Form 10-K.

In the opinion of management, these statements include all normal recurring adjustments necessary for a fair presentation of the Company’s results. Operating results for the three month period ended March 31, 2014, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2014. All material inter-company accounts and transactions have been eliminated in consolidation.

2. New Accounting Standards

#### Adoption of New Accounting Standards

#### Financial Services – Investment Companies Topic

In June 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-08, “Amendments to the Scope, Measurement, and Disclosure Requirements” (“ASU 2013-08”), which provides comprehensive accounting guidance for assessing whether an entity is an investment company. For a more detailed description of ASU 2013-08, see “Future Adoption of New Accounting Standards – Financial Services – Investment Companies Topic” in Note 2 of our 2013 Form 10-K. We adopted the requirements in ASU 2013-08 effective January 1, 2014, and evaluated all of our entities under the investment company criteria defined in ASU 2013-08. The adoption of ASU 2013-08 did not have an effect on our consolidated financial condition and results of operations.

#### Income Taxes Topic

In July 2013, the FASB issued ASU No. 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists” (“ASU 2013-11”) in order to explicitly define the financial statement presentation requirements in GAAP. For a more detailed description of ASU 2013-11, see “Future Adoption of New Accounting Standards – Income Taxes Topic” in Note 2 of our 2013 Form 10-K. We adopted the requirements of ASU 2013-11 effective January 1, 2014. The adoption of ASU 2013-11 did not have an effect on the deferred tax asset or liability classification on our balance sheet and did not result in any additional disclosures to our financial statements.

#### Other Expenses Topic

In July 2011, the FASB issued ASU No. 2011-06, “Fees Paid to the Federal Government by Health Insurers” (“ASU 2011-06”) in order to address the question of how health insurers should recognize and classify fees mandated by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act. For a more detailed description of ASU 2011-06, see “Future Adoption of New Accounting Standards – Other Expenses Topic” in Note 2 of our 2013 Form 10-K. We adopted the requirements of ASU 2011-06 effective January 1, 2014. The adoption of ASU 2011-06 did not have a material effect on our consolidated financial condition and results of operations.

Future Adoption of New Accounting Standards

Investments – Equity Method and Joint Ventures Topic

In January 2014, the FASB issued ASU No. 2014-01, “Accounting for Investments in Qualified Affordable Housing Projects” (“ASU 2014-01”) in response to stakeholders’ feedback that the presence of certain conditions in order to apply the effective yield method to investments in qualified affordable housing projects may be overly restrictive and could result in certain investments being accounted for under a method of accounting that may not fairly represent the economics of the investments. For a more detailed description of ASU 2014-01, see “Future Adoption of New Accounting Standards – Investments – Equity Method and Joint Ventures” in Note 2 of our 2013 Form 10-K. We will adopt the requirements of ASU 2014-01 effective January 1, 2015, and do not expect the adoption will have a material effect on our consolidated financial condition and results of operations.

3. Variable Interest Entities (“VIEs”)

Consolidated VIEs

See Note 4 in our 2013 Form 10-K for a detailed discussion of our consolidated VIEs, which information is incorporated herein by reference.

The following summarizes information regarding the credit-linked note (“CLN”) structures (dollars in millions) as of March 31, 2014:

|   | Amount and Date of Issuance |       |
|---|-----------------------------|-------|
|   | \$400                       | \$200 |
|   | December                    | April |
|   | 2006                        | 2007  |
| Original attachment point (subordination) | 5.50%                       | 2.05% |
| Current attachment point (subordination)  | 4.17%                       | 1.48% |



|  |            |           |
|--|------------|-----------|
| Maturity   | 12/20/2016 | 3/20/2017 |
| Current rating of tranche                        | BB+        | Ba2       |
| Current rating of underlying collateral pool     | Aa1-B1     | Aaa-Caa2  |
| Number of defaults in underlying collateral pool | 2          | 2         |
| Number of entities                               | 124        | 99        |
| Number of countries                              | 20         | 21        |

The following summarizes the exposure of the CLN structures' underlying reference portfolios by industry and rating as of March 31, 2014:

| Industry                         | AAA  | AA    | A     | BBB   | BB   | B    | CCC  | Total  |
|----------------------------------|------|-------|-------|-------|------|------|------|--------|
| Financial intermediaries         | 0.0% | 2.1%  | 6.3%  | 2.1%  | 0.0% | 0.0% | 0.0% | 10.5%  |
| Telecommunications               | 0.0% | 0.0%  | 3.5%  | 5.5%  | 2.0% | 0.0% | 0.0% | 11.0%  |
| Oil and gas                      | 0.3% | 2.1%  | 1.0%  | 4.6%  | 0.0% | 0.0% | 0.0% | 8.0%   |
| Utilities                        | 0.0% | 0.0%  | 2.6%  | 2.0%  | 0.0% | 0.0% | 0.0% | 4.6%   |
| Chemicals and plastics           | 0.0% | 0.0%  | 2.3%  | 1.2%  | 0.3% | 0.0% | 0.0% | 3.8%   |
| Drugs                            | 0.3% | 2.2%  | 1.2%  | 0.0%  | 0.0% | 0.0% | 0.0% | 3.7%   |
| Retailers (except food and drug) | 0.0% | 0.0%  | 2.1%  | 0.9%  | 0.5% | 0.0% | 0.0% | 3.5%   |
| Industrial equipment             | 0.0% | 0.0%  | 2.6%  | 0.7%  | 0.0% | 0.0% | 0.0% | 3.3%   |
| Sovereign                        | 0.0% | 0.7%  | 1.5%  | 1.0%  | 0.0% | 0.0% | 0.0% | 3.2%   |
| Conglomerates                    | 0.0% | 2.3%  | 0.9%  | 0.0%  | 0.0% | 0.0% | 0.0% | 3.2%   |
| Forest products                  | 0.0% | 0.0%  | 0.5%  | 1.1%  | 1.4% | 0.0% | 0.0% | 3.0%   |
| Other                            | 0.0% | 4.6%  | 15.0% | 17.4% | 4.2% | 0.7% | 0.3% | 42.2%  |
| Total                            | 0.6% | 14.0% | 39.5% | 36.5% | 8.4% | 0.7% | 0.3% | 100.0% |

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

|                                | As of March 31, 2014        |                     |                   | As of December 31, 2013     |                     |                   |
|--------------------------------|-----------------------------|---------------------|-------------------|-----------------------------|---------------------|-------------------|
|                                | Number<br>of<br>Instruments | Notional<br>Amounts | Carrying<br>Value | Number<br>of<br>Instruments | Notional<br>Amounts | Carrying<br>Value |
| <b>Assets</b>                  |                             |                     |                   |                             |                     |                   |
| Fixed maturity securities:     |                             |                     |                   |                             |                     |                   |
| Asset-backed credit card loans | N/A                         | \$ -                | \$ 597            | N/A                         | \$ -                | \$ 595            |
| U.S. government bonds          | N/A                         | -                   | -                 | N/A                         | -                   | 102               |
| Total return swap              | 1                           | 361                 | -                 | 1                           | 361                 | -                 |
| Total assets (1)               | 1                           | \$ 361              | \$ 597            | 1                           | \$ 361              | \$ 697            |
| <b>Liabilities</b>             |                             |                     |                   |                             |                     |                   |
| Non-qualifying hedges:         |                             |                     |                   |                             |                     |                   |
| Credit default swaps           | 2                           | \$ 600              | \$ 22             | 2                           | \$ 600              | \$ 27             |
| Contingent forwards            | 2                           | -                   | -                 | 2                           | -                   | -                 |
| Total liabilities (2)          | 4                           | \$ 600              | \$ 22             | 4                           | \$ 600              | \$ 27             |

(1) Reported in variable interest entities' fixed maturity securities on our Consolidated Balance Sheets.

(2) Reported in variable interest entities' liabilities on our Consolidated Balance Sheets.

For details related to the fixed maturity available-for-sale ("AFS") securities for these VIEs, see Note 4.

As described more fully in Note 1 of our 2013 Form 10-K, we regularly review our investment holdings for other-than-temporary impairment ("OTTI"). Based upon this review, we believe that the AFS fixed maturity securities were not other-than-temporarily impaired as of March 31, 2014.

The gains (losses) for the consolidated VIEs (in millions) recorded on our Consolidated Statements of Comprehensive Income (Loss) were as follows:

For the  
Three  
Months  
Ended  
March 31,  
2014 2013

Non-Qualifying Hedges

|                                 |      |       |
|---------------------------------|------|-------|
| Credit default swaps            | \$ 5 | \$ 15 |
| Contingent forwards             | -    | -     |
| Total non-qualifying hedges (1) | \$ 5 | \$ 15 |

(1) Reported in realized gain (loss) on our Consolidated Statements of Comprehensive Income (Loss).

Unconsolidated VIEs

See Note 4 in our 2013 Form 10-K for a detailed discussion of our unconsolidated VIEs, which information is incorporated herein by reference.

We invest in certain limited partnerships (“LPs”) that operate qualified affordable housing projects that we have concluded are VIEs. We receive returns from the LPs in the form of income tax credits that are guaranteed by creditworthy third parties, and our exposure to loss is limited to the capital we invest in the LPs. We are not the primary beneficiary of these VIEs as we do not have the power to direct the most significant activities of the LPs. Our maximum exposure to loss was \$80 million and \$77 million as of March 31, 2014, and December 31, 2013, respectively.

4. Investments

AFS Securities

See Note 1 in our 2013 Form 10-K for information regarding our accounting policy relating to AFS securities, which also includes additional disclosures regarding our fair value measurements.

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The amortized cost, gross unrealized gains, losses and OTTI and fair value of AFS securities (in millions) were as follows:

|   | As of March 31, 2014 |             |                   |        |            |
|---|----------------------|-------------|-------------------|--------|------------|
|   | Amortized Cost       | Gross Gains | Unrealized Losses | OTTI   | Fair Value |
| Fixed maturity securities:                      |                      |             |                   |        |            |
| Corporate bonds                                 | \$ 66,853            | \$ 5,516    | \$ 594            | \$ 94  | \$ 71,681  |
| U.S. government bonds                           | 363                  | 32          | 7                 | -      | 388        |
| Foreign government bonds                        | 503                  | 56          | -                 | -      | 559        |
| Residential mortgage-backed securities ("RMBS") | 4,003                | 266         | 1                 | 27     | 4,241      |
| Commercial mortgage-backed securities ("CMBS")  | 685                  | 36          | 1                 | 17     | 703        |
| Collateralized Loan Obligations ("CLOs")        | 246                  | 1           | -                 | 6      | 241        |
| State and municipal bonds                       | 3,693                | 523         | 12                | -      | 4,204      |
| Hybrid and redeemable preferred securities      | 917                  | 97          | 43                | -      | 971        |
| VIEs' fixed maturity securities                 | 583                  | 14          | -                 | -      | 597        |
| Total fixed maturity securities                 | 77,846               | 6,541       | 658               | 144    | 83,585     |
| Equity securities                               | 186                  | 21          | -                 | -      | 207        |
| Total AFS securities                            | \$ 78,032            | \$ 6,562    | \$ 658            | \$ 144 | \$ 83,792  |

|  | As of December 31, 2013 |             |                   |        |            |
|--|-------------------------|-------------|-------------------|--------|------------|
|  | Amortized Cost          | Gross Gains | Unrealized Losses | OTTI   | Fair Value |
| Fixed maturity securities:                 |                         |             |                   |        |            |
| Corporate bonds                            | \$ 65,808               | \$ 4,374    | \$ 1,157          | \$ 90  | \$ 68,935  |
| U.S. government bonds                      | 355                     | 26          | 14                | -      | 367        |
| Foreign government bonds                   | 505                     | 45          | 1                 | -      | 549        |
| RMBS                                       | 4,135                   | 256         | 10                | 31     | 4,350      |
| CMBS                                       | 713                     | 36          | 4                 | 17     | 728        |
| CLOs                                       | 232                     | -           | 1                 | 6      | 225        |
| State and municipal bonds                  | 3,638                   | 308         | 27                | -      | 3,919      |
| Hybrid and redeemable preferred securities | 967                     | 89          | 51                | -      | 1,005      |
| VIEs' fixed maturity securities            | 682                     | 15          | -                 | -      | 697        |
| Total fixed maturity securities            | 77,035                  | 5,149       | 1,265             | 144    | 80,775     |
| Equity securities                          | 182                     | 19          | -                 | -      | 201        |
| Total AFS securities                       | \$ 77,217               | \$ 5,168    | \$ 1,265          | \$ 144 | \$ 80,976  |

The amortized cost and fair value of fixed maturity AFS securities by contractual maturities (in millions) as of March 31, 2014, were as follows:

|  | Amortized<br>Cost | Fair<br>Value |
|--|-------------------|---------------|
| Due in one year or less                | \$ 2,539          | \$ 2,597      |
| Due after one year through five years  | 16,026            | 17,422        |
| Due after five years through ten years | 23,582            | 24,703        |
| Due after ten years                    | 30,765            | 33,678        |
| Subtotal                               | 72,912            | 78,400        |
| Mortgage-backed securities ("MBS")     | 4,688             | 4,944         |
| CLOs                                   | 246               | 241           |
| Total fixed maturity AFS securities    | \$ 77,846         | \$ 83,585     |

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

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

|  | As of March 31, 2014                   |   |                               |   |           |   |
|--|--|---|-------------------------------|---|-----------|---|
|  | Less Than or Equal<br>to Twelve Months |   | Greater Than<br>Twelve Months |   | Total     | Gross<br>Unrealized<br>Losses and<br>OTTI |
|  | Fair<br>Value                          | Gross<br>Unrealized<br>Losses and<br>OTTI | Fair<br>Value                 | Gross<br>Unrealized<br>Losses and<br>OTTI |           |   |
| Fixed maturity securities:                                       |  |   |                               |   |           |   |
| Corporate bonds  | \$ 10,868                              | \$ 431                                    | \$ 2,012                      | \$ 257                                    | \$ 12,880 | \$ 688                                    |
| U.S. government bonds  | 149                                    | 7   | -                             | -   | 149       | 7   |
| RMBS   | 435                                    | 11  | 226                           | 17  | 661       | 28  |
| CMBS   | 131                                    | 5   | 41                            | 13  | 172       | 18  |
| CLOs   | 138                                    | 3   | 48                            | 3   | 186       | 6   |
| State and municipal bonds  | 89                                     | 3   | 54                            | 9   | 143       | 12  |
| Hybrid and redeemable<br>preferred securities                    | 48                                     | 2   | 173                           | 41  | 221       | 43  |
| Total AFS securities   | \$ 11,858                              | \$ 462                                    | \$ 2,554                      | \$ 340                                    | \$ 14,412 | \$ 802                                    |
| Total number of AFS securities in an unrealized<br>loss position |  |   |                               |   |           | 1,158                                     |

|   | As of December 31, 2013                |   |                               |   |           |   |
|---|--|---|-------------------------------|---|-----------|---|
|   | Less Than or Equal<br>to Twelve Months |   | Greater Than<br>Twelve Months |   | Total     | Gross<br>Unrealized<br>Losses and<br>OTTI |
|   | Fair<br>Value                          | Gross<br>Unrealized<br>Losses and<br>OTTI | Fair<br>Value                 | Gross<br>Unrealized<br>Losses and<br>OTTI |           |   |
| Fixed maturity securities:                    |  |   |                               |   |           |   |
| Corporate bonds                               | \$ 16,918                              | \$ 1,018                                  | \$ 1,258                      | \$ 229                                    | \$ 18,176 | \$ 1,247                                  |
| U.S. Government bonds                         | 163                                    | 14  | -                             | -   | 163       | 14  |
| Foreign government bonds                      | 69                                     | 1   | -                             | -   | 69        | 1   |
| RMBS  | 488                                    | 17  | 267                           | 24  | 755       | 41  |
| CMBS  | 109                                    | 7   | 43                            | 14  | 152       | 21  |
| CLOs  | 136                                    | 2   | 50                            | 5   | 186       | 7   |
| State and municipal bonds                     | 377                                    | 20  | 24                            | 7   | 401       | 27  |
| Hybrid and redeemable<br>preferred securities | 62                                     | 6   | 197                           | 45  | 259       | 51  |
| Total AFS securities                          | \$ 18,322                              | \$ 1,085                                  | \$ 1,839                      | \$ 324                                    | \$ 20,161 | \$ 1,409                                  |

|   |       |
|---|-------|
| Total number of AFS securities in an unrealized loss position | 1,484 |
|---|-------|

For information regarding our investments in VIEs, see Note 3.

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We perform detailed analysis on the AFS securities backed by pools of residential and commercial mortgages that are most at risk of impairment based on factors discussed in Note 1 in our 2013 Form 10-K. Selected information for these securities in a gross unrealized loss position (in millions) was as follows:

|   | As of March 31, 2014 |               |                    |
|---|----------------------|---------------|--------------------|
|   | Amortized<br>Cost    | Fair<br>Value | Unrealized<br>Loss |
| Total   |                      |               |                    |
| AFS securities backed by pools of residential mortgages | \$ 1,135             | \$ 1,046      | \$ 89              |
| AFS securities backed by pools of commercial mortgages  | 211                  | 191           | 20                 |
| Total   | \$ 1,346             | \$ 1,237      | \$ 109             |
| Subject to Detailed Analysis                            |                      |               |                    |
| AFS securities backed by pools of residential mortgages | \$ 806               | \$ 726        | \$ 80              |
| AFS securities backed by pools of commercial mortgages  | 29                   | 25            | 4                  |
| Total   | \$ 835               | \$ 751        | \$ 84              |

|   | As of December 31, 2013 |               |                    |
|---|-------------------------|---------------|--------------------|
|   | Amortized<br>Cost       | Fair<br>Value | Unrealized<br>Loss |
| Total   |                         |               |                    |
| AFS securities backed by pools of residential mortgages | \$ 1,261                | \$ 1,146      | \$ 115             |
| AFS securities backed by pools of commercial mortgages  | 193                     | 169           | 24                 |
| Total   | \$ 1,454                | \$ 1,315      | \$ 139             |
| Subject to Detailed Analysis                            |                         |               |                    |
| AFS securities backed by pools of residential mortgages | \$ 933                  | \$ 833        | \$ 100             |
| AFS securities backed by pools of commercial mortgages  | 29                      | 24            | 5                  |
| Total   | \$ 962                  | \$ 857        | \$ 105             |

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



As of March 31, 2014

|   | Fair Value | Gross Unrealized Losses | OTTI  | Number of Securities (1) |
|---|------------|-------------------------|-------|--------------------------|
| Less than six months                                | \$ 2       | \$ 2                    | \$ -  | 5                        |
| Nine months or greater, but less than twelve months | 5          | 1                       | -     | 2                        |
| Twelve months or greater                            | 250        | 48                      | 78    | 82                       |
| Total   | \$ 257     | \$ 51                   | \$ 78 | 89                       |

As of December 31, 2013

|   | Fair Value | Gross Unrealized Losses | OTTI  | Number of Securities (1) |
|---|------------|-------------------------|-------|--------------------------|
| Less than six months                                | \$ 1       | \$ 1                    | \$ -  | 4                        |
| Six months or greater, but less than nine months    | 7          | 3                       | -     | 1                        |
| Nine months or greater, but less than twelve months | 59         | 19                      | -     | 4                        |
| Twelve months or greater                            | 349        | 92                      | 81    | 92                       |
| Total   | \$ 416     | \$ 115                  | \$ 81 | 101                      |

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

We regularly review our investment holdings for OTTI. Our gross unrealized losses, including the portion of OTTI recognized in OCI, on AFS securities decreased by \$607 million for the three months ended March 31, 2014. As discussed further below, we believe the unrealized loss position as of March 31, 2014, did not represent OTTI as (i) we did not intend to sell the fixed maturity AFS securities; (ii) it is not more likely than not that we will be required to sell the fixed maturity AFS securities before recovery of their amortized cost basis; (iii) the estimated future cash flows were equal to or greater than the amortized cost basis of the debt securities; and (iv) we had the ability and intent to hold the equity AFS securities for a period of time sufficient for recovery.

Based upon this evaluation as of March 31, 2014, management believes we have the ability to generate adequate amounts of cash from our normal operations (e.g., insurance premiums and fees and investment income) to meet cash requirements with a prudent margin of safety without requiring the sale of our temporarily-impaired securities.

As of March 31, 2014, the unrealized losses associated with our corporate bond securities were attributable primarily to securities that were backed by commercial loans and individual issuer companies. For our corporate bond securities with commercial loans as the underlying collateral, we evaluated the projected credit losses in the underlying collateral and concluded that we had sufficient subordination or other credit enhancement when compared with our estimate of credit losses for the individual security and we expected to recover the entire amortized cost for each security. For individual issuers, we performed detailed analysis of the financial performance of the issuer and determined that we expected to recover the entire amortized cost for each security.

As of March 31, 2014, the unrealized losses associated with our MBS and collateralized debt obligations (“CDOs”) were attributable primarily to collateral losses and credit spreads. We assessed our MBS and CDOs for credit impairment using a cash flow model that incorporates key assumptions including default rates, severities and prepayment rates. We estimated losses for a security by forecasting the underlying loans in each transaction. The forecasted loan performance was used to project cash flows to the various tranches in the structure, as applicable. Our forecasted cash flows also considered, as applicable, independent industry analyst reports and forecasts, sector credit ratings and other independent market data. Based upon our assessment of the expected credit losses of the security given the performance of the underlying collateral compared to our subordination or other credit enhancement, we expected to recover the entire amortized cost basis of each temporarily-impaired security.

As of March 31, 2014, the unrealized losses associated with our hybrid and redeemable preferred securities were attributable primarily to wider credit spreads caused by illiquidity in the market and subordination within the capital structure, as well as credit risk of specific issuers. For our hybrid and redeemable preferred securities, we evaluated the financial performance of the issuer based upon credit performance and investment ratings and determined that we expected to recover the entire amortized cost of each security.

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

|                                   | For the Three<br>Months<br>Ended<br>March 31, |        |
|-----------------------------------|---|--------|
|                                   | 2014  | 2013   |
| Balance as of beginning-of-period | \$ 404  | \$ 424 |

## Increases attributable to:

|   |        |        |
|---|--------|--------|
| Credit losses on securities for which an OTTI was not previously recognized | -      | 1      |
| Credit losses on securities for which an OTTI was previously recognized     | 4      | 16     |
| Decreases attributable to:  |        |        |
| Securities sold   | -      | (4 )   |
| Balance as of end-of-period   | \$ 408 | \$ 437 |

During the three months ended March 31, 2014 and 2013, we recorded credit losses on securities for which an OTTI was not previously recognized as we determined the cash flows expected to be collected would not be sufficient to recover the entire amortized cost basis of the debt security. The credit losses we recorded on securities for which an OTTI was not previously recognized were attributable primarily to one or a combination of the following reasons:

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

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

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Details of the amount of credit loss of OTTI recognized in net income (loss) for which a portion related to other factors was recognized in OCI (in millions), were as follows:

|                 | As of March 31, 2014    |       |          |            |               |
|-----------------|-------------------------|-------|----------|------------|---------------|
|                 | Gross Unrealized Losses |       |          | OTTI in    |               |
|                 | Amortized Cost          | Gains | and OTTI | Fair Value | Credit Losses |
| Corporate bonds | \$ 270                  | \$ 20 | \$ 43    | \$ 247     | \$ 136        |
| RMBS            | 527                     | 24    | 14       | 537        | 185           |
| CMBS            | 53                      | 5     | 13       | 45         | 87            |
| Total           | \$ 850                  | \$ 49 | \$ 70    | \$ 829     | \$ 408        |

|                 | As of December 31, 2013 |       |          |            |               |
|-----------------|-------------------------|-------|----------|------------|---------------|
|                 | Gross Unrealized Losses |       |          | OTTI in    |               |
|                 | Amortized Cost          | Gains | and OTTI | Fair Value | Credit Losses |
| Corporate bonds | \$ 265                  | \$ 18 | \$ 49    | \$ 234     | \$ 133        |
| RMBS            | 550                     | 18    | 18       | 550        | 184           |
| CMBS            | 35                      | 4     | 12       | 27         | 87            |
| Total           | \$ 850                  | \$ 40 | \$ 79    | \$ 811     | \$ 404        |

Mortgage Loans on Real Estate

See Note 1 in our 2013 Form 10-K for information regarding our accounting policy relating to mortgage loans on real estate.

Mortgage loans on real estate principally involve commercial real estate. The commercial loans are geographically diversified throughout the U.S. with the largest concentrations in California and Texas, which accounted for 32% of mortgage loans on real estate as of March 31, 2014, and December 31, 2013.

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

|   | As of<br>March 31,<br>2014 | As of<br>December<br>31,<br>2013 |
|---|----------------------------|----------------------------------|
| Current   | \$ 7,084                   | \$ 7,200                         |
| 60 to 90 days past due  | -                          | 4                                |
| Greater than 90 days past due   | 3                          | 3                                |
| Valuation allowance associated with<br>impaired mortgage loans on real estate | (3 )                       | (3 )                             |
| Unamortized premium (discount)  | 5                          | 6                                |
| Total carrying value  | \$ 7,089                   | \$ 7,210                         |

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

|   | As of<br>March<br>31,<br>2014 | As of<br>December<br>31,<br>2013 |
|---|-------------------------------|----------------------------------|
| Number of impaired mortgage loans on<br>real estate                           | 3                             | 3                                |
| Principal balance of impaired mortgage<br>loans on real estate                | \$ 27                         | \$ 27                            |
| Valuation allowance associated with<br>impaired mortgage loans on real estate | (3 )                          | (3 )                             |
| Carrying value of impaired mortgage<br>loans on real estate                   | \$ 24                         | \$ 24                            |

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

|                                 | As of<br>March<br>31,<br>2014 | As of<br>December<br>31,<br>2013 |
|---------------------------------|-------------------------------|----------------------------------|
| Balance as of beginning-of-year | \$ 3                          | \$ 21                            |
| Additions                       | -                             | 3                                |
| Charge-offs, net of recoveries  | -                             | (21)                             |
| Balance as of end-of-period     | \$ 3                          | \$ 3                             |

The average carrying value on the impaired mortgage loans on real estate (in millions) was as follows:

|  | For the<br>Three<br>Months<br>Ended<br>March 31,<br>2014 2013 |       |
|--|---|-------|
| Average carrying value for impaired mortgage loans on real estate    | \$ 24   | \$ 46 |
| Interest income recognized on impaired mortgage loans on real estate | -   | 1     |
| Interest income collected on impaired mortgage loans on real estate  | -   | 1     |

As described in Note 1 in our 2013 Form 10-K, we use the loan-to-value and debt-service coverage ratios as credit quality indicators for our mortgage loans, which were as follows (dollars in millions):

| As of March 31, 2014 | As of December 31, 2013 |
|----------------------|-------------------------|
| Debt-<br>Service     | Debt-<br>Service        |

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|                                     | Principal<br>Amount | % of<br>Total | Coverage<br>Ratio | Principal<br>Amount | % of<br>Total | Coverage<br>Ratio |
|-------------------------------------|---------------------|---------------|-------------------|---------------------|---------------|-------------------|
| Less than 65%                       | \$ 5,996            | 84.6%         | 1.77              | \$ 6,026            | 83.6%         | 1.78              |
| 65% to 74%                          | 661                 | 9.3%          | 1.41              | 744                 | 10.3%         | 1.42              |
| 75% to 100%                         | 394                 | 5.6%          | 0.83              | 402                 | 5.6%          | 0.83              |
| Greater than 100%                   | 35                  | 0.5%          | 0.78              | 35                  | 0.5%          | 0.78              |
| Total mortgage loans on real estate | \$ 7,086            | 100.0%        |                   | \$ 7,207            | 100.0%        |                   |

Alternative Investments

As of March 31, 2014, and December 31, 2013, alternative investments included investments in 126 and 121 different partnerships, respectively, and the portfolio represented approximately 1% of our overall invested assets.

## Realized Gain (Loss) Related to Certain Investments

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

|  | For the<br>Three<br>Months<br>Ended<br>March 31,<br>2014 2013 |         |
|--|---|---------|
| Fixed maturity AFS securities:   |   |         |
| Gross gains  | \$ 8  | \$ 7    |
| Gross losses   | (6 )  | (19 )   |
| Equity AFS securities:   |   |         |
| Gross gains  | -   | 6       |
| Gross losses   | -   | -       |
| Gain (loss) on other investments   | -   | (1 )    |
| Associated amortization of DAC, VOBA,<br>DSI, and DFEL and changes in other<br>contract holder funds | (7 )  | (7 )    |
| Total realized gain (loss) related to<br>certain investments, pre-tax                                | \$ (5 )   | \$ (14) |

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

|                                      | For the<br>Three<br>Months<br>Ended<br>March 31,<br>2014 2013 |         |
|--------------------------------------|---|---------|
| OTTI Recognized in Net Income (Loss) |   |         |
| Fixed maturity securities:           |   |         |
| Corporate bonds                      | \$ (3 )   | \$ (3 ) |
| RMBS                                 | (2 )  | (11 )   |
| CMBS                                 | -   | (2 )    |
| Commercial real estate ("CRE") CDOs  | -   | (1 )    |
| Gross OTTI recognized in net         |   |         |



|  |         |         |
|--|---------|---------|
| income (loss)  | (5 )    | (17)    |
| Associated amortization of DAC,<br>VOBA, DSI, and DFEL | 2       | 3       |
| Net OTTI recognized in net<br>income (loss), pre-tax   | \$ (3 ) | \$ (14) |

|   |      |      |
|---|------|------|
| Portion of OTTI Recognized in OCI                 |      |      |
| Gross OTTI recognized in OCI                      | \$ 7 | \$ 7 |
| Change in DAC, VOBA, DSI and DFEL                 | -    | (1 ) |
| Net portion of OTTI recognized in OCI,<br>pre-tax | \$ 7 | \$ 6 |

#### Determination of Credit Losses on Corporate Bonds and CDOs

As of March 31, 2014, and December 31, 2013, we reviewed our corporate bond and CDO portfolios for potential shortfall in contractual principal and interest based on numerous subjective and objective inputs. The factors used to determine the amount of credit loss for each individual security, include, but are not limited to, near term risk, substantial discrepancy between book and market value, sector or company-specific volatility, negative operating trends and trading levels wider than peers.

Credit ratings express opinions about the credit quality of a security. Securities rated investment grade, that is those rated BBB- or higher by Standard & Poor's ("S&P") Rating Services or Baa3 or higher by Moody's Investors Service ("Moody's"), are generally considered by the rating agencies and market participants to be low credit risk. As of March 31, 2014, and December 31, 2013, 96% of the fair value of our corporate bond portfolio was rated investment grade. As of March 31, 2014, and December 31, 2013, the portion of our corporate bond portfolio rated below investment grade had an amortized cost of \$3.1 billion and \$3.0 billion, respectively, and a fair value of \$3.1 billion and \$2.9 billion, respectively. As of March 31, 2014, and December 31, 2013, 95% and 94%, respectively, of the fair value of our CDO portfolio was rated investment grade. As of March 31, 2014, and December 31, 2013, the portion of our CDO portfolio rated

below investment grade had an amortized cost of \$15 million and \$16 million, respectively, and fair value of \$13 million. Based upon the analysis discussed above, we believe as of March 31, 2014, and December 31, 2013, that we would recover the amortized cost of each investment grade corporate bond and CDO security.

#### Determination of Credit Losses on MBS

As of March 31, 2014, and December 31, 2013, default rates were projected by considering underlying MBS loan performance and collateral type. Projected default rates on existing delinquencies vary between approximately 10% to 100% depending on loan type and severity of delinquency status. In addition, we estimate the potential contributions of currently performing loans that may become delinquent in the future based on the change in delinquencies and loan liquidations experienced in the recent history. Finally, we develop a default rate timing curve by aggregating the defaults for all loans in the pool (delinquent loans, foreclosure and real estate owned and new delinquencies from currently performing loans) and the associated loan-level loss severities.

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

#### Payables for Collateral on Investments

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

|   | As of March 31,<br>2014 |               | As of December<br>31, 2013 |               |
|---|-------------------------|---------------|----------------------------|---------------|
|   | Carrying<br>Value       | Fair<br>Value | Carrying<br>Value          | Fair<br>Value |
| Collateral payable held for derivative investments (1)                            | \$ 946                  | \$ 946        | \$ 638                     | \$ 638        |
| Securities pledged under securities lending agreements (2)                        | 157                     | 151           | 184                        | 178           |
| Securities pledged under repurchase agreements (3)                                | 380                     | 397           | 530                        | 553           |
| Securities pledged for Term Asset-Backed Securities<br>Loan Facility ("TALF") (4) | 36                      | 49            | 36                         | 49            |
| Investments pledged for Federal Home Loan Bank of<br>Indianapolis ("FHLBI") (5)   | 2,000                   | 3,324         | 1,850                      | 3,127         |
| Total payables for collateral on investments                                      | \$ 3,519                | \$ 4,867      | \$ 3,238                   | \$ 4,545      |

- (1) We obtain collateral based upon contractual provisions with our counterparties. These agreements take into consideration the counterparties' credit rating as compared to ours, the fair value of the derivative investments and specified thresholds that if exceeded result in the receipt of cash that is typically invested in cash and invested cash. See Note 5 for details about maximum collateral potentially required to post on our credit default swaps.
- (2) Our pledged securities under securities lending agreements are included in fixed maturity AFS securities on our Consolidated Balance Sheets. We generally obtain collateral in an amount equal to 102% and 105% of the fair value of the domestic and foreign securities, respectively. We value collateral daily and obtain additional collateral when deemed appropriate. The cash received in our securities lending program is typically invested in cash and invested cash or fixed maturity AFS securities.
- (3) Our pledged securities under repurchase agreements are included in fixed maturity AFS securities on our Consolidated Balance Sheets. We obtain collateral in an amount equal to 95% of the fair value of the securities, and our agreements with third parties contain contractual provisions to allow for additional collateral to be obtained when necessary. The cash received in our repurchase program is typically invested in fixed maturity AFS securities.
- (4) Our pledged securities for TALF are included in fixed maturity AFS securities on our Consolidated Balance Sheets. We obtain collateral in an amount that has typically averaged 90% of the fair value of the TALF securities. The cash received in these transactions is invested in fixed maturity AFS securities.
- (5) Our pledged investments for FHLBI are included in fixed maturity AFS securities and mortgage loans on real estate on our Consolidated Balance Sheets. The collateral requirements are generally 105% to 115% of the fair value for fixed maturity AFS securities and 165% to 175% of the fair value for mortgage loans on real estate. The cash received in these transactions is primarily invested in cash and invested cash or fixed maturity AFS securities.

For information related to balance sheet offsetting of our securities lending and repurchase agreements, see Note 5.

Increase (decrease) in payables for collateral on investments (in millions) included on the Consolidated Statements of Cash Flows consisted of the following:

|   | For the Three<br>Months Ended<br>March 31,<br>2014 2013 |          |
|---|---|----------|
| Collateral payable held for derivative investments                  | \$ 308  | \$ (575) |
| Securities pledged under securities lending agreements              | (27 )   | 2        |
| Securities pledged under repurchase agreements                      | (150)   | -        |
| Securities pledged for TALF   | -   | (1 )     |
| Investments pledged for FHLBI                                       | 150   | 500      |
| Total increase (decrease) in payables for collateral on investments | \$ 281  | \$ (74 ) |

#### Investment Commitments

As of March 31, 2014, our investment commitments were \$ 1 billion, which included \$586 million of LPs, \$223 million of private placement securities and \$207 million of mortgage loans on real estate.

#### Concentrations of Financial Instruments

As of March 31, 2014, and December 31, 2013, our most significant investments in one issuer were our investments in securities issued by the Federal Home Loan Mortgage Corporation with a fair value of \$2.6 billion, or 3% of our invested assets portfolio, respectively, and our investments in securities issued by Fannie Mae with a fair value of \$1.6 billion and \$1.7 billion, respectively, or 2% of our invested assets portfolio. These investments are included in corporate bonds in the tables above.

As of March 31, 2014, and December 31, 2013, our most significant investments in one industry were our investment securities in the electric industry with a fair value of \$9.3 billion and \$8.7 billion, respectively, or 9% of our invested assets portfolio, and our investment securities in the banking industry with a fair value of \$5.0 billion, or 5% of our invested assets portfolio. We utilized the industry classifications to obtain the concentration of financial instruments amount; as such, this amount will not agree to the AFS securities table above.

## 5. Derivative Instruments

We maintain an overall risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate risk, foreign currency exchange risk, equity market risk, default risk, basis risk and credit risk. See Note 1 in our 2013 Form 10-K for a detailed discussion of the accounting treatment for derivative instruments. See Note 6 in our 2013 Form 10-K for a detailed discussion of our derivative instruments and use of them in our overall risk management strategy, which information is incorporated herein by reference. See Note 12 for additional disclosures related to the fair value of our derivative instruments and Note 3 for derivative instruments related to our consolidated VIEs.

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

|  | As of March 31, 2014 |                     |           | As of December 31, 2013 |                     |           |
|--|----------------------|---------------------|-----------|-------------------------|---------------------|-----------|
|  | Notional<br>Amounts  | Fair Value<br>Asset | Liability | Notional<br>Amounts     | Fair Value<br>Asset | Liability |
| Qualifying Hedges                                |                      |                     |           |                         |                     |           |
| Cash flow hedges:                                |                      |                     |           |                         |                     |           |
| Interest rate contracts (1)                      | \$ 4,269             | \$ 534              | \$ 138    | \$ 4,339                | \$ 562              | \$ 148    |
| Foreign currency contracts (1)                   | 590                  | 34                  | 50        | 615                     | 32                  | 46        |
| Total cash flow hedges                           | 4,859                | 568                 | 188       | 4,954                   | 594                 | 194       |
| Fair value hedges:                               |                      |                     |           |                         |                     |           |
| Interest rate contracts (1)                      | 875                  | 129                 | 9         | 875                     | 92                  | 33        |
| Non-Qualifying Hedges                            |                      |                     |           |                         |                     |           |
| Interest rate contracts (1)                      | 53,270               | 367                 | 560       | 45,620                  | 215                 | 744       |
| Foreign currency contracts (1)                   | 51                   | -                   | -         | 102                     | -                   | -         |
| Equity market contracts (1)                      | 20,479               | 860                 | 239       | 19,917                  | 957                 | 193       |
| Credit contracts (2)                             | 126                  | -                   | 2         | 126                     | -                   | 2         |
| Embedded derivatives:                            |                      |                     |           |                         |                     |           |
| Guaranteed living benefit reserves (3) ("GLB")   |                      |                     |           |                         |                     |           |
| GLB reserves (2)                                 | -                    | 1,022               | -         | -                       | 1,244               | -         |
| Reinsurance related (4)                          | -                    | -                   | 43        | -                       | -                   | -         |
| Indexed annuity and universal life contracts (5) | -                    | -                   | 135       | -                       | -                   | 108       |
| Total derivative instruments                     | \$ 79,660            | \$ 2,946            | \$ 2,266  | \$ 71,594               | \$ 3,102            | \$ 2,322  |

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

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

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

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

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

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

|                                | Remaining Life as of March 31, 2014 |                |                 |                  |                  | Total     |
|--------------------------------|-------------------------------------|----------------|-----------------|------------------|------------------|-----------|
|                                | Less Than<br>1 Year                 | 1 – 5<br>Years | 6 – 10<br>Years | 11 – 30<br>Years | Over 30<br>Years |           |
| Interest rate contracts (1)    | \$ 4,232                            | \$ 31,532      | \$ 11,230       | \$ 10,207        | \$ 1,213         | \$ 58,414 |
| Foreign currency contracts (2) | 99                                  | 110            | 305             | 127              | -                | 641       |

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|   |           |           |           |           |          |           |
|---|-----------|-----------|-----------|-----------|----------|-----------|
| Equity market contracts                               | 10,894    | 4,221     | 5,342     | 20        | 2        | 20,479    |
| Credit contracts                                      | -         | 126       | -         | -         | -        | 126       |
| Total derivative instruments<br>with notional amounts | \$ 15,225 | \$ 35,989 | \$ 16,877 | \$ 10,354 | \$ 1,215 | \$ 79,660 |

- (1) As of March 31, 2014, the latest maturity date for which we were hedging our exposure to the variability in future cash flows for these instruments was April 2067.
- (2) As of March 31, 2014, the latest maturity date for which we were hedging our exposure to the variability in future cash flows for these instruments was April 2028.

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

|  | For the Three<br>Months<br>Ended<br>March 31,<br>2014 2013 |        |
|--|--|--------|
| Unrealized Gain (Loss) on Derivative Instruments                                 |  |        |
| Balance as of beginning-of-year  | \$ 256   | \$ 163 |
| Other comprehensive income (loss):   |  |        |
| Unrealized holding gains (losses) arising during the year:                       |  |        |
| Cash flow hedges:  |  |        |
| Interest rate contracts  | (29 )  | 34     |
| Foreign currency contracts   | (2 )   | 13     |
| Fair value hedges:   |  |        |
| Interest rate contracts  | 1  | 1      |
| Change in foreign currency exchange rate adjustment                              | (2 )   | 11     |
| Change in DAC, VOBA, DSI and DFEL  | -  | 2      |
| Income tax benefit (expense)   | 11   | (22 )  |
| Less:  |  |        |
| Reclassification adjustment for gains (losses)<br>included in net income (loss): |  |        |
| Cash flow hedges:  |  |        |
| Interest rate contracts (1)  | (7 )   | (5 )   |
| Foreign currency contracts (1)   | -  | 2      |
| Fair value hedges:   |  |        |
| Interest rate contracts (2)  | 1  | 1      |
| Associated amortization of DAC, VOBA, DSI and DFEL                               | -  | 1      |
| Income tax benefit (expense)   | 2  | -      |
| Balance as of end-of-period  | \$ 239   | \$ 203 |

(1) The OCI offset is reported within net investment income on our Consolidated Statements of Comprehensive Income (Loss).

(2) The OCI offset is reported within interest and debt expense on our Consolidated Statements of Comprehensive Income (Loss).



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

|   | For the Three<br>Months Ended<br>March 31,<br>2014 2013 |          |
|---|---|----------|
| Qualifying Hedges                                   |   |          |
| Cash flow hedges:                                   |   |          |
| Interest rate contracts (1)                         | \$ (7 )   | \$ (6 )  |
| Foreign currency contracts (1)                      | -   | 2        |
| Total cash flow hedges                              | (7 )  | (4 )     |
| Fair value hedges:                                  |   |          |
| Interest rate contracts (2)                         | 9   | 9        |
| Non-Qualifying Hedges                               |   |          |
| Interest rate contracts (3)                         | 332   | (178)    |
| Foreign currency contracts (3)                      | 1   | (10 )    |
| Equity market contracts (3)                         | (155)   | (534)    |
| Equity market contracts (4)                         | 1   | 12       |
| Credit contracts (3)                                | -   | (1 )     |
| Embedded derivatives:                               |   |          |
| GLB reserves (3)                                    | (281)   | 710      |
| Reinsurance related (3)                             | (27 )   | 16       |
| Indexed annuity and universal life<br>contracts (3) | (49 )   | (130)    |
| Total derivative instruments                        | \$ (176)  | \$ (110) |

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

Gains (losses) (in millions) on derivative instruments designated and qualifying as cash flow hedges were as follows:

|   | For the<br>Three<br>Months<br>Ended<br>March 31,<br>2014 2013 |  |
|---|---|--|
| Gain (loss) recognized as a component of OCI with |   |  |

the offset to net investment income \$ (7) \$ (4 )

As of March 31, 2014, \$25 million of the deferred net losses on derivative instruments in accumulated OCI were expected to be reclassified to earnings during the next 12 months. This reclassification would be due primarily to interest rate variances related to our interest rate swap agreements.

For the three months ended March 31, 2014 and 2013, there were no material reclassifications to earnings due to hedged firm commitments no longer deemed probable or due to hedged forecasted transactions that had not occurred by the end of the originally specified time period.

Gains (losses) (in millions) on derivative instruments designated and qualifying as fair value hedges were as follows:

|   | For the<br>Three<br>Months<br>Ended<br>March 31,<br>2014 2013 |      |
|---|---|------|
| Gain (loss) recognized as a component of OCI with<br>the offset to interest expense | \$ 1  | \$ 1 |

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Information related to our open credit default swap liabilities for which we are the seller (dollars in millions) was as follows:

As of March 31, 2014

|                | Reason for | Nature of | Credit Rating of Underlying Obligation (1) | Number of Instruments | Fair Value (2) | Maximum Potential Payout |
|----------------|------------|-----------|--|-----------------------|----------------|--------------------------|
| Maturity       | Entering   | Recourse  |  |                       |                |                          |
| 12/20/2016 (3) | (4)        | (5)       | BBB-                                       | 3                     | \$ (1 )        | \$ 68                    |
| 3/20/2017 (3)  | (4)        | (5)       | BBB-                                       | 3                     | (1 )           | 58                       |
|                |            |           |  | 6                     | \$ (2 )        | \$ 126                   |

As of December 31, 2013

|                | Reason for | Nature of | Credit Rating of Underlying Obligation (1) | Number of Instruments | Fair Value (2) | Maximum Potential Payout |
|----------------|------------|-----------|--|-----------------------|----------------|--------------------------|
| Maturity       | Entering   | Recourse  |  |                       |                |                          |
| 12/20/2016 (3) | (4)        | (5)       | BBB-                                       | 3                     | \$ (1 )        | \$ 68                    |
| 3/20/2017 (3)  | (4)        | (5)       | BBB-                                       | 3                     | (1 )           | 58                       |
|                |            |           |  | 6                     | \$ (2 )        | \$ 126                   |

- (1) Represents average credit ratings based on the midpoint of the applicable ratings among Moody's, S&P and Fitch Ratings, as scaled to the corresponding S&P ratings.
- (2) Broker quotes are used to determine the market value of credit default swaps.
- (3) These credit default swaps were sold to a counterparty of the consolidated VIEs discussed in Note 4 in our 2013 Form 10-K.
- (4) Credit default swaps were entered into in order to generate income by providing default protection in return for a quarterly payment.
- (5) Sellers do not have the right to demand indemnification or compensation from third parties in case of a loss (payment) on the contract.

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

As of      As of

|   | March<br>31,<br>2014 | December<br>31,<br>2013 |
|---|----------------------|-------------------------|
| Maximum potential payout                        | \$ 126               | \$ 126                  |
| Less: Counterparty thresholds                   | -                    | -                       |
| Maximum collateral potentially required to post | \$ 126               | \$ 126                  |

Certain of our credit default swap agreements contain contractual provisions that allow for the netting of collateral with our counterparties related to all of our collateralized financing transactions that we have outstanding. If these netting agreements were not in place, we would have been required to post \$2 million as of March 31, 2014, after considering the fair values of the associated investments counterparties' credit ratings as compared to ours and specified thresholds that once exceeded result in the payment of cash.

### Credit Risk

We are exposed to credit loss in the event of non-performance by our counterparties on various derivative contracts and reflect assumptions regarding the credit or non-performance risk ("NPR"). The NPR is based upon assumptions for each counterparty's credit spread over the estimated weighted average life of the counterparty exposure less collateral held. As of March 31, 2014, the NPR adjustment was \$1 million. The credit risk associated with such agreements is minimized by purchasing such agreements from financial institutions with long-standing, superior performance records. Additionally, we maintain a policy of requiring all derivative contracts to be governed by an International Swaps and Derivatives Association ("ISDA") Master Agreement. We are required to maintain minimum ratings as a matter of routine practice in negotiating ISDA agreements. Under some ISDA agreements, our insurance subsidiaries have agreed to maintain certain financial strength or claims-paying ratings. A downgrade below these levels could result in termination of derivative contracts, at which time any amounts payable by us would be dependent on the market value of the underlying derivative contracts. In certain transactions, we and the counterparty have entered into a credit support annex requiring either party to post collateral when net exposures exceed pre-determined thresholds. These thresholds vary by counterparty and credit rating. The amount of such exposure is essentially the net replacement cost or market value less collateral held for such agreements with each counterparty if the net market value is in our favor. As of March 31, 2014, our exposure was \$52 million.

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

| S&P<br>Credit<br>Rating of<br>Counterparty | As of March 31,<br>2014  |  | As of December<br>31, 2013                     |  |
|--|--|--|--|--|
|  | Collateral<br>Posted<br>by<br>Counter-<br>Party<br>(Held<br>by<br>LNC) | Collateral<br>Posted by<br>LNC<br>(Held by<br>Counter-<br>Party) | Collateral<br>Posted<br>by<br>Counter-<br>LNC) | Collateral<br>Posted by<br>LNC<br>(Held by<br>Counter-<br>Party) |
| AA-  | \$ 38  | \$ (6 )  | \$ 34  | \$ (10 )   |
| A+   | 37   | -  | 19   | -  |
| A  | 847  | (110 )   | 339  | (183 )   |
| A-   | -  | -  | 468  | (123 )   |
| BBB+                                       | 71   | -  | 79   | -  |
|  | \$ 993   | \$ (116 )  | \$ 939   | \$ (316 )  |

Balance Sheet Offsetting

Information related to our derivative instruments, securities lending transactions and repurchase agreements and the effects of offsetting on our Consolidated Balance Sheets (in millions) were as follows:

|                                   | As of March 31, 2014      |                                       |   | Total    |
|-----------------------------------|---------------------------|---------------------------------------|---|----------|
|                                   | Derivative<br>Instruments | Embedded<br>Derivative<br>Instruments | Securities<br>Lending and<br>Repurchase<br>Agreements |          |
| Financial Assets                  |                           |                                       |   |          |
| Gross amount of recognized assets | \$ 1,848                  | \$ 1,022                              | \$ -  | \$ 2,870 |
| Gross amounts offset              | (804 )                    | -                                     | -   | (804 )   |
| Net amount of assets              | 1,044                     | 1,022                                 | -   | 2,066    |
| Gross amounts not offset:         |                           |                                       |   |          |
| Cash collateral received          | (877 )                    | -                                     | -   | (877 )   |
| Net amount                        | \$ 167                    | \$ 1,022                              | \$ -  | \$ 1,189 |

Financial Liabilities

|  |        |          |          |          |
|--|--------|----------|----------|----------|
| Gross amount of recognized liabilities | \$ 193 | \$ 1,268 | \$ 2,573 | \$ 4,034 |
| Gross amounts offset                   | (75 )  | -        | -        | (75 )    |
| Net amount of liabilities              | 118    | 1,268    | 2,573    | 3,959    |
| Gross amounts not offset:              |        |          |          |          |
| Cash collateral received               | -      | -        | (2,573 ) | (2,573)  |
| Net amount                             | \$ 118 | \$ 1,268 | \$ -     | \$ 1,386 |

|  | As of December 31, 2013 |             |             |          |
|--|-------------------------|-------------|-------------|----------|
|  |                         |             | Securities  |          |
|  | Derivative              | Embedded    | Lending and |          |
|  | Instruments             | Derivative  | Repurchase  | Total    |
|  |                         | Instruments | Agreements  |          |
| <b>Financial Assets</b>                |                         |             |             |          |
| Gross amount of recognized assets      | \$ 1,805                | \$ 1,244    | \$ -        | \$ 3,049 |
| Gross amounts offset                   | (924 )                  | -           | -           | (924 )   |
| Net amount of assets                   | 881                     | 1,244       | -           | 2,125    |
| Gross amounts not offset:              |                         |             |             |          |
| Cash collateral received               | (623 )                  | -           | -           | (623 )   |
| Net amount                             | \$ 258                  | \$ 1,244    | \$ -        | \$ 1,502 |
| <b>Financial Liabilities</b>           |                         |             |             |          |
| Gross amount of recognized liabilities | \$ 242                  | \$ 1,156    | \$ 2,600    | \$ 3,998 |
| Gross amounts offset                   | (55 )                   | -           | -           | (55 )    |
| Net amount of liabilities              | 187                     | 1,156       | 2,600       | 3,943    |
| Gross amounts not offset:              |                         |             |             |          |
| Cash collateral received               | -                       | -           | (2,600 )    | (2,600 ) |
| Net amount                             | \$ 187                  | \$ 1,156    | \$ -        | \$ 1,343 |

## 6. Federal Income Taxes

The effective tax rate is the ratio of tax expense over pre-tax income (loss). The effective tax rate was 23% and 22% for the three months ended March 31, 2014 and 2013, respectively. The effective tax rate on pre-tax income from continuing operations was lower than the prevailing corporate federal income tax rate. Differences in the effective rates and the U.S. statutory rate of 35% were the result of certain tax preferred investment income, separate account dividends-received deductions, foreign tax credits and other tax preference items.

## 7. Guaranteed Benefit Features

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

|  | As of<br>March 31,<br>2014 | As of<br>December 31,<br>2013 |
|--|----------------------------|-------------------------------|
| <b>Return of Net Deposits</b>            |                            |                               |
| Total account value                      | \$ 80,976                  | \$ 79,391                     |
| Net amount at risk (1)                   | 134                        | 141                           |
| Average attained age of contract holders | 61 years                   | 61 years                      |
| <b>Minimum Return</b>                    |                            |                               |
| Total account value                      | \$ 147                     | \$ 151                        |
| Net amount at risk (1)                   | 27                         | 27                            |
| Average attained age of contract holders | 73 years                   | 73 years                      |
| Guaranteed minimum return                | 5%                         | 5%                            |
| <b>Anniversary Contract Value</b>        |                            |                               |
| Total account value                      | \$ 25,905                  | \$ 25,958                     |
| Net amount at risk (1)                   | 557                        | 570                           |
| Average attained age of contract holders | 68 years                   | 68 years                      |

(1) Represents the amount of death benefit in excess of the account balance. There were no material changes in net amounts at risk when comparing March 31, 2014, to December 31, 2013, as equity markets remained flat during the first three months of 2014.



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

|                                 | For the<br>Three<br>Months<br>Ended<br>March 31,<br>2014 2013 |        |
|---------------------------------|---|--------|
| Balance as of beginning-of-year | \$ 73   | \$ 104 |
| Changes in reserves             | 8   | (4 )   |
| Benefits paid                   | (4 )  | (7 )   |
| Balance as of end-of-period     | \$ 77   | \$ 93  |

#### Variable Annuity Contracts

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

| Asset Type   | As of<br>March 31,<br>2014 | As of<br>December 31,<br>2013 |
|--|----------------------------|-------------------------------|
| Domestic equity  | \$ 47,331                  | \$ 47,042                     |
| International equity   | 18,500                     | 18,341                        |
| Bonds  | 25,328                     | 24,547                        |
| Money market   | 11,374                     | 10,926                        |
| Total  | \$ 102,533                 | \$ 100,856                    |
| Percent of total variable annuity<br>separate account values | 98%                        | 98%                           |

#### Secondary Guarantee Products

Future contract benefits also includes reserves for our secondary guarantee products sold through our Life Insurance segment. These UL and VUL products with secondary guarantees represented 33% of total life insurance in-force reserves as of March 31, 2014, and 41% of total sales for the three months ended March 31, 2014.

## 8. Contingencies and Commitments

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

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

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

We establish liabilities for litigation and regulatory loss contingencies when information related to the loss contingencies shows both that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. It is possible that some matters could require us to pay damages or make other expenditures or establish accruals in amounts that could not be estimated as of March 31, 2014. While the potential future charges could be material in the particular quarterly or annual periods in which they are recorded, based on

information currently known by management, management does not believe any such charges are likely to have a material adverse effect on LNC's financial condition.

On June 13, 2009, a single named plaintiff filed a putative national class action in the Circuit Court of Allen County, Indiana, captioned Peter S. Bezich v. The Lincoln National Life Insurance Company ("LNL"), No. 02C01-0906-PL73, asserting he was charged a cost-of-insurance fee that exceeded the applicable mortality charge, and that this fee breached the terms of the insurance contract. We dispute the allegations and are vigorously defending this matter. Plaintiffs have filed a motion for class certification. We expect a ruling on class certification this summer.

During 2013, we entered into a Global Resolution Agreement with multiple jurisdictions' treasury and controller offices for compliance with laws and regulations concerning the identification, reporting and escheatment of unclaimed contract benefits or abandoned funds. Under the terms of the Global Resolution Agreement, a third-party auditor acting on behalf of the signatory jurisdictions will compare expanded matching criteria to the Social Security Death Master File ("SSDMF") to identify deceased insureds and contract holders where a valid claim has not been made. In addition, we entered into a Regulatory Settlement Agreement with the insurance regulators of 52 jurisdictions to settle regulatory inquiries and examinations with respect to our processes for identifying and paying claims and benefits in the future. As part of the settlement, we have agreed to reimburse the participating jurisdictions \$12.6 million for the costs of such examinations. The Regulatory Settlement Agreement applies prospectively and requires us to adopt and implement additional procedures comparing our records to the SSDMF to identify unclaimed death benefits, and prescribes procedures for identifying and locating beneficiaries once deaths are identified.

See Note 13 in our 2013 Form 10-K for additional discussion of commitments and contingencies, which information is incorporated herein by reference.

## 9. Shares and Stockholders' Equity

### Common and Preferred Shares

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

For the Three  
Months Ended  
March 31,

|   | 2014         | 2013         |
|---|--------------|--------------|
| <b>Series A Preferred Stock</b>             |              |              |
| Balance as of beginning-of-period           | -            | 9,532        |
| Balance as of end-of-period                 | -            | 9,532        |
| <b>Common Stock</b>                         |              |              |
| Balance as of beginning-of-period           | 262,896,701  | 271,402,586  |
| Stock issued for exercise of warrants       | 3,044,765    | -            |
| Stock compensation/issued for benefit plans | 728,515      | 427,429      |
| Retirement/cancellation of shares           | (2,987,819 ) | (3,372,457 ) |
| Balance as of end-of-period                 | 263,682,162  | 268,457,558  |
| <b>Common Stock as of End-of-Period</b>     |              |              |
| Assuming conversion of preferred stock      | 263,682,162  | 268,610,070  |
| Diluted basis                               | 270,379,143  | 277,230,360  |

Our common and Series A preferred stocks are without par value.

## Average Shares

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

|   | For the Three<br>Months Ended<br>March 31, |              |
|---|--|--------------|
|   | 2014                                       | 2013         |
| Weighted-average shares, as used in basic calculation   | 262,738,542                                | 270,265,766  |
| Shares to cover exercise of outstanding warrants  | 7,194,803                                  | 10,150,108   |
| Shares to cover conversion of preferred stock   | -  | 152,512      |
| Shares to cover non-vested stock  | 1,559,679                                  | 1,282,721    |
| Average stock options outstanding during the period   | 3,898,853                                  | 1,726,615    |
| Assumed acquisition of shares with assumed proceeds from exercising outstanding warrants  | (1,514,514 )                               | (3,630,023 ) |
| Assumed acquisition of shares with assumed proceeds and benefits from exercising stock options (at average market price for the period) | (2,699,754 )                               | (1,272,272 ) |
| Shares repurchaseable from measured but unrecognized stock option expense   | (105,046 )                                 | (83,328 )    |
| Average deferred compensation shares  | 1,042,441                                  | -            |
| Weighted-average shares, as used in diluted calculation   | 272,115,004                                | 278,592,099  |

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

We have participants in our deferred compensation plans who selected LNC stock as the measure for the investment return attributable to their deferral amounts. For the three months ended March 31, 2014, the effect of settling this obligation in LNC stock (“equity classification”) was more dilutive than the scenario of settling it in cash (“liability classification”). Therefore, for our EPS calculation for this period, we added these shares to the denominator and adjusted the numerator to present net income as if the shares had been accounted for under equity classification by removing the mark-to-market adjustment included in net income attributable to these deferred units of LNC stock. The amount of this adjustment was \$1 million for the three months ended March 31, 2014.

The income used in the calculation of our diluted EPS is our net income (loss) reduced by preferred stock dividends.



## Accumulated OCI (“AOCI”)

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

|  | For the Three<br>Months Ended<br>March 31, |           |
|--|--|-----------|
|  | 2014                                       | 2013      |
| Unrealized Gain (Loss) on AFS Securities   |  |           |
| Balance as of beginning-of-year  | \$ 1,609                                   | \$ 4,066  |
| Unrealized holding gains (losses) arising during the period                        | 2,003                                      | (732 )    |
| Change in foreign currency exchange rate adjustment                                | 2  | (13 )     |
| Change in DAC, VOBA, DSI, future contract benefits and other contract holder funds | (604 )                                     | 286       |
| Income tax benefit (expense)   | (490 )                                     | 161       |
| Less:  |  |           |
| Reclassification adjustment for gains (losses) included in net income (loss)       | 2  | (6 )      |
| Associated amortization of DAC, VOBA, DSI and DFEL                                 | (7 )                                       | (8 )      |
| Income tax benefit (expense)   | 2  | 5         |
| Balance as of end-of-period  | \$ 2,523                                   | \$ 3,777  |
| Unrealized OTTI on AFS Securities  |  |           |
| Balance as of beginning-of-year  | \$ (78 )                                   | \$ (107 ) |
| (Increases) attributable to:   |  |           |
| Gross OTTI recognized in OCI during the period                                     | (7 )                                       | (7 )      |
| Change in DAC, VOBA, DSI and DFEL  | -  | 1         |
| Income tax benefit (expense)   | 2  | 2         |
| Decreases attributable to:   |  |           |
| Sales, maturities or other settlements of AFS securities                           | 7  | 43        |
| Change in DAC, VOBA, DSI and DFEL  | (1 )                                       | (5 )      |
| Income tax benefit (expense)   | (2 )                                       | (14 )     |
| Balance as of end-of-period  | \$ (79 )                                   | \$ (87 )  |
| Unrealized Gain (Loss) on Derivative Instruments                                   |  |           |
| Balance as of beginning-of-year  | \$ 256                                     | \$ 163    |
| Unrealized holding gains (losses) arising during the period                        | (30 )                                      | 48        |
| Change in foreign currency exchange rate adjustment                                | (2 )                                       | 11        |
| Change in DAC, VOBA, DSI and DFEL  | -  | 2         |
| Income tax benefit (expense)   | 11   | (22 )     |
| Less:  |  |           |
| Reclassification adjustment for gains (losses) included in net income (loss)       | (6 )                                       | (2 )      |
| Associated amortization of DAC, VOBA, DSI and DFEL                                 | -  | 1         |
| Income tax benefit (expense)   | 2  | -         |
| Balance as of end-of-period  | \$ 239                                     | \$ 203    |
| Foreign Currency Translation Adjustment  |  |           |
| Balance as of beginning-of-year  | \$ (5 )                                    | \$ (4 )   |

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|   |           |           |
|---|-----------|-----------|
| Foreign currency translation adjustment arising during the period | (5 )      | (3 )      |
| Income tax benefit (expense)                                      | -         | 1         |
| Balance as of end-of-period                                       | \$ (10 )  | \$ (6 )   |
| <b>Funded Status of Employee Benefit Plans</b>                    |           |           |
| Balance as of beginning-of-year                                   | \$ (219 ) | \$ (310 ) |
| Adjustment arising during the period                              | (1 )      | 6         |
| Income tax benefit (expense)                                      | -         | (2 )      |
| Balance as of end-of-period                                       | \$ (220 ) | \$ (306 ) |



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

|   | For the Three<br>Months Ended<br>March 31, |         |   |
|---|--|---------|---|
|   | 2014                                       | 2013    |   |
| <b>Unrealized Gain (Loss) on AFS Securities</b>             |  |         |   |
| Gross reclassification                                      | \$ 2                                       | \$ (6 ) | Total realized gain (loss)                            |
| Associated amortization of DAC,<br>VOBA, DSI and DFEL       | (7 )                                       | (8 )    | Total realized gain (loss)                            |
| Reclassification before income<br>tax benefit (expense)     | (5 )                                       | (14)    | Income (loss) from continuing operations before taxes |
| Income tax benefit (expense)                                | 2  | 5       | Federal income tax expense (benefit)                  |
| Reclassification, net of income tax                         | \$ (3 )                                    | \$ (9 ) | Net income (loss)                                     |
| <b>Unrealized OTTI on AFS Securities</b>                    |  |         |   |
| Gross reclassification                                      | \$ 7                                       | \$ 43   | Total realized gain (loss)                            |
| Change in DAC, VOBA, DSI and DFEL                           | (1 )                                       | (5 )    | Total realized gain (loss)                            |
| Reclassification before income<br>tax benefit (expense)     | 6  | 38      | Income (loss) from continuing operations before taxes |
| Income tax benefit (expense)                                | (2 )                                       | (14)    | Federal income tax expense (benefit)                  |
| Reclassification, net of income tax                         | \$ 4                                       | \$ 24   | Net income (loss)                                     |
| <b>Unrealized Gain (Loss) on Derivative<br/>Instruments</b> |  |         |   |
| Gross reclassifications:                                    |  |         |   |
| Interest rate contracts                                     | \$ (7 )                                    | \$ (5 ) | Net investment income                                 |
| Interest rate contracts                                     | 1  | 1       | Interest and debt expense                             |
| Foreign currency contracts                                  | -  | 2       | Net investment income                                 |
| Total gross reclassifications                               | (6 )                                       | (2 )    |   |
| Associated amortization of DAC,<br>VOBA, DSI and DFEL       | -  | 1       | Commissions and other expenses                        |
| Reclassifications before income<br>tax benefit (expense)    | (6 )                                       | (1 )    | Income (loss) from continuing operations before taxes |
| Income tax benefit (expense)                                | 2  | -       | Federal income tax expense (benefit)                  |
| Reclassification, net of income tax                         | \$ (4 )                                    | \$ (1 ) | Net income (loss)                                     |



## 10. Realized Gain (Loss)

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

|   | For the Three<br>Months<br>Ended<br>March 31, |         |
|---|---|---------|
|   | 2014  | 2013    |
| Total realized gain (loss) related to certain investments (1)         | \$ (5 )                                       | \$ (14) |
| Realized gain (loss) on the mark-to-market on certain instruments (2) | (20)  | 9       |
| Indexed annuity and universal life net derivatives results: (3)       |   |         |
| Gross gain (loss)   | (23)  | (13)    |
| Associated amortization of DAC, VOBA, DSI and DFEL                    | 5   | 2       |
| Variable annuity net derivatives results: (4)                         |   |         |
| Gross gain (loss)   | 31  | (50)    |
| Associated amortization of DAC, VOBA, DSI and DFEL                    | (6 )  | 7       |
| Total realized gain (loss)  | \$ (18)                                       | \$ (59) |

(1) See “Realized Gain (Loss) Related to Certain Investments” section in Note 4.

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

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

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

## 11. Stock-Based Incentive Compensation Plans

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

LNC stock-based awards granted were as follows:

|                           | For the<br>Three<br>Months<br>Ended<br>March 31,<br>2014 |
|---------------------------|--|
| 10-year LNC stock options | 476,845  |
| Performance shares        | 177,315  |
| SARs                      | 62,887   |
| RSUs                      | 432,810  |
| Non-employee:             |  |
| Agent stock options       | 86,615   |
| Director RSUs             | 8,200  |

## 12. Fair Value of Financial Instruments

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

|   | As of March 31, 2014 |            | As of December 31, 2013 |            |
|---|----------------------|------------|-------------------------|------------|
|   | Carrying Value       | Fair Value | Carrying Value          | Fair Value |
| <b>Assets</b>   |                      |            |                         |            |
| <b>AFS securities:</b>  |                      |            |                         |            |
| Fixed maturity securities   | \$ 82,988            | \$ 82,988  | \$ 80,078               | \$ 80,078  |
| VIEs' fixed maturity securities                                   | 597                  | 597        | 697                     | 697        |
| Equity securities   | 207                  | 207        | 201                     | 201        |
| Trading securities  | 2,316                | 2,316      | 2,282                   | 2,282      |
| Mortgage loans on real estate                                     | 7,089                | 7,315      | 7,210                   | 7,386      |
| Derivative investments (1)  | 1,044                | 1,044      | 881                     | 881        |
| Other investments   | 1,237                | 1,237      | 1,218                   | 1,218      |
| Cash and invested cash  | 1,849                | 1,849      | 2,364                   | 2,364      |
| Other assets – GLB reserves embedded derivatives (2)              | 1,022                | 1,022      | -                       | -          |
| Separate account assets   | 118,968              | 118,968    | 117,135                 | 117,135    |
| <b>Liabilities</b>  |                      |            |                         |            |
| <b>Future contract benefits:</b>                                  |                      |            |                         |            |
| Indexed annuity and universal life contracts embedded derivatives | (1,090 )             | (1,090 )   | (1,048 )                | (1,048 )   |
| GLB reserves embedded derivatives                                 | -                    | -          | 1,244                   | 1,244      |
| <b>Other contract holder funds:</b>                               |                      |            |                         |            |
| Remaining guaranteed interest and similar contracts               | (781 )               | (781 )     | (809 )                  | (809 )     |
| Account values of certain investment contracts                    | (29,291 )            | (30,741 )  | (29,078 )               | (30,574 )  |
| Short-term debt   | -                    | -          | (501 )                  | (500 )     |
| Long-term debt  | (5,380 )             | (5,903 )   | (5,320 )                | (5,762 )   |
| Reinsurance related embedded derivatives                          | (135 )               | (135 )     | (108 )                  | (108 )     |
| VIEs' liabilities – derivative instruments                        | (22 )                | (22 )      | (27 )                   | (27 )      |
| <b>Other liabilities:</b>   |                      |            |                         |            |
| Credit default swaps  | (2 )                 | (2 )       | (2 )                    | (2 )       |
| Derivative liabilities (1)  | (116 )               | (116 )     | (187 )                  | (187 )     |
| GLB reserves embedded derivatives (2)                             | (43 )                | (43 )      | -                       | -          |

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

(2) Portions of our GLB reserves embedded derivatives are ceded to our third-party reinsurance counterparties. Refer to Note 5 for additional detail.

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

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

### Mortgage Loans on Real Estate

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

#### Other Investments

The carrying value of our assets classified as other investments approximates fair value. Other investments include LPs and other privately held investments that are accounted for using the equity method of accounting and the carrying value is based on our proportional share of the net assets of the LPs. The inputs used to measure the fair value of our other investments are classified as Level 3 within the fair value hierarchy.

#### Other Contract Holder Funds

Other contract holder funds include remaining guaranteed interest and similar contracts and account values of certain investment contracts. The fair value for the remaining guaranteed interest and similar contracts is estimated using discounted cash flow calculations as of the balance sheet date. These calculations are based on interest rates currently offered on similar contracts with maturities that are consistent with those remaining for the contracts being valued. As of March 31, 2014, and December 31, 2013, the remaining guaranteed interest and similar contracts carrying value approximated fair value. The fair value of the account values of certain investment contracts is based on their approximate surrender value as of the balance sheet date. The inputs used to measure the fair value of our other contract holder funds are classified as Level 3 within the fair value hierarchy.

#### Short-Term and Long-Term Debt

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

#### Financial Instruments Carried at Fair Value

We did not have any assets or liabilities measured at fair value on a nonrecurring basis as of March 31, 2014, or December 31, 2013, and we noted no changes in our valuation methodologies between these periods.

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The following summarizes our financial instruments carried at fair value (in millions) on a recurring basis by the fair value hierarchy levels described in “Summary of Significant Accounting Policies” in Note 1 of our 2013 Form 10-K:

|   | As of March 31, 2014  |  |  |                        |
|---|---|--|--|------------------------|
|   | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total<br>Fair<br>Value |
| <b>Assets</b>   |   |  |  |                        |
| <b>Investments:</b>   |   |  |  |                        |
| <b>Fixed maturity AFS securities:</b>   |   |  |  |                        |
| Corporate bonds   | \$ 62   | \$ 69,661  | \$ 1,958   | \$ 71,681              |
| U.S. government bonds   | 367   | 21   | -  | 388                    |
| Foreign government bonds  | -   | 452  | 107  | 559                    |
| RMBS  | -   | 4,240  | 1  | 4,241                  |
| CMBS  | -   | 682  | 21   | 703                    |
| CLOs  | -   | 46   | 195  | 241                    |
| State and municipal bonds   | -   | 4,175  | 29   | 4,204                  |
| Hybrid and redeemable preferred securities  | 44  | 872  | 55   | 971                    |
| VIEs' fixed maturity securities   | -   | 597  | -  | 597                    |
| Equity AFS securities   | 7   | 38   | 162  | 207                    |
| Trading securities  | -   | 2,263  | 53   | 2,316                  |
| Derivative investments (1)  | -   | 858  | 1,065  | 1,923                  |
| Cash and invested cash  | -   | 1,849  | -  | 1,849                  |
| Other assets – GLB reserves embedded derivatives  | -   | -  | 1,022  | 1,022                  |
| Separate account assets   | 1,320   | 117,648  | -  | 118,968                |
| <b>Total assets</b>   | <b>\$ 1,800</b>   | <b>\$ 203,402</b>                                | <b>\$ 4,668</b>                                    | <b>\$ 209,870</b>      |
| <b>Liabilities</b>  |   |  |  |                        |
| Future contract benefits – indexed annuity<br>and universal life contracts embedded derivatives | \$ -  | \$ -   | \$ (1,090 )  | \$ (1,090 )            |
| Long-term debt  | -   | (1,203 )   | -  | (1,203 )               |
| Reinsurance related embedded derivatives  | -   | (135 )   | -  | (135 )                 |
| VIEs' liabilities – derivative instruments  | -   | -  | (22 )  | (22 )                  |
| <b>Other liabilities:</b>   |   |  |  |                        |
| Credit default swaps  | -   | -  | (2 )   | (2 )                   |
| Derivative liabilities (1)  | -   | (741 )   | (254 )   | (995 )                 |
| GLB reserves embedded derivatives   | -   | -  | (43 )  | (43 )                  |
| <b>Total liabilities</b>  | <b>\$ -</b>   | <b>\$ (2,079 )</b>                               | <b>\$ (1,411 )</b>                                 | <b>\$ (3,490 )</b>     |





|  | As of December 31, 2013                            |  |  |                        |
|--|--|--|--|------------------------|
|  | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for |  |  |                        |
|  | Identical<br>Assets<br>(Level<br>1)                | Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total<br>Fair<br>Value |
| Assets   |  |  |  |                        |
| Investments:   |  |  |  |                        |
| Fixed maturity AFS securities:                                       |  |  |  |                        |
| Corporate bonds  | \$ 60  | \$ 67,164  | \$ 1,711   | \$ 68,935              |
| U.S. government bonds  | 346  | 21   | -  | 367                    |
| Foreign government bonds   | -  | 470  | 79   | 549                    |
| RMBS   | -  | 4,349  | 1  | 4,350                  |
| CMBS   | -  | 708  | 20   | 728                    |
| CLOs   | -  | 46   | 179  | 225                    |
| State and municipal bonds  | -  | 3,891  | 28   | 3,919                  |
| Hybrid and redeemable preferred securities                           | 40   | 899  | 66   | 1,005                  |
| VIEs' fixed maturity securities                                      | 102  | 595  | -  | 697                    |
| Equity AFS securities  | 3  | 37   | 161  | 201                    |
| Trading securities   | -  | 2,230  | 52   | 2,282                  |
| Derivative investments (1)   | -  | 340  | 1,518  | 1,858                  |
| Cash and invested cash   | -  | 2,364  | -  | 2,364                  |
| Separate account assets  | 1,767  | 115,368  | -  | 117,135                |
| Total assets   | \$ 2,318   | \$ 198,482                                       | \$ 3,815   | \$ 204,615             |
| Liabilities  |  |  |  |                        |
| Future contract benefits:  |  |  |  |                        |
| Indexed annuity and universal life contracts<br>embedded derivatives |  |  |  |                        |
|  | \$ -   | \$ -   | \$ (1,048 )  | \$ (1,048 )            |
| GLB reserves embedded derivatives                                    | -  | -  | 1,244  | 1,244                  |
| Long-term debt   | -  | (1,203 )   | -  | (1,203 )               |
| Reinsurance related embedded derivatives                             | -  | (108 )   | -  | (108 )                 |
| VIEs' liabilities – derivative instruments                           | -  | -  | (27 )  | (27 )                  |
| Other liabilities:   |  |  |  |                        |
| Credit default swaps   | -  | -  | (2 )   | (2 )                   |
| Derivative liabilities (1)   | -  | (912 )   | (252 )   | (1,164 )               |
| Total liabilities  | \$ -   | \$ (2,223 )                                      | \$ (85 )   | \$ (2,308 )            |

(1)

Derivative investment assets and liabilities presented within the fair value hierarchy are presented on a gross basis by derivative type and not on a master netting basis by counterparty.

The following summarizes changes to our financial instruments carried at fair value (in millions) and classified within Level 3 of the fair value hierarchy. This summary excludes any effect of amortization of DAC, VOBA, DSI and DFEL. The gains and losses below may include changes in fair value due in part to observable inputs that are a component of the valuation methodology.

## For the Three Months Ended March 31, 2014

|  | Beginning in<br>Fair<br>Value | Items<br>Included<br>Net<br>Income | Gains<br>(Losses)<br>in<br>OCI<br>and<br>Other (1) | Issuances,<br>Sales,<br>Maturities,<br>Calls,<br>Settlements,<br>Net | Transfers<br>In or<br>Out<br>of<br>Level 3,<br>Net (2)(3) | Ending<br>Fair<br>Value |
|--|-------------------------------|------------------------------------|--|--|---|-------------------------|
| Investments: (4)   |                               |                                    |  |  |   |                         |
| Fixed maturity AFS securities:                                       |                               |                                    |  |  |   |                         |
| Corporate bonds  | \$ 1,711                      | \$ 3                               | \$ 25  | \$ 19  | \$ 200  | \$ 1,958                |
| Foreign government bonds   | 79                            | -                                  | 3  | -  | 25  | 107                     |
| RMBS   | 1                             | -                                  | -  | -  | -   | 1                       |
| CMBS   | 20                            | -                                  | 1  | (6 )   | 6   | 21                      |
| CLOs   | 179                           | -                                  | 1  | 7  | 8   | 195                     |
| State and municipal bonds  | 28                            | -                                  | 1  | -  | -   | 29                      |
| Hybrid and redeemable<br>preferred securities                        | 66                            | -                                  | (1 )   | -  | (10 )   | 55                      |
| Equity AFS securities  | 161                           | -                                  | 1  | -  | -   | 162                     |
| Trading securities   | 52                            | 1                                  | 3  | (1 )   | (2 )  | 53                      |
| Derivative investments   | 1,266                         | (108 )                             | 134  | (55 )  | (426 )  | 811                     |
| Other assets – GLB reserves<br>embedded derivatives (5)              | 27                            | (249 )                             | -  | -  | 1,244   | 1,022                   |
| Future contract benefits: (5)  |                               |                                    |  |  |   |                         |
| Indexed annuity and universal life<br>contracts embedded derivatives | (1,048)                       | (49 )                              | -  | 7  | -   | (1,090)                 |
| GLB reserves embedded derivatives                                    | 1,244                         | -                                  | -  | -  | (1,244 )  | -                       |
| VIEs' liabilities – derivative instruments (6)                       | (27 )                         | 5                                  | -  | -  | -   | (22 )                   |
| Other liabilities:   |                               |                                    |  |  |   |                         |
| Credit default swaps (7)   | (2 )                          | -                                  | -  | -  | -   | (2 )                    |
| GLB reserves embedded derivatives (5)                                | (27 )                         | (16 )                              | -  | -  | -   | (43 )                   |
| Total, net   | \$ 3,730                      | \$ (413 )                          | \$ 168   | \$ (29 )   | \$ (199 )   | \$ 3,257                |



## For the Three Months Ended March 31, 2013

|  | Beginning<br>Fair<br>Value | Items<br>Included<br>Net<br>Income | Gains<br>(Losses)<br>in<br>OCI<br>and<br>Other (1) | Issuances,<br>Sales<br>Maturities,<br>Settlements,<br>Calls,<br>Net | Transfers<br>In or<br>Out<br>of<br>Level 3,<br>Net (2) | Ending<br>Fair<br>Value |
|--|----------------------------|------------------------------------|--|---|--|-------------------------|
| Investments: (4)   |                            |                                    |  |   |  |                         |
| Fixed maturity AFS securities:                                       |                            |                                    |  |   |  |                         |
| Corporate bonds  | \$ 1,505                   | \$ -                               | \$ 12  | \$ 156  | \$ 152   | \$ 1,825                |
| U.S. government bonds  | 1                          | -                                  | -  | (1 )  | -  | -                       |
| Foreign government bonds   | 46                         | -                                  | -  | 30  | -  | 76                      |
| RMBS   | 3                          | -                                  | -  | (2 )  | -  | 1                       |
| CMBS   | 27                         | (1 )                               | 2  | (1 )  | -  | 27                      |
| CLOs   | 154                        | (1 )                               | 2  | (6 )  | -  | 149                     |
| State and municipal bonds  | 32                         | -                                  | -  | -   | -  | 32                      |
| Hybrid and redeemable<br>preferred securities                        | 118                        | -                                  | 5  | -   | (21 )  | 102                     |
| Equity AFS securities  | 87                         | -                                  | 2  | 21  | -  | 110                     |
| Trading securities   | 56                         | 1                                  | (2 )   | (1 )  | -  | 54                      |
| Derivative investments   | 2,026                      | (258 )                             | 40   | 27  | -  | 1,835                   |
| Future contract benefits: (5)  |                            |                                    |  |   |  |                         |
| Indexed annuity and universal life<br>contracts embedded derivatives | (732 )                     | (130 )                             | -  | 9   | -  | (853 )                  |
| GLB reserves embedded derivatives                                    | (909 )                     | 710                                | -  | -   | -  | (199 )                  |
| VIEs' liabilities – derivative instruments (6)                       | (128 )                     | 15                                 | -  | -   | -  | (113 )                  |
| Other liabilities – credit default swaps (7)                         | (11 )                      | 1                                  | -  | -   | -  | (10 )                   |
| Total, net   | \$ 2,275                   | \$ 337                             | \$ 61  | \$ 232  | \$ 131   | \$ 3,036                |

- (1) The changes in fair value of the interest rate swaps are offset by an adjustment to derivative investments (see Note 5).
- (2) Transfers in or out of Level 3 for AFS and trading securities are displayed at amortized cost as of the beginning-of-period. For AFS and trading securities, the difference between beginning-of-period amortized cost and beginning-of-period fair value was included in OCI and earnings, respectively, in prior periods.
- (3) Transfers in or out of Level 3 for GLB reserves embedded derivatives represent reclassifications between future contract benefits, other assets and other liabilities on our Consolidated Balance Sheets.
- (4) Amortization and accretion of premiums and discounts are included in net investment income on our Consolidated Statements of Comprehensive Income (Loss). Gains (losses) from sales, maturities, settlements and calls and OTTI are included in realized gain (loss) on our Consolidated Statements of Comprehensive Income (Loss).
- (5) Gains (losses) from sales, maturities, settlements and calls are included in realized gain (loss) on our Consolidated Statements of Comprehensive Income (Loss).
- (6) Gains (losses) from sales, maturities, settlements and calls are included in net investment income on our Consolidated Statements of Comprehensive Income (Loss).
- (7)

The changes in fair value of the credit default swaps and contingency forwards are included in realized gain (loss) on our Consolidated Statements of Comprehensive Income (Loss).

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The following provides the components of the items included in issuances, sales, maturities, settlements and calls, net, excluding any effect of amortization of DAC, VOBA, DSI and DFEL and changes in future contract benefits, (in millions) as reported above:

For the Three Months Ended March 31, 2014

|  | Issuances | Sales   | Maturities | Settlements | Calls   | Total   |
|--|-----------|---------|------------|-------------|---------|---------|
| Investments:   |           |         |            |             |         |         |
| Fixed maturity AFS securities:   |           |         |            |             |         |         |
| Corporate bonds  | \$ 145    | \$ (10) | \$ (58)    | \$ (16)     | \$ (42) | \$ 19   |
| CMBS   | -         | -       | -          | (6)         | -       | (6)     |
| CLOs   | 12        | -       | -          | (5)         | -       | 7       |
| Trading securities   | 1         | -       | -          | (2)         | -       | (1)     |
| Derivative investments   | 36        | (20)    | (71)       | -           | -       | (55)    |
| Future contract benefits – indexed annuity and universal life contracts embedded derivatives | (25)      | -       | -          | 32          | -       | 7       |
| Total, net   | \$ 169    | \$ (30) | \$ (129)   | \$ 3        | \$ (42) | \$ (29) |

For the Three Months Ended March 31, 2013

|  | Issuances | Sales  | Maturities | Settlements | Calls  | Total  |
|--|-----------|--------|------------|-------------|--------|--------|
| Investments:   |           |        |            |             |        |        |
| Fixed maturity AFS securities:   |           |        |            |             |        |        |
| Corporate bonds  | \$ 183    | \$ (2) | \$ (4)     | \$ (15)     | \$ (6) | \$ 156 |
| U.S. government bonds  | -         | -      | -          | (1)         | -      | (1)    |
| Foreign government bonds   | 30        | -      | -          | -           | -      | 30     |
| RMBS   | -         | -      | -          | (2)         | -      | (2)    |
| CMBS   | -         | -      | -          | (1)         | -      | (1)    |
| CLOs   | -         | -      | -          | (6)         | -      | (6)    |
| Equity AFS securities  | 25        | (4)    | -          | -           | -      | 21     |
| Trading securities   | -         | -      | -          | (1)         | -      | (1)    |
| Derivative investments   | 32        | 53     | (58)       | -           | -      | 27     |
| Future contract benefits – indexed annuity and universal life contracts embedded derivatives | (19)      | -      | -          | 28          | -      | 9      |
| Total, net   | \$ 251    | \$ 47  | \$ (62)    | \$ 2        | \$ (6) | \$ 232 |



The following summarizes changes in unrealized gains (losses) included in net income, excluding any effect of amortization of DAC, VOBA, DSI and DFEL and changes in future contract benefits, related to financial instruments carried at fair value classified within Level 3 that we still held (in millions):

|  | For the Three<br>Months Ended<br>March 31, |          |
|--|--|----------|
|  | 2014                                       | 2013     |
| Derivative investments (1)                     | \$ (110)                                   | \$ (197) |
| Credit default swaps (1)                       | -  | 1        |
| VIEs' liabilities – derivative instruments (2) | 5  | 15       |
| Embedded derivatives: (1)                      |  |          |
| Indexed annuity and universal life contracts   | (24 )                                      | (23 ) .  |
| GLB reserves                                   | (172)                                      | 761      |
| Total, net                                     | \$ (301)                                   | \$ 557   |

(1) Included in realized gain (loss) on our Consolidated Statements of Comprehensive Income (Loss).

(2) Included in net investment income on our Consolidated Statements of Comprehensive Income (Loss).

The following provides the components of the transfers in and out of Level 3 (in millions) as reported above:

|  | For the Three<br>Months Ended<br>March 31, 2014 |                                |           | For the Three<br>Months Ended<br>March 31, 2013 |                                |        |
|--|---|--------------------------------|-----------|---|--------------------------------|--------|
|  | Transfers<br>In to<br>Level 3                   | Transfers<br>Out of<br>Level 3 | Total     | Transfers<br>In to<br>Level<br>3                | Transfers<br>Out of<br>Level 3 | Total  |
| Investments:                                     |   |                                |           |   |                                |        |
| Fixed maturity AFS securities:                   |   |                                |           |   |                                |        |
| Corporate bonds                                  | \$ 260  | \$ (60 )                       | \$ 200    | \$ 158  | \$ (6 )                        | \$ 152 |
| Foreign government bonds                         | 25  | -                              | 25        | -   | -                              | -      |
| CMBS   | 6   | -                              | 6         | -   | -                              | -      |
| CLOs   | 8   | -                              | 8         | -   | -                              | -      |
| Hybrid and redeemable preferred securities       | 12  | (22 )                          | (10 )     | 5   | (26 )                          | (21 )  |
| Trading securities                               | 4   | (6 )                           | (2 )      | -   | -                              | -      |
| Derivative investments                           | -   | (426 )                         | (426 )    | -   | -                              | -      |
| Other assets – GLB reserves embedded derivatives | 1,244   | -                              | 1,244     | -   | -                              | -      |
| Future contract benefits:                        |   |                                |           |   |                                |        |
| GLB reserves embedded derivatives                | -   | (1,244 )                       | (1,244)   | -   | -                              | -      |
| Total, net                                       | \$ 1,559  | \$ (1,758 )                    | \$ (199 ) | \$ 163  | \$ (32 )                       | \$ 131 |

Transfers in and out of Level 3 are generally the result of observable market information on a security no longer being available or becoming available to our pricing vendors. For the three months ended March 31, 2014 and 2013, our investments transfers in and out were attributable primarily to the securities' observable market information no longer being available or becoming available. Transfers in and out for GLB reserves embedded derivatives represent reclassifications between future contract benefits and other assets. Transfers in and out of Levels 1 and 2 are generally the result of a change in the type of input used to measure the fair value of an asset or liability at the end of the reporting period. When quoted prices in active markets become available, transfers from Level 2 to Level 1 will result. When quoted prices in active markets become unavailable, but we are able to employ a valuation methodology using significant observable inputs, transfers from Level 1 to Level 2 will result. For the three months ended March 31, 2014 and 2013, the transfers between Levels 1 and 2 of the fair value hierarchy were less than \$1 million for our financial instruments carried at fair value.

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The following summarizes the fair value (in millions), valuation techniques and significant unobservable inputs of the Level 3 fair value measurements as of March 31, 2014:

|   | Fair Value | Valuation Technique  | Significant Unobservable Inputs           | Assumption or Input Ranges |
|---|------------|----------------------|---|----------------------------|
| <b>Assets</b>   |            |                      |   |                            |
| <b>Investments:</b>   |            |                      |   |                            |
| Fixed maturity AFS and trading securities:                    |            |                      |   |                            |
| Corporate bonds   | \$ 1,360   | Discounted cash flow | Liquidity/duration adjustment (1)         | 0.7% - 9.5 %               |
| Foreign government bonds                                      | 80         | Discounted cash flow | Liquidity/duration adjustment (1)         | 1.8% - 3.7 %               |
| Hybrid and redeemable preferred securities                    | 20         | Discounted cash flow | Liquidity/duration adjustment (1)         | 1.7% - 2.3 %               |
| Equity AFS and trading securities                             | 29         | Discounted cash flow | Liquidity/duration adjustment (1)         | 4.3% - 6.2 %               |
| Other assets – GLB reserves                                   |            |                      |   |                            |
| embedded derivatives  | 1,022      | Discounted cash flow | Long-term lapse rate (2)                  | 1 % - 27 %                 |
|   |            |                      | Utilization of guaranteed withdrawals (3) | 90 % - 100 %               |
|   |            |                      | Claims utilization factor (4)             | 60 % - 100 %               |
|   |            |                      | Premiums utilization factor (4)           | 77 % - 132 %               |
|   |            |                      | NPR (5)                                   | 0 % - 0.49%                |
|   |            |                      | Mortality rate (6)                        | (8)                        |
|   |            |                      | Volatility (7)                            | 1 % - 28 %                 |
| <b>Liabilities</b>  |            |                      |   |                            |
| Future contract benefits – indexed annuity and universal life |            |                      |   |                            |
| contracts embedded derivatives                                | (1,090)    | Discounted cash flow | Lapse rate (2)                            | 1 % - 15 %                 |

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|                                  |       |   |              |
|----------------------------------|-------|---|--------------|
|                                  |       | Mortality rate (6)                        | (9)          |
| Other liabilities – GLB reserves |       |   |              |
|                                  |       | Long-term lapse rate (2)                  |              |
| embedded derivatives             | (43 ) | Discounted cash flow                      | 1 % - 27 %   |
|                                  |       | Utilization of guaranteed withdrawals (3) | 90 % - 100 % |
|                                  |       | Claims utilization factor (4)             | 60 % - 100 % |
|                                  |       | Premiums utilization factor (4)           | 77 % - 132 % |
|                                  |       | NPR (5)                                   | 0 % - 0.49 % |
|                                  |       | Mortality rate (6)                        | (8)          |
|                                  |       | Volatility (7)                            | 1 % - 28 %   |

- (1) The liquidity/duration adjustment input represents an estimated market participant composite of adjustments attributable to liquidity premiums, expected durations, structures and credit quality that would be applied to the market observable information of an investment.
- (2) The lapse rate input represents the estimated probability of a contract surrendering during a year, and thereby forgoing any future benefits. The range for indexed annuity and universal life contracts represents the lapse rates during the surrender charge period.
- (3) The utilization of guaranteed withdrawals input represents the estimated percentage of contract holders that utilize the guaranteed withdrawal feature.
- (4) The utilization factors are applied to the present value of claims or premiums, as appropriate, in the GLB reserve calculation to estimate the impact of inefficient withdrawal behavior, including taking less than or more than the maximum guaranteed withdrawal.
- (5) The NPR input represents the estimated additional credit spread that market participants would apply to the market observable discount rate when pricing a contract.
- (6) The mortality rate input represents the estimated probability of when an individual belonging to a particular group, categorized according to age or some other factor such as gender, will die.
- (7) The volatility input represents overall volatilities assumed for the underlying variable annuity funds, which include a mixture of equity and fixed income assets. Fair value of the variable annuity GLB embedded derivatives would increase if higher volatilities were used for valuation.
- (8) The mortality rate is based on a combination of company and industry experience, adjusted for improvement factors.
- (9) Based on the “Annuity 2000 Mortality Table” developed by the Society of Actuaries Committee on Life Insurance Research that was adopted by the National Association of Insurance Commissioners in 1996 for our mortality input.

From the table above, we have excluded Level 3 fair value measurements obtained from independent, third-party pricing sources. We do not develop the significant inputs used to measure the fair value of these assets and liabilities, and the information regarding the significant inputs is not readily available to us. Independent broker-quoted fair values are non-binding quotes developed by market



makers or broker-dealers obtained from third-party sources recognized as market participants. The fair value of a broker-quoted asset or liability is based solely on the receipt of an updated quote from a single market maker or a broker-dealer recognized as a market participant as we do not adjust broker quotes when used as the fair value measurement for an asset or liability. Significant increases or decreases in any of the quotes received from a third-party broker-dealer may result in a significantly higher or lower fair value measurement.

Changes in any of the significant inputs presented in the table above may result in a significant change in the fair value measurement of the asset or liability as follows:

- Investments – An increase in the liquidity/duration adjustment input would result in a decrease in the fair value measurement.
- Indexed annuity and universal life contracts embedded derivatives – An increase in the lapse rate or mortality rate inputs would result in a decrease in the fair value measurement.
- GLB reserves embedded derivatives – Assuming our GLB reserves embedded derivatives are in a liability position: an increase in our lapse rate, NPR or mortality rate inputs would result in a decrease in the fair value measurement; and an increase in the utilization of guarantee withdrawal or volatility inputs would result in an increase in the fair value measurement.

For each category discussed above, the unobservable inputs are not inter-related; therefore, a directional change in one input will not affect the other inputs.

As part of our on-going valuation process, we assess the reasonableness of our valuation techniques or models and make adjustments as necessary. For more information, see “Summary of Significant Accounting Policies” in Note 1 of our 2013 Form 10-K.

### 13. Segment Information

We provide products and services and report results through our Annuities, Retirement Plan Services, Life Insurance and Group Protection segments. We also have Other Operations, which includes the financial data for operations that are not directly related to the business segments. Our reporting segments reflect the manner by which our chief operating decision makers view and manage the business. See Note 22 of our 2013 Form 10-K for a brief description of these segments and Other Operations.

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

- Realized gains and losses associated with the following (“excluded realized gain (loss)”):
  - § Sales or disposals of securities;
  - § Impairments of securities;
  - § Changes in the fair value of derivatives, embedded derivatives within certain reinsurance arrangements and trading securities;
  - § Changes in the fair value of the derivatives we own to hedge our GDB riders within our variable annuities;
  - § Changes in the fair value of the embedded derivatives of our GLB riders accounted for at fair value, net of the change in the fair value of the derivatives we own to hedge them; and
  - § Changes in the fair value of the embedded derivative liabilities related to index call options we may purchase in the future to hedge contract holder index allocations applicable to future reset periods for our indexed annuity products accounted for at fair value;
- Changes in reserves resulting from benefit ratio unlocking on our GDB and GLB riders;
- Income (loss) from reserve changes, net of related amortization, on business sold through reinsurance;
- Gains (losses) on early extinguishment of debt;
- Losses from the impairment of intangible assets;
- Income (loss) from discontinued operations; and
- Income (loss) from the initial adoption of new accounting standards.

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

- Excluded realized gain (loss);
- Revenue adjustments from the initial adoption of new accounting standards;
- Amortization of DFEL arising from changes in GDB and GLB benefit ratio unlocking; and
- Amortization of deferred gains arising from reserve changes on business sold through reinsurance.

We use our prevailing corporate federal income tax rate of 35% while taking into account any permanent differences for events recognized differently in our financial statements and federal income tax returns when reconciling our non-GAAP measures to the most comparable GAAP measure. Operating revenues and income (loss) from operations do not replace revenues and net income as the GAAP measures of our consolidated results of operations.

Segment information (in millions) was as follows:

|  | For the Three<br>Months Ended<br>March 31, |          |
|--|--|----------|
|  | 2014                                       | 2013     |
| Revenues   |  |          |
| Operating revenues:  |  |          |
| Annuities  | \$ 909                                     | \$ 777   |
| Retirement Plan Services   | 271  | 260      |
| Life Insurance   | 1,337                                      | 1,241    |
| Group Protection   | 610  | 550      |
| Other Operations   | 106  | 102      |
| Excluded realized gain (loss), pre-tax   | (58 )                                      | (91 )    |
| Amortization of deferred gain arising<br>from reserve changes on business<br>sold through reinsurance, pre-tax | 1  | 1        |
| Amortization of DFEL associated<br>with benefit ratio unlocking, pre-tax                                       | -  | (1 )     |
| Total revenues   | \$ 3,176                                   | \$ 2,839 |

|  | For the Three<br>Months<br>Ended<br>March 31, |        |
|--|---|--------|
|  | 2014  | 2013   |
| Net Income (Loss)                        |   |        |
| Income (loss) from operations:           |   |        |
| Annuities                                | \$ 216  | \$ 159 |
| Retirement Plan Services                 | 39  | 35     |
| Life Insurance                           | 120   | 112    |
| Group Protection                         | 20  | 14     |
| Other Operations                         | (30 )   | (35 )  |
| Excluded realized gain (loss), after-tax | (38 )   | (60 )  |
| Benefit ratio unlocking, after-tax       | 2   | 14     |
| Net income (loss)                        | \$ 329  | \$ 239 |





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

The following Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the financial condition as of March 31, 2014, compared with December 31, 2013, and the results of operations for the three months ended March 31, 2014, compared with the corresponding period in 2013 of Lincoln National Corporation and its consolidated subsidiaries. Unless otherwise stated or the context otherwise requires, "LNC," "Lincoln," "Company," "we," "our" or "us" refers to Lincoln National Corporation and its consolidated subsidiaries. The MD&A is provided as a supplement to, and should be read in conjunction with our consolidated financial statements and the accompanying notes to the consolidated financial statements ("Notes") presented in "Part I – Item 1. Financial Statements"; our Form 10-K for the year ended December 31, 2013 ("2013 Form 10-K"), including the sections entitled "Part I – Item 1A. Risk Factors," "Part II – Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Part II – Item 8. Financial Statements and Supplementary Data"; and our current reports on Form 8-K filed in 2014.

In this report, in addition to providing consolidated revenues and net income (loss), we also provide segment operating revenues and income (loss) from operations because we believe they are meaningful measures of revenues and the profitability of our operating segments. Financial information that follows is presented in conformity with accounting principles generally accepted in the United States of America ("GAAP"), unless otherwise indicated. See Note 1 in our 2013 Form 10-K for a discussion of GAAP.

Operating revenues and income (loss) from operations are the financial performance measures we use to evaluate and assess the results of our segments. Accordingly, we define and report operating revenues and income (loss) from operations by segment in Note 13. Our management believes that operating revenues and income (loss) from operations explain the results of our ongoing businesses in a manner that allows for a better understanding of the underlying trends in our current businesses because the excluded items are unpredictable and not necessarily indicative of current operating fundamentals or future performance of the business segments, and, in many instances, decisions regarding these items do not necessarily relate to the operations of the individual segments. In addition, we believe that our definitions of operating revenues and income (loss) from operations will provide investors with a more valuable measure of our performance because it better reveals trends in our business.

**FORWARD-LOOKING STATEMENTS – CAUTIONARY LANGUAGE**

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

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

- Deterioration in general economic and business conditions that may affect account values, investment results, guaranteed benefit liabilities, premium levels, claims experience and the level of pension benefit costs, funding and investment results;
- Adverse global capital and credit market conditions could affect our ability to raise capital, if necessary, and may cause us to realize impairments on investments and certain intangible assets, including goodwill and the valuation allowance against deferred tax assets, which may reduce future earnings and/or affect our financial condition and ability to raise additional capital or refinance existing debt as it matures;
- Because of our holding company structure, the inability of our subsidiaries to pay dividends to the holding company in sufficient amounts could harm the holding company's ability to meet its obligations;
- Legislative, regulatory or tax changes, both domestic and foreign, that affect the cost of, or demand for, our subsidiaries' products, the required amount of reserves and/or surplus, or otherwise affect our ability to conduct business, including changes to statutory reserve requirements related to secondary guarantee universal life and annuities; regulations regarding captive reinsurance arrangements; restrictions on revenue sharing and 12b-1 payments; and the potential for U.S. federal tax reform;
- Actions taken by reinsurers to raise rates on in-force business;
- Declines in or sustained low interest rates causing a reduction in investment income, the interest margins of our businesses, estimated gross profits ("EGPs") and demand for our products;
- Rapidly increasing interest rates causing contract holders to surrender life insurance and annuity policies, thereby causing realized investment losses, and reduced hedge performance related to variable annuities;
- Uncertainty about the effect of rules and regulations to be promulgated under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") on us and the economy and financial services sector in particular;
- The initiation of legal or regulatory proceedings against us, and the outcome of any legal or regulatory proceedings, such as: adverse actions related to present or past business practices common in businesses in which we compete; adverse decisions in significant actions including, but not limited to, actions brought by federal and state authorities and class action cases; new decisions that result in changes in law; and unexpected trial court rulings;

- A decline in the equity markets causing a reduction in the sales of our subsidiaries' products, a reduction of asset-based fees that our subsidiaries charge on various investment and insurance products, an acceleration of the net amortization of deferred acquisition costs ("DAC"), value of business acquired ("VOBA"), deferred sales inducements ("DSI") and deferred front-end loads ("DFEL") and an increase in liabilities related to guaranteed benefit features of our subsidiaries' variable annuity products;
- Ineffectiveness of our risk management policies and procedures, including various hedging strategies used to offset the effect of changes in the value of liabilities due to changes in the level and volatility of the equity markets and interest rates;
- A deviation in actual experience regarding future persistency, mortality, morbidity, interest rates or equity market returns from the assumptions used in pricing our subsidiaries' products, in establishing related insurance reserves and in the net amortization of DAC, VOBA, DSI and DFEL, which may reduce future earnings;
- Changes in GAAP, including convergence with International Financial Reporting Standards ("IFRS"), that may result in unanticipated changes to our net income;
- Lowering of one or more of our debt ratings issued by nationally recognized statistical rating organizations and the adverse effect such action may have on our ability to raise capital and on our liquidity and financial condition;
- Lowering of one or more of the insurer financial strength ratings of our insurance subsidiaries and the adverse effect such action may have on the premium writings, policy retention, profitability of our insurance subsidiaries and liquidity;
- Significant credit, accounting, fraud, corporate governance or other issues that may adversely affect the value of certain investments in our portfolios, as well as counterparties to which we are exposed to credit risk, requiring that we realize losses on investments;
- Inability to protect our intellectual property rights or claims of infringement of the intellectual property rights of others;
- Interruption in telecommunication, information technology or other operational systems or failure to safeguard the confidentiality or privacy of sensitive data on such systems from cyber attacks or other breaches of our data security systems;
- The effect of acquisitions and divestitures, restructurings, product withdrawals and other unusual items;
- The adequacy and collectibility of reinsurance that we have purchased;
- Acts of terrorism, a pandemic, war or other man-made and natural catastrophes that may adversely affect our businesses and the cost and availability of reinsurance;
- Competitive conditions, including pricing pressures, new product offerings and the emergence of new competitors, that may affect the level of premiums and fees that our subsidiaries can charge for their products;
- The unknown effect on our subsidiaries' businesses resulting from changes in the demographics of their client base, as aging baby-boomers move from the asset-accumulation stage to the asset-distribution stage of life; and
- Loss of key management, financial planners or wholesalers.

The risks included here are not exhaustive. Our annual report on Form 10-K, current reports on Form 8-K and other documents filed with the Securities and Exchange Commission ("SEC") include additional factors that could affect our businesses and financial performance. Moreover, we operate in a rapidly changing and competitive environment. New risk factors emerge from time to time, and it is not possible for management to predict all such risk factors.

Further, it is not possible to assess the effect of all risk factors on our businesses or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. In addition, we disclaim any obligation to update any forward-looking statements to reflect events or circumstances that occur after the date of this report.

## INTRODUCTION

### Executive Summary

We are a holding company that operates multiple insurance and retirement businesses through subsidiary companies. Through our business segments, we sell a wide range of wealth protection, accumulation and retirement income products and solutions. These products include fixed and indexed annuities, variable annuities, universal life insurance (“UL”), variable universal life insurance (“VUL”), linked-benefit universal life, indexed UL, term life insurance, employer-sponsored retirement plans and services, and group life, disability and dental.

We provide products and services and report results through our Annuities, Retirement Plan Services, Life Insurance and Group Protection segments. We also have Other Operations. These segments and Other Operations are described in “Part I – Item 1. Business” of our 2013 Form 10-K.

For information on how we derive our revenues, see the discussion in results of operations by segment below.

Our current market conditions, significant operational matters, industry trends, issues and outlook are described in “Introduction – Executive Summary” of our 2013 Form 10-K.

For factors that could cause actual results to differ materially from those set forth in this section, see “Forward-Looking Statements – Cautionary Language” above and “Part I – Item 1A. Risk Factors” in our 2013 Form 10-K.

## Critical Accounting Policies and Estimates

The MD&A included in our 2013 Form 10-K contains a detailed discussion of our critical accounting policies and estimates. The following information updates the “Critical Accounting Policies and Estimates” provided in our 2013 Form 10-K and, accordingly, should be read in conjunction with the “Critical Accounting Policies and Estimates” discussed in our 2013 Form 10-K.

### DAC, VOBA, DSI and DFEL

### Reversion to the Mean (“RTM”)

As variable fund returns do not move in a systematic manner, we reset the baseline of account values from which EGPs are projected, which we refer to as our RTM process, as discussed in our 2013 Form 10-K.

Our long-term variable fund growth rate assumption, which is used in the determination of DAC, VOBA, DSI and DFEL amortization for the variable component of our variable annuity and VUL products, is an immediate drop of approximately 16% followed by growth going forward of 7% to 9% depending on the block of business and reflecting differences in contract holder fund allocations between fixed-income and equity-type investments. If we had unlocked our RTM assumption as of March 31, 2014, we would have recorded a favorable unlocking of approximately \$330 million, pre-tax, for Annuities, approximately \$30 million, pre-tax, for Retirement Plan Services, and approximately \$45 million, pre-tax, for Life Insurance.

### Investments

#### Investment Valuation

The following summarizes our available-for-sale (“AFS”) and trading securities and derivative investments carried at fair value by pricing source and fair value hierarchy level (in millions) as of March 31, 2014:

Quoted  
Prices

|  | in Active<br>Markets<br>for<br>Identical<br>Assets | Significant<br>Observable<br>Inputs | Significant<br>Unobservable<br>Inputs | Total<br>Fair<br>Value |
|--|--|-------------------------------------|---------------------------------------|------------------------|
|  | (Level 1)  | (Level 2)                           | (Level 3)                             |                        |
| Priced by third-party pricing services     | \$ 480   | \$ 70,591                           | \$ -                                  | \$ 71,071              |
| Priced by independent broker<br>quotations | -  | -                                   | 1,903                                 | 1,903                  |
| Priced by matrices                         | -  | 12,573                              | -                                     | 12,573                 |
| Priced by other methods (1)                | -  | -                                   | 1,489                                 | 1,489                  |
| Total                                      | \$ 480   | \$ 83,164                           | \$ 3,392                              | \$ 87,036              |
| Percent of total                           | 1%   | 95%                                 | 4%                                    | 100%                   |

(1) Represents primarily securities for which pricing models were used to compute fair value.

For more information about the valuation of our financial instruments carried at fair value, see “Part II – Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Introduction – Critical Accounting Policies and Estimates – Investments – Investment Valuation” in our 2013 Form 10-K and Note 12 herein.

As of March 31, 2014, we evaluated the markets that our securities trade in and concluded that none were inactive. We will continue to re-evaluate this conclusion, as needed, based on market conditions. We use unobservable inputs to measure the fair value of securities trading in less liquid or illiquid markets with limited or no pricing information. We obtain broker quotes for securities such as synthetic convertibles, index-linked certificates of deposit and collateralized debt obligations (“CDOs”) when sufficient security structure or other market information is not available to produce an evaluation. For broker-quoted only securities, non-binding quotes from market makers or broker-dealers are obtained from sources recognized as market participants. Broker-quoted securities are based solely on receipt of updated quotes from a single market maker or a broker-dealer recognized as a market participant. Our broker-quoted only securities are generally classified as Level 3 of the fair value hierarchy. As of March 31, 2014, we used broker quotes for 63 securities as our final price source, representing approximately 1% of total securities owned.

#### Derivatives

Our accounting policies for derivatives and the potential effect on interest spreads in a falling rate environment are discussed in Note 5 of this report and “Part II – Item 7A. Quantitative and Qualitative Disclosures About Market Risk” in our 2013 Form 10-K.





## Guaranteed Living Benefits (“GLB”)

Within our individual annuity business, approximately 72% of our variable annuity account values contained GLB features as of March 31, 2014. Declines in the equity markets increase our exposure to potential benefits with the GLB features, leading to an increase in our existing liability for those benefits. For example, a contract with a GLB feature is “in the money” if the contract holder’s account balance falls below the present value of guaranteed withdrawal or income benefits, assuming no lapses. As of March 31, 2014 and 2013, 4% and 6%, respectively, of all in-force contracts with a GLB feature were “in the money,” and our exposure, after reinsurance, as of March 31, 2014 and 2013, was \$307 million and \$415 million, respectively. However, the only way the contract holder can realize the excess of the present value of benefits over the account value of the contract is through a series of withdrawals or income payments that do not exceed a maximum amount. If, after the series of withdrawals or income payments, the account value is exhausted, the contract holder will receive a series of annuity payments. The account value can also fluctuate with equity market returns on a daily basis resulting in increases or decreases in the excess of the present value of benefits over account value.

For information on our variable annuity hedge program performance, see our discussion in “Realized Gain (Loss) and Benefit Ratio Unlocking – Variable Annuity Net Derivatives Results” below.

The following table presents our estimates of the potential instantaneous effect to net income, which could result from sudden changes that may occur in equity markets, interest rates and implied market volatilities (in millions) at the levels indicated in the table and excludes the net cost of operating the hedging program. The amounts represent the estimated difference between the change in the portion of GLB reserves that is calculated on a fair value basis and the change in the value of the underlying hedge instruments after the amortization of DAC, VOBA, DSI and DFEL and taxes. These effects do not include any estimate of unlocking that could occur, nor do they estimate any change in the non-performance risk (“NPR”) component of the GLB reserve or any estimate of effects to our GLB benefit ratio unlocking. These estimates are based upon the recorded reserves as of March 31, 2014, and the related hedge instruments in place as of that date. The effects presented in the table below are not representative of the aggregate impacts that could result if a combination of such changes to equity market returns, interest rates and implied volatilities occurred.

|                                   | In-Force Sensitivities |         |        |         |
|-----------------------------------|------------------------|---------|--------|---------|
| Equity Market Return              | -20%                   | -10%    | -5%    | 5%      |
| Hypothetical effect to net income | \$ (90)                | \$ (21) | \$ (5) | \$ (3)  |
| Interest Rates                    | -50                    | -25     | +25    | +50     |
|                                   | bps                    | bps     | bps    | bps     |
| Hypothetical effect to net income | \$ (16)                | \$ (4)  | \$ (3) | \$ (14) |
| Implied Volatilities              | -4%                    | -2%     | 2%     | 4%      |

Hypothetical effect to net income \$ 6 \$ 3 \$ (3) \$ (6 )

The following table shows the effect (dollars in millions) of indicated changes in equity market returns, interest rate scenarios and market-implied volatilities:

|            | Assumptions of Changes In |           |              | Hypothetical |
|------------|---------------------------|-----------|--------------|--------------|
|            | Equity                    | Interest  | Market       | Effect to    |
|            | Market                    | Rate      | Implied      | Net          |
|            | Return                    | Yields    | Volatilities | Income       |
| Scenario 1 | -5%                       | -12.5 bps | +1%          | \$ (12 )     |
| Scenario 2 | -10%                      | -25.0 bps | +2%          | (44 )        |
| Scenario 3 | -20%                      | -50.0 bps | +4%          | (181 )       |

The actual effects of the results illustrated in the two tables above could vary significantly depending on a variety of factors, many of which are out of our control, and consideration should be given to the following:

- The analysis is only valid as of March 31, 2014, due to changing market conditions, contract holder activity, hedge positions and other factors;
- The analysis assumes instantaneous shifts in the capital market factors and no ability to rebalance hedge positions prior to the market changes;
- The analysis assumes constant exchange rates and implied dividend yields;
- Assumptions regarding shifts in the market factors, such as assuming parallel shifts in interest rate and implied volatility term structures, may be overly simplistic and not indicative of actual market behavior in stress scenarios;
- It is very unlikely that one capital market sector (e.g., equity markets) will sustain such a large instantaneous movement without affecting other capital market sectors; and
- The analysis assumes that there is no tracking or basis risk between the funds and/or indices affecting the GLB reserves and the instruments utilized to hedge these exposures.

## Acquisitions and Dispositions

For information about acquisitions and divestitures, see Note 3 in our 2013 Form 10-K.

## RESULTS OF CONSOLIDATED OPERATIONS

Details underlying the consolidated results, deposits, net flows and account values (in millions) were as follows:

|  | For the Three<br>Months<br>Ended<br>March 31, |        |        |
|--|---|--------|--------|
|  | 2014  | 2013   | Change |
| Net Income (Loss)                        |   |        |        |
| Income (loss) from operations:           |   |        |        |
| Annuities                                | \$ 216  | \$ 159 | 36%    |
| Retirement Plan Services                 | 39  | 35     | 11%    |
| Life Insurance                           | 120   | 112    | 7%     |
| Group Protection                         | 20  | 14     | 43%    |
| Other Operations                         | (30 )   | (35 )  | 14%    |
| Excluded realized gain (loss), after-tax | (38 )   | (60 )  | 37%    |
| Benefit ratio unlocking, after-tax       | 2   | 14     | -86%   |
| Net income (loss)                        | \$ 329  | \$ 239 | 38%    |

|  | For the Three<br>Months Ended<br>March 31, |      |        |
|--|--|------|--------|
|  | 2014                                       | 2013 | Change |

|                          |          |          |    |
|--------------------------|----------|----------|----|
| Deposits                 |          |          |    |
| Annuities                | \$ 3,379 | \$ 3,219 | 5% |
| Retirement Plan Services | 1,758    | 1,667    | 5% |
| Life Insurance           | 1,266    | 1,240    | 2% |
| Total deposits           | \$ 6,403 | \$ 6,126 | 5% |

|                          |          |          |      |
|--------------------------|----------|----------|------|
| Net Flows                |          |          |      |
| Annuities                | \$ 695   | \$ 885   | -21% |
| Retirement Plan Services | (361 )   | 344      | NM   |
| Life Insurance           | 829      | 848      | -2%  |
| Total net flows          | \$ 1,163 | \$ 2,077 | -44% |

|                          |                 |            |        |
|--------------------------|-----------------|------------|--------|
|                          | As of March 31, |            |        |
|                          | 2014            | 2013       | Change |
| Account Values           |                 |            |        |
| Annuities                | \$ 116,784      | \$ 101,414 | 15%    |
| Retirement Plan Services | 51,851          | 46,442     | 12%    |
| Life Insurance           | 40,552          | 38,018     | 7%     |
| Total account values     | \$ 209,187      | \$ 185,874 | 13%    |

#### Comparison of the Three Months Ended March 31, 2014 to 2013

Net income increased due primarily to the following:

- Growth in account values, insurance in force and group earned premiums;
- Lower losses on variable annuity net derivatives results during 2014; and
- More favorable investment income on alternative investments.

The increase in net income was partially offset primarily by the following:

- Higher death claims in our Life Insurance segment and unfavorable disability results in our Group Protection segment; and
- Spread compression due to new money rates averaging below our current portfolio yields, partially offset by actions implemented to reduce interest crediting rates.



## RESULTS OF ANNUITIES

## Income (Loss) from Operations

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

|  | For the Three<br>Months Ended<br>March 31, |        |        |
|--|--|--------|--------|
|  | 2014                                       | 2013   | Change |
| Operating Revenues                         |  |        |        |
| Insurance premiums (1)                     | \$ 45                                      | \$ 33  | 36%    |
| Fee income                                 | 464  | 369    | 26%    |
| Net investment income                      | 259  | 257    | 1%     |
| Operating realized gain (loss) (2)         | 39   | 31     | 26%    |
| Other revenues (3)                         | 102  | 87     | 17%    |
| Total operating revenues                   | 909  | 777    | 17%    |
| Operating Expenses                         |  |        |        |
| Interest credited                          | 154  | 153    | 1%     |
| Benefits                                   | 87   | 65     | 34%    |
| Commissions and other expenses             | 402  | 365    | 10%    |
| Total operating expenses                   | 643  | 583    | 10%    |
| Income (loss) from operations before taxes | 266  | 194    | 37%    |
| Federal income tax expense (benefit)       | 50   | 35     | 43%    |
| Income (loss) from operations              | \$ 216                                     | \$ 159 | 36%    |

(1) Includes primarily our income annuities, which have a corresponding offset in benefits for changes in reserves.

(2) See "Realized Gain (Loss) and Benefit Ratio Unlocking" below.

(3) Consists primarily of revenues attributable to broker-dealer services that are subject to market volatility.

## Comparison of the Three Months Ended March 31, 2014 to 2013

Income from operations for this segment increased due primarily to higher fee income driven by higher average daily variable account values.

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

- Higher commissions and other expenses due to higher account values, resulting in higher trail commissions, and higher incentive compensation as a result of higher earnings and production performance relative to planned goals. These increases were partially offset by higher average equity markets than our model projections assumed resulting in a lower amortization rate.
- Higher benefits attributable to an increase in the growth in benefit reserves due to a higher proportion of account values covered by guaranteed living benefit riders.

We provide information about this segment's operating revenue and operating expense line items, the period in which amounts are recognized, key drivers of changes and historical details underlying the line items and their associated drivers below.

See the Variable Account Value Information table within "Fee Income" below for drivers of changes in our variable account values and the Fixed Account Value Information table within "Net Investment Income and Interest Credited" below for drivers of changes in our fixed account values.

#### Additional Information

New deposits are an important component of net flows and key to our efforts to grow our business. Although deposits do not significantly affect current period income from operations, they are an important indicator of future profitability. We continue to monitor the marketplace and economic environment and make changes to our product offerings as needed to sustain the future profitability of our segment.

The other component of net flows relates to the retention of the business. An important measure of retention is the lapse rate, which compares the amount of withdrawals to the average account values. The overall lapse rate for our annuity products was 7% for the three months ended March 31, 2014, compared to 8% for the corresponding period in 2013.

Our fixed annuity business includes products with discretionary crediting rates that are reset on an annual basis and are not subject to surrender charges. Our ability to retain annual reset annuities will be subject to current competitive conditions at the time interest rates

for these products reset. We expect to manage the effects of spreads on near-term income from operations through portfolio management and, to a lesser extent, crediting rate actions, which assumes no significant changes in net flows into or out of our fixed accounts or other changes that may cause interest rate spreads to differ from our expectations. For information on interest rate spreads and interest rate risk, see “Item 3. Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk” herein and “Item 7A. Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk – Interest Rate Risk on Fixed Insurance Businesses – Falling Rates” and “Part I – Item 1A. Risk Factors – Market Conditions – Changes in interest rates and sustained low interest rates may cause interest rate spreads to decrease and changes in interest rates may also result in increased contract withdrawals” in our 2013 Form 10-K.

For factors that could cause actual results to differ materially from those set forth in this section, see “Forward-Looking Statements – Cautionary Language” above and “Part I – Item 1A. Risk Factors” in our 2013 Form 10-K.

### Fee Income

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

|  | For the Three<br>Months<br>Ended<br>March 31, |        |        |
|--|---|--------|--------|
|  | 2014  | 2013   | Change |
| Fee Income                               |   |        |        |
| Mortality, expense and other assessments | \$ 457  | \$ 364 | 26%    |
| Surrender charges                        | 8   | 5      | 60%    |
| DFEL:                                    |   |        |        |
| Deferrals                                | (8 )  | (5 )   | -60%   |
| Amortization, net of interest            | 7   | 5      | 40%    |
| Total fee income                         | \$ 464  | \$ 369 | 26%    |

As of or For the  
Three  
Months Ended



|  | March 31, |          |        |
|--|-----------|----------|--------|
|  | 2014      | 2013     | Change |
| Variable Account Value Information   |           |          |        |
| Variable annuity deposits (1)  | \$ 2,291  | \$ 2,157 | 6%     |
| Increases (decreases) in variable annuity account values:  |           |          |        |
| Net flows (1)  | 103       | 333      | -69%   |
| Change in market value (1)   | 788       | 3,715    | -79%   |
| Transfers to the variable portion of variable annuity products from the fixed portion of variable annuity products |           |          |        |
|  | 798       | 762      | 5%     |
| Variable annuity account values (1)  | 95,512    | 80,312   | 19%    |
| Average daily variable annuity account values (1)  | 94,058    | 78,489   | 20%    |
| Average daily S&P 500  | 1,835     | 1,515    | 21%    |

(1) Excludes the fixed portion of variable.

We charge contract holders mortality and expense assessments on variable annuity accounts to cover insurance and administrative expenses. These assessments are a function of the rates priced into the product and the average daily variable account values. Average daily account values are driven by net flows and variable fund returns. In addition, for our fixed annuity contracts and for some variable contracts, we collect surrender charges when contract holders surrender their contracts during their surrender charge periods to protect us from premature withdrawals. Fee income includes charges on both our variable and fixed annuity products, but excludes the attributed fees on our GLB products; see “Part II – Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Realized Gain (Loss) and Benefit Ratio Unlocking – Operating Realized Gain (Loss)” in our 2013 Form 10-K for discussion of these attributed fees.

## Net Investment Income and Interest Credited

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

|  | For the Three<br>Months<br>Ended<br>March 31, |        |        |
|--|---|--------|--------|
|  | 2014  | 2013   | Change |
| <b>Net Investment Income</b>   |   |        |        |
| Fixed maturity securities, mortgage loans<br>on real estate and other, net of<br>investment expenses | \$ 216  | \$ 227 | -5%    |
| Commercial mortgage loan prepayment and<br>bond make-whole premiums (1)                              | 4   | 4      | 0%     |
| Surplus investments (2)  | 39  | 26     | 50%    |
| Total net investment income  | \$ 259  | \$ 257 | 1%     |
| <b>Interest Credited</b>   |   |        |        |
| Amount provided to contract holders  | \$ 146  | \$ 144 | 1%     |
| DSI deferrals  | (2 )  | (2 )   | 0%     |
| Interest credited before DSI amortization  | 144   | 142    | 1%     |
| DSI amortization   | 10  | 11     | -9%    |
| Total interest credited  | \$ 154  | \$ 153 | 1%     |

(1) See “Consolidated Investments – Commercial Mortgage Loan Prepayment and Bond Make-Whole Premiums” below for additional information.

(2) Represents net investment income on the required statutory surplus for this segment and includes the effect of investment income on alternative investments for such assets that are held in the portfolios supporting statutory surplus versus the portfolios supporting product liabilities.

|  | For the Three<br>Months Ended<br>March 31, |       |                          |
|--|--|-------|--------------------------|
|  | 2014                                       | 2013  | Basis<br>Point<br>Change |
| <b>Interest Rate Spread</b>  |  |       |                          |
| Fixed maturity securities, mortgage loans<br>on real estate and other, net of<br>investment expenses | 4.55%                                      | 4.78% | (23 )                    |
| Commercial mortgage loan prepayment and<br>bond make-whole premiums                                  | 0.08%                                      | 0.09% | (1 )                     |

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|  |       |       |     |   |
|--|-------|-------|-----|---|
| Net investment income yield on reserves    | 4.63% | 4.87% | (24 | ) |
| Interest rate credited to contract holders | 2.81% | 2.77% | 4   |   |
| Interest rate spread                       | 1.82% | 2.10% | (28 | ) |

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|   | As of or For the<br>Three<br>Months Ended<br>March 31, |          |        |
|---|--|----------|--------|
|   | 2014   | 2013     | Change |
| Fixed Account Value Information   |  |          |        |
| Fixed annuity deposits (1)  | \$ 1,088   | \$ 1,062 | 2%     |
| Increases (decreases) in fixed annuity<br>account values:   |  |          |        |
| Net flows (1)   | 592  | 552      | 7%     |
| Transfers from the fixed portion<br>of variable annuity products to<br>the variable portion of variable<br>annuity products | (798 )   | (762 )   | -5%    |
| Reinvested interest credited (1)  | 192  | 278      | -31%   |
| Fixed annuity account values (1)  | 21,272   | 21,102   | 1%     |
| Average fixed account values (1)  | 21,224   | 21,056   | 1%     |
| Average invested assets on reserves   | 19,102   | 18,980   | 1%     |

(1) Includes the fixed portion of variable.

A portion of our investment income earned is credited to the contract holders of our fixed annuity products, including the fixed portion of variable annuity contracts. We expect to earn a spread between what we earn on the underlying general account investments supporting the fixed annuity product line, including the fixed portion of variable annuity contracts, and what we credit to our fixed annuity contract holders' accounts, including the fixed portion of variable annuity contracts. Changes in commercial mortgage loan prepayments and bond make-whole premiums, investment income on alternative investments and surplus investment income can vary significantly from period to period due to a number of factors and, therefore, may contribute to investment income results that are not indicative of the underlying trends.

## Benefits

Benefits for this segment include changes in income annuity reserves driven by premiums, changes in benefit reserves and our expected costs associated with purchases of derivatives used to hedge our benefit ratio unlocking on benefit reserves associated with our guaranteed death benefit riders.

## Commissions and Other Expenses

Details underlying commissions and other expenses (in millions) were as follows:

|  | For the Three<br>Months Ended<br>March 31, |        |        |
|--|--|--------|--------|
|  | 2014                                       | 2013   | Change |
| Commissions and Other Expenses   |  |        |        |
| Commissions:   |  |        |        |
| Deferrable   | \$ 146                                     | \$ 142 | 3%     |
| Non-deferrable   | 104  | 87     | 20%    |
| General and administrative expenses  | 105  | 95     | 11%    |
| Inter-segment reimbursement associated<br>with reserve financing and<br>LOC expenses (1) | 1  | 1      | 0%     |
| Taxes, licenses and fees   | 13   | 10     | 30%    |
| Total expenses incurred, excluding<br>broker-dealer                                      | 369  | 335    | 10%    |
| DAC deferrals  | (165 )                                     | (163 ) | -1%    |
| Total pre-broker-dealer expenses<br>incurred, excluding amortization,<br>net of interest | 204  | 172    | 19%    |
| DAC and VOBA amortization,<br>net of interest:   |  |        |        |
| Amortization, net of interest,<br>excluding unlocking                                    | 100  | 103    | -3%    |
| Unlocking  | -  | 2      | -100%  |
| Broker-dealer expenses incurred  | 98   | 88     | 11%    |
| Total commissions and other<br>expenses  | \$ 402                                     | \$ 365 | 10%    |
| DAC Deferrals  |  |        |        |
| As a percentage of sales/deposits  | 4.9%                                       | 5.1%   |        |

(1) Includes reimbursements to Annuities from the Life Insurance segment for reserve financing, net of expenses incurred by Annuities for its use of letters of credit (“LOCs”). The inter-segment amounts are not reported on our Consolidated Statements of Comprehensive Income (Loss).

Commissions and other costs that result directly from and are essential to the successful acquisition of new or renewal business are deferred to the extent recoverable and are amortized over the lives of the contracts in relation to EGPs. Certain of our commissions, such as trail commissions that are based on account values, are expensed as incurred rather than deferred and amortized.

Broker-dealer expenses that vary with and are related to sales are expensed as incurred and not deferred and amortized. Fluctuations in these expenses correspond with fluctuations in other revenues.

## RESULTS OF RETIREMENT PLAN SERVICES

## Income (Loss) from Operations

Details underlying the results for Retirement Plan Services (in millions) were as follows:

|  | For the Three<br>Months Ended<br>March 31, |       |        |
|--|--|-------|--------|
|  | 2014                                       | 2013  | Change |
| Operating Revenues                         |  |       |        |
| Fee income                                 | \$ 61                                      | \$ 56 | 9%     |
| Net investment income                      | 207  | 202   | 2%     |
| Other revenues (1)                         | 3  | 2     | 50%    |
| Total operating revenues                   | 271  | 260   | 4%     |
| Operating Expenses                         |  |       |        |
| Interest credited                          | 118  | 117   | 1%     |
| Commissions and other expenses             | 100  | 95    | 5%     |
| Total operating expenses                   | 218  | 212   | 3%     |
| Income (loss) from operations before taxes | 53   | 48    | 10%    |
| Federal income tax expense (benefit)       | 14   | 13    | 8%     |
| Income (loss) from operations              | \$ 39                                      | \$ 35 | 11%    |

(1) Consists primarily of mutual fund account program revenues for mid to large employers.

## Comparison of the Three Months Ended March 31, 2014 to 2013

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

- Higher fee income driven by higher average daily account values.
- Higher net investment income, net of interest credited, driven by more favorable investment income on alternative investments within our surplus portfolio. These increases were partially offset by spread compression due to new money rates averaging below our current portfolio yields.

The increase in income from operations was partially offset primarily by higher commissions and other expenses due to higher incentive compensation as a result of higher earnings and production performance relative to planned goals.

We provide information about this segment's operating revenue and operating expense line items, the period in which amounts are recognized, key drivers of changes and historical details underlying the line items and their associated drivers below.

See the Variable Account Value Information table within "Fee Income" below for drivers of changes in our variable account values and the Fixed Account Value Information table within "Net Investment Income and Interest Credited" below for drivers of changes in our fixed account values.

#### Additional Information

We expect to continue making strategic investments during 2014 to improve our infrastructure and expand distribution that will result in higher expenses.

Net flows in this business fluctuate based on the timing of larger plans being implemented on our platform and terminating over the course of the year, and we expect this trend will continue during 2014.

New deposits are an important component of net flows and key to our efforts to grow our business. Although deposits do not significantly affect current period income from operations, they are an important indicator of future profitability. The other component of net flows relates to the retention of the business. An important measure of retention is the lapse rate, which compares the amount of withdrawals to the average account values. The overall lapse rate for our annuity and mutual fund products was 16% for the three months ended March 31, 2014, compared to 12% for the corresponding period in 2013.

Our lapse rate is negatively affected by the continued net outflows from our oldest blocks of annuities business (as presented on our Account Value Roll Forward table below as "Multi-Fund® and Other Variable Annuities"), which are also our higher margin product lines in this segment, due to the fact that they are mature blocks with much of the account values out of their surrender charge period. The proportion of these products to our total account values was 33% and 35% as of March 31, 2014 and 2013, respectively. Due to this



expected overall shift in business mix toward products with lower returns, a significant increase in new deposit production continues to be necessary to maintain earnings at current levels.

Our fixed annuity business includes products with discretionary and index-based crediting rates that are reset on a quarterly basis. Our ability to retain quarterly reset annuities will be subject to current competitive conditions at the time interest rates for these products reset. We expect to manage the effects of spreads on near-term income from operations through portfolio management and, to a lesser extent, crediting rate actions, which assumes no significant changes in net flows into or out of our fixed accounts or other changes that may cause interest rate spreads to differ from our expectations. For information on interest rate spreads and interest rate risk, see “Item 3. Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk” herein and “Item 7A. Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk – Interest Rate Risk on Fixed Insurance Businesses – Falling Rates” and “Part I – Item 1A. Risk Factors – Market Conditions – Changes in interest rates and sustained low interest rates may cause interest rate spreads to decrease and changes in interest rates may also result in increased contract withdrawals” in our 2013 Form 10-K.

For factors that could cause actual results to differ materially from those set forth in this section, see “Forward-Looking Statements – Cautionary Language” above and “Part I – Item 1A. Risk Factors” in our 2013 Form 10-K.

## Fee Income

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

|                             | For the<br>Three<br>Months<br>Ended<br>March 31, |       |        |
|-----------------------------|--|-------|--------|
|                             | 2014   | 2013  | Change |
| Fee Income                  |  |       |        |
| Annuity expense assessments | \$ 49  | \$ 46 | 7%     |
| Mutual fund fees            | 12   | 9     | 33%    |
| Total expense assessments   | 61   | 55    | 11%    |
| Surrender charges           | -  | 1     | -100%  |
| Total fee income            | \$ 61  | \$ 56 | 9%     |

|  | For the Three<br>Months Ended<br>March 31, |           |        |
|--|--|-----------|--------|
|  | 2014                                       | 2013      | Change |
| Account Value Roll Forward (1)                 |  |           |        |
| Small Market:                                  |  |           |        |
| Balance as of beginning-of-year                | \$ 8,203                                   | \$ 7,001  | 17%    |
| Gross deposits                                 | 470  | 407       | 15%    |
| Withdrawals and deaths                         | (510 )                                     | (409 )    | -25%   |
| Net flows                                      | (40 )                                      | (2 )      | NM     |
| Transfers between fixed and variable accounts  | -  | (14 )     | 100%   |
| Investment increase and change in market value | 60   | 388       | -85%   |
| Balance as of end-of-period                    | \$ 8,223                                   | \$ 7,373  | 12%    |
| Mid – Large Market:                            |  |           |        |
| Balance as of beginning-of-year                | \$ 26,468                                  | \$ 21,050 | 26%    |
| Gross deposits                                 | 1,111                                      | 1,099     | 1%     |
| Withdrawals and deaths                         | (1,213 )                                   | (532 )    | NM     |
| Net flows                                      | (102 )                                     | 567       | NM     |
| Transfers between fixed and variable accounts  | 9  | 13        | -31%   |
| Investment increase and change in market value | 333  | 1,146     | -71%   |
| Balance as of end-of-period                    | \$ 26,708                                  | \$ 22,776 | 17%    |
| Multi-Fund® and Other Variable Annuities:      |  |           |        |
| Balance as of beginning-of-year                | \$ 16,947                                  | \$ 15,880 | 7%     |
| Gross deposits                                 | 177  | 161       | 10%    |
| Withdrawals and deaths                         | (396 )                                     | (382 )    | -4%    |
| Net flows                                      | (219 )                                     | (221 )    | 1%     |
| Investment increase and change in market value | 192  | 634       | -70%   |
| Balance as of end-of-period                    | \$ 16,920                                  | \$ 16,293 | 4%     |
| Total Annuities and Mutual Funds:              |  |           |        |
| Balance as of beginning-of-year                | \$ 51,618                                  | \$ 43,931 | 17%    |
| Gross deposits                                 | 1,758                                      | 1,667     | 5%     |
| Withdrawals and deaths                         | (2,119 )                                   | (1,323 )  | -60%   |
| Net flows                                      | (361 )                                     | 344       | NM     |
| Transfers between fixed and variable accounts  | 9  | (1 )      | NM     |
| Investment increase and change in market value | 585  | 2,168     | -73%   |
| Balance as of end-of-period                    | \$ 51,851                                  | \$ 46,442 | 12%    |

- (1) Includes mutual fund account values and other third-party trustee-held assets. These items are not included in the separate accounts reported on our Consolidated Balance Sheets as we do not have any ownership interest in them.

|  | As of or For the   |        |        |
|--|--------------------|--------|--------|
|  | Three Months Ended |        |        |
|  | March 31,          |        |        |
|  | 2014               | 2013   | Change |
| Variable Account Value Information   |                    |        |        |
| Variable annuity deposits (1)  | \$ 361             | \$ 437 | -17%   |
| Increases (decreases) in variable annuity account values:  |                    |        |        |
| Net flows (1)  | (229 )             | (86 )  | NM     |
| Change in market value (1)   | 164                | 930    | -82%   |
| Transfers from the variable portion of variable annuity products to the fixed portion of variable annuity products |                    |        |        |
|  | (55 )              | (78 )  | 29%    |
| Variable annuity account values (1)  | 15,190             | 14,233 | 7%     |
| Average daily variable annuity account values (1)  | 15,122             | 13,970 | 8%     |
| Average daily S&P 500  | 1,835              | 1,515  | 21%    |

(1) Excludes the fixed portion of variable.

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

#### Net Investment Income and Interest Credited

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

|                       | For the Three |      |        |
|-----------------------|---------------|------|--------|
|                       | Months Ended  |      |        |
|                       | March 31,     |      |        |
|                       | 2014          | 2013 | Change |
| Net Investment Income |               |      |        |

|  |        |        |     |
|--|--------|--------|-----|
| Fixed maturity securities, mortgage loans<br>on real estate and other, net of<br>investment expenses | \$ 184 | \$ 184 | 0%  |
| Commercial mortgage loan prepayment and<br>bond make-whole premiums (1)                              | 5      | 4      | 25% |
| Surplus investments (2)  | 18     | 14     | 29% |
| Total net investment income  | \$ 207 | \$ 202 | 2%  |
| Interest Credited  | \$ 118 | \$ 117 | 1%  |

(1) See “Consolidated Investments – Commercial Mortgage Loan Prepayment and Bond Make-Whole Premiums” below for additional information.

(2) Represents net investment income on the required statutory surplus for this segment and includes the effect of investment income on alternative investments for such assets that are held in the portfolios supporting statutory surplus versus the portfolios supporting product liabilities.

|  | For the Three<br>Months Ended |                   |     | Basis           |
|--|-------------------------------|-------------------|-----|-----------------|
|  | March 31,<br>2014             | March 31,<br>2013 |     | Point<br>Change |
| <b>Interest Rate Spread</b>  |                               |                   |     |                 |
| Fixed maturity securities, mortgage loans<br>on real estate and other, net of<br>investment expenses | 4.89%                         | 5.02%             | (13 | )               |
| Commercial mortgage loan prepayment and<br>bond make-whole premiums                                  | 0.12%                         | 0.10%             | 2   |                 |
| Net investment income yield on reserves  | 5.01%                         | 5.12%             | (11 | )               |
| Interest rate credited to contract holders   | 3.06%                         | 3.14%             | (8  | )               |
| Interest rate spread   | 1.95%                         | 1.98%             | (3  | )               |

|   | As of or For the<br>Three<br>Months Ended |                   |  |        |
|---|---|-------------------|--|--------|
|   | March 31,<br>2014                         | March 31,<br>2013 |  | Change |
| <b>Fixed Account Value Information</b>  |   |                   |  |        |
| Fixed annuity deposits (1)  | \$ 508                                    | \$ 443            |  | 15%    |
| Increases (decreases) in fixed annuity<br>account values:   |   |                   |  |        |
| Net flows (1)   | (91 )                                     | (13 )             |  | NM     |
| Transfers to the fixed portion of<br>variable annuity products from<br>the variable portion of variable<br>annuity products | 55  | 78                |  | -29%   |
| Reinvested interest credited (1)  | 116                                       | 113               |  | 3%     |
| Fixed annuity account values (1)  | 15,397                                    | 14,896            |  | 3%     |
| Average fixed account values (1)  | 15,373                                    | 14,809            |  | 4%     |
| Average invested assets on reserves   | 15,149                                    | 14,755            |  | 3%     |

(1) Includes the fixed portion of variable.

A portion of our investment income earned is credited to the contract holders of our fixed annuity products, including the fixed portion of variable annuity contracts. We expect to earn a spread between what we earn on the underlying general account investments supporting the fixed annuity product line, including the fixed portion of variable annuity

contracts, and what we credit to our fixed annuity contract holders' accounts, including the fixed portion of variable annuity contracts. Commercial mortgage loan prepayments and bond make-whole premiums, investment income on alternative investments and surplus investment income can vary significantly from period to period due to a number of factors and, therefore, may contribute to investment income results that are not indicative of the underlying trends.

#### Benefits

Benefits for this segment include changes in benefit reserves and our expected costs associated with purchases of derivatives used to hedge our benefit ratio unlocking.

## Commissions and Other Expenses

Details underlying commissions and other expenses (in millions) were as follows:

|  | For the Three<br>Months Ended<br>March 31, |       |        |
|--|--|-------|--------|
|  | 2014                                       | 2013  | Change |
| Commissions and Other Expenses                   |  |       |        |
| Commissions:                                     |  |       |        |
| Deferrable                                       | \$ 3                                       | \$ 4  | -25%   |
| Non-deferrable                                   | 15   | 14    | 7%     |
| General and administrative expenses              | 73   | 72    | 1%     |
| Taxes, licenses and fees                         | 7  | 5     | 40%    |
| Total expenses incurred                          | 98   | 95    | 3%     |
| DAC deferrals                                    | (8 )                                       | (9 )  | 11%    |
| Total expenses recognized before<br>amortization | 90   | 86    | 5%     |
| DAC and VOBA amortization, net of<br>interest    | 10   | 9     | 11%    |
| Total commissions and other<br>expenses          | \$ 100                                     | \$ 95 | 5%     |
| <br>DAC Deferrals                                |  |       |        |
| As a percentage of annuity sales/deposits        | 0.9%                                       | 1.0%  |        |

Commissions and other costs that result directly from and are essential to the successful acquisition of new or renewal business are deferred to the extent recoverable and are amortized over the lives of the contracts in relation to EGPs. Certain of our commissions, such as trail commissions that are based on account values, are expensed as incurred rather than deferred and amortized. Distribution expenses associated with the sale of mutual fund products are expensed as incurred.

## RESULTS OF LIFE INSURANCE

## Income (Loss) from Operations

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



|  | For the Three<br>Months Ended<br>March 31, |        |        |
|--|--|--------|--------|
|  | 2014                                       | 2013   | Change |
| Operating Revenues                         |  |        |        |
| Insurance premiums (1)                     | \$ 132                                     | \$ 113 | 17%    |
| Fee income                                 | 574  | 533    | 8%     |
| Net investment income                      | 624  | 585    | 7%     |
| Operating realized gain (loss) (2)         | 1  | 2      | -50%   |
| Other revenues                             | 6  | 8      | -25%   |
| Total operating revenues                   | 1,337                                      | 1,241  | 8%     |
| Operating Expenses                         |  |        |        |
| Interest credited                          | 334  | 320    | 4%     |
| Benefits                                   | 541  | 505    | 7%     |
| Commissions and other expenses             | 284  | 249    | 14%    |
| Total operating expenses                   | 1,159                                      | 1,074  | 8%     |
| Income (loss) from operations before taxes | 178  | 167    | 7%     |
| Federal income tax expense (benefit)       | 58   | 55     | 5%     |
| Income (loss) from operations              | \$ 120                                     | \$ 112 | 7%     |

(1) Includes term insurance premiums, which have a corresponding partial offset in benefits for changes in reserves.

(2) See "Realized Gain (Loss) and Benefit Ratio Unlocking" below.

Comparison of the Three Months Ended March 31, 2014 to 2013

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

- Higher fee income due to growth in business in force.
- Higher net investment income, net of interest credited, driven by more favorable investment income on alternative investments.

This increase in income from operations was partially offset primarily by the following:

- Higher benefits due to higher death claims.
- Higher commissions and other expenses due to growth in business in force and lower margins than our model projections assumed.

We provide information about this segment's operating revenue and operating expense line items, the period in which amounts are recognized, key drivers of changes and historical details underlying the line items and their associated drivers below.

See "Consolidated Investments – Alternative Investments" below for more information on alternative investments.

#### Strategies to Address Statutory Reserve Strain

Our insurance subsidiaries have statutory surplus and risk-based capital ("RBC") levels above current regulatory required levels. Term products and UL products containing secondary guarantees require reserves calculated pursuant to the Valuation of Life Insurance Policies Model Regulation ("XXX") and Actuarial Guideline 38 ("AG38"), respectively. During the third quarter of 2013, the New York State Department of Financial Services ("NYDFS") announced that it would not recognize the National Association of Insurance Commissioners ("NAIC") revisions in its application of Regulation 147, which is the New York law governing the reserves to be held for UL and VUL products containing secondary guarantees. The change, effective as of December 31, 2013, impacts New York-domiciled companies, including our New York-domiciled insurance subsidiary, the Lincoln Life & Annuity Company of New York ("LLANY"). LLANY discontinued the sale of these products in early 2013, but the change affects those policies sold prior to that time. In 2013, we began phasing in the increase in reserves over a five-year period, which totaled \$180 million as of March 31, 2014. The additional increase in reserves over the remaining years is subject to on-going discussions with the NYDFS. However, we do not expect the amount for each of the remaining years to exceed \$90 million per year. We do not expect the total reserve increase to have a material adverse effect on our financial condition. For more discussion of our strategies to lessen the burden of increased AG38 and XXX statutory reserves associated with UL products containing secondary guarantees and term products containing

long-term premium guarantees on our insurance subsidiaries, see “Part II – Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Results of Life Insurance – Income (Loss) from Operations – Strategies to Address Statutory Reserve Strain” in our 2013 Form 10-K.

Included in the LOCs issued as of March 31, 2014, was approximately \$3.2 billion of long-dated LOCs issued to support inter-company reinsurance arrangements. Approximately \$2.2 billion of such LOCs were issued for UL products containing secondary guarantees (approximately \$1.8 billion will expire in 2031, and approximately \$350 million will expire in 2018). Approximately \$1.0 billion of such LOCs were issued for term business solutions (approximately \$880 million will expire in 2023, and approximately \$155 million is automatically renewable until 2023). We have also used the proceeds from senior note issuances of approximately \$875 million to execute long-term structured solutions supporting UL products containing secondary guarantees. LOCs and related capital market alternatives lower the capital effect of term and UL products containing secondary guarantees. An inability to obtain the necessary LOC capacity or other capital market alternatives could affect our returns on our in-force term and UL products containing secondary guarantees. However, we believe that our insurance subsidiaries have sufficient capital to support the increase in statutory reserves, based on our current reserve projections, if such structures were no longer available. See “Review of Consolidated Financial Condition – Liquidity and Capital Resources – Sources of Liquidity and Cash Flow – Subsidiaries’ Statutory Reserving and Surplus” herein and “Part I – Item 1A. Risk Factors – Legislative, Regulatory and Tax – Attempts to mitigate the impact of Regulation XXX and Actuarial Guideline 38 may fail in whole or in part resulting in an adverse effect on our financial condition and results of operations” in our 2013 Form 10-K for further information on XXX and AG38 reserves. See the table in “Commissions and Other Expenses” below for the presentation of our expenses associated with reserve financing.

#### Additional Information

We expect to manage the effects of spreads on near-term income from operations through portfolio management, which assumes no significant changes in net flows into or out of our fixed accounts or other changes that may cause interest rate spreads to differ from our expectations.

For information on interest rate spreads and interest rate risk, see “Item 3. Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk” herein and “Item 7A. Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk – Interest Rate Risk on Fixed Insurance Businesses – Falling Rates” and “Part I – Item 1A. Risk Factors – Market Conditions – Changes in interest rates and sustained low interest rates may cause interest rate spreads to decrease and changes in interest rates may also result in increased contract withdrawals” in our 2013 Form 10-K.

For factors that could cause actual results to differ materially from those set forth in this section, see “Forward-Looking Statements – Cautionary Language” above and “Part I – Item 1A. Risk Factors” in our 2013 Form 10-K.

### Insurance Premiums

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

### Fee Income

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

|                               | For the Three<br>Months<br>Ended<br>March 31, |        |        |
|-------------------------------|---|--------|--------|
|                               | 2014  | 2013   | Change |
| Fee Income                    |   |        |        |
| Mortality assessments         | \$ 346  | \$ 332 | 4%     |
| Expense assessments           | 228   | 213    | 7%     |
| Surrender charges             | 15  | 16     | -6%    |
| DFEL:                         |   |        |        |
| Deferrals                     | (73 )   | (77 )  | 5%     |
| Amortization, net of interest | 58  | 49     | 18%    |
| Total fee income              | \$ 574  | \$ 533 | 8%     |

|                  | For the Three<br>Months Ended<br>March 31, |      |        |
|------------------|--|------|--------|
|                  | 2014                                       | 2013 | Change |
| Sales by Product |  |      |        |
| UL:              |  |      |        |

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|                                      |        |        |      |
|--------------------------------------|--------|--------|------|
| Excluding MoneyGuard® and indexed UL | \$ 21  | \$ 31  | -32% |
| MoneyGuard®                          | 34     | 46     | -26% |
| Indexed UL                           | 18     | 9      | 100% |
| Total UL                             | 73     | 86     | -15% |
| VUL                                  | 46     | 23     | 100% |
| COLI and BOLI                        | 3      | 26     | -88% |
| Term                                 | 23     | 16     | 44%  |
| Total sales                          | \$ 145 | \$ 151 | -4%  |

|                        |          |          |      |
|------------------------|----------|----------|------|
| Net Flows              |          |          |      |
| Deposits               | \$ 1,266 | \$ 1,240 | 2%   |
| Withdrawals and deaths | (437 )   | (392 )   | -11% |
| Net flows              | \$ 829   | \$ 848   | -2%  |

|                             |        |        |    |
|-----------------------------|--------|--------|----|
| Contract Holder Assessments | \$ 853 | \$ 828 | 3% |
|-----------------------------|--------|--------|----|

|                               | As of March 31, |           |        |
|-------------------------------|-----------------|-----------|--------|
|                               | 2014            | 2013      | Change |
| Account Values                |                 |           |        |
| UL                            | \$ 30,814       | \$ 29,727 | 4%     |
| VUL                           | 7,470           | 6,032     | 24%    |
| Interest-sensitive whole life | 2,268           | 2,259     | 0%     |
| Total account values          | \$ 40,552       | \$ 38,018 | 7%     |

|                            |            |            |    |
|----------------------------|------------|------------|----|
| In-Force Face Amount       |            |            |    |
| UL and other               | \$ 319,414 | \$ 311,588 | 3% |
| Term insurance             | 303,200    | 282,463    | 7% |
| Total in-force face amount | \$ 622,614 | \$ 594,051 | 5% |

Fee income relates only to interest-sensitive products and includes mortality assessments, expense assessments (net of deferrals and amortization related to DFEL) and surrender charges. Mortality and expense assessments are deducted from our contract holders' account values. These amounts are a function of the rates priced into the product and premiums received, face amount in force and account values. Insurance in force, in turn, is driven by sales, persistency and mortality experience.

Sales are not recorded as a component of revenues (other than for traditional products) and do not have a significant effect on current quarter income from operations but are indicators of future profitability. Generally, we have higher sales during the second half of the year with the fourth quarter being our strongest.

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

- MoneyGuard®, our linked-benefit product – 15% of total expected premium deposits;
- Single premium bank-owned UL and VUL (“BOLI”) – 15% of single premium deposits;
- UL, VUL, and corporate-owned UL and VUL (“COLI”) – first year commissionable premiums plus 5% of excess premiums received, including an adjustment for internal replacements of approximately 50% of commissionable premiums; and
- Term – 100% of annualized first year premiums.

UL products with secondary guarantees represented approximately 12% of sales for the three months ended March 31, 2014, as compared to approximately 18% for the corresponding period in 2013. Changes in the marketplace and continuing efforts to increase sales of higher return products in a low interest rate environment are resulting in a shift in our business mix to products like VUL, indexed UL and term that are not primarily focused upon secondary guarantees.

#### Net Investment Income and Interest Credited

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

|   | For the Three<br>Months Ended<br>March 31, |      |        |
|---|--|------|--------|
|   | 2014                                       | 2013 | Change |
| Net Investment Income   |  |      |        |
| Fixed maturity securities, mortgage loans<br>on real estate and other, net of |  |      |        |

|  |        |        |      |
|--|--------|--------|------|
| investment expenses  | \$ 564 | \$ 553 | 2%   |
| Commercial mortgage loan prepayment and bond make-whole premiums (1) | 6      | 3      | 100% |
| Alternative investments (2)  | 16     | -      | NM   |
| Surplus investments (3)  | 38     | 29     | 31%  |
| Total net investment income  | \$ 624 | \$ 585 | 7%   |
| Interest Credited  | \$ 334 | \$ 320 | 4%   |

- (1) See “Consolidated Investments – Commercial Mortgage Loan Prepayment and Bond Make-Whole Premiums” below for additional information.
- (2) See “Consolidated Investments – Alternative Investments” below for additional information.
- (3) Represents net investment income on the required statutory surplus for this segment and includes the effect of investment income on alternative investments for such assets that are held in the portfolios supporting statutory surplus versus the portfolios supporting product liabilities.

|  | For the Three<br>Months Ended |       |     | Basis           |
|--|-------------------------------|-------|-----|-----------------|
|  | March 31,<br>2014             | 2013  |     | Point<br>Change |
| <b>Interest Rate Yields and Spread</b>   |                               |       |     |                 |
| Attributable to interest-sensitive products:   |                               |       |     |                 |
| Fixed maturity securities, mortgage loans<br>on real estate and other, net of<br>investment expenses | 5.46%                         | 5.60% | (14 | )               |
| Commercial mortgage loan prepayment and<br>bond make-whole premiums                                  | 0.04%                         | 0.03% | 1   |                 |
| Alternative investments  | 0.18%                         | 0.00% | 18  |                 |
| Net investment income yield on reserves  | 5.68%                         | 5.63% | 5   |                 |
| Interest rate credited to contract holders   | 3.94%                         | 3.92% | 2   |                 |
| Interest rate spread   | 1.74%                         | 1.71% | 3   |                 |
| Attributable to traditional products:  |                               |       |     |                 |
| Fixed maturity securities, mortgage loans<br>on real estate and other, net of<br>investment expenses | 5.87%                         | 5.70% | 18  |                 |
| Commercial mortgage loan prepayment and<br>bond make-whole premiums                                  | 0.22%                         | 0.05% | 17  |                 |
| Alternative investments  | 0.00%                         | 0.00% | -   |                 |
| Net investment income yield on reserves  | 6.09%                         | 5.75% | 34  |                 |

|  | For the Three<br>Months Ended |           |     |        |
|--|-------------------------------|-----------|-----|--------|
|  | March 31,<br>2014             | 2013      |     | Change |
| <b>Averages</b>                              |                               |           |     |        |
| Attributable to interest-sensitive products: |                               |           |     |        |
| Invested assets on reserves                  | \$ 36,851                     | \$ 35,093 | 5%  |        |
| Account values - universal and whole life    | 33,559                        | 32,391    | 4%  |        |
| Attributable to traditional products:        |                               |           |     |        |
| Invested assets on reserves                  | 4,168                         | 4,352     | -4% |        |

A portion of the investment income earned for this segment is credited to contract holder accounts. Statutory reserves will typically grow at a faster rate than account values because of the AG38 reserve requirements. Invested assets are based upon the statutory reserve liabilities and are affected by various reserve adjustments, including financing



transactions providing relief from AG38 reserve requirements. These financing transactions lead to a transfer of invested assets from this segment to Other Operations. We expect to earn a spread between what we earn on the underlying general account investments and what we credit to our contract holders' accounts. We use our investment income to offset the earnings effect of the associated growth of our policy reserves for traditional products. Commercial mortgage loan prepayments and bond make-whole premiums and investment income on alternative investments can vary significantly from period to period due to a number of factors, and, therefore, may contribute to investment income results that are not indicative of the underlying trends.

## Benefits

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

|   | For the Three<br>Months Ended<br>March 31, |        |        |
|---|--|--------|--------|
|   | 2014                                       | 2013   | Change |
| Benefits  |  |        |        |
| Death claims direct and assumed                                   | \$ 927                                     | \$ 865 | 7%     |
| Death claims ceded  | (415)                                      | (405)  | -2%    |
| Reserves released on death  | (161)                                      | (139)  | -16%   |
| Net death benefits  | 351  | 321    | 9%     |
| Change in secondary guarantee life insurance<br>product reserves: | 120  | 131    | -8%    |
| Other benefits (1)  | 70   | 53     | 32%    |
| Total benefits  | \$ 541                                     | \$ 505 | 7%     |
| Death claims per \$1,000 of in-force                              | 2.27                                       | 2.17   | 5%     |

(1) Includes primarily traditional product changes in reserves and dividends.

Benefits for this segment include claims incurred during the period in excess of the associated reserves for its interest-sensitive and traditional products. In addition, benefits include the change in secondary guarantee life insurance product reserves. The reserve for secondary guarantees is affected by changes in expected future trends of expense assessments causing unlocking adjustments to this liability similar to DAC, VOBA and DFEL. See "Future Contract Benefits and Other Contract Holder Funds" in Note 1 of our 2013 Form 10-K for additional information.

## Commissions and Other Expenses

Details underlying commissions and other expenses (in millions) were as follows:

For the Three  
Months Ended  
March 31,

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|   | 2014   | 2013   | Change |
|---|--------|--------|--------|
| Commissions and Other Expenses                |        |        |        |
| Commissions                                   | \$ 163 | \$ 139 | 17%    |
| General and administrative expenses           | 119    | 114    | 4%     |
| Expenses associated with reserve financing    | 20     | 18     | 11%    |
| Taxes, licenses and fees                      | 42     | 36     | 17%    |
| Total expenses incurred                       | 344    | 307    | 12%    |
| DAC and VOBA deferrals                        | (178 ) | (157 ) | -13%   |
| Total expenses recognized before amortization | 166    | 150    | 11%    |
| DAC and VOBA amortization, net of interest    | 117    | 98     | 19%    |
| Other intangible amortization                 | 1      | 1      | 0%     |
| Total commissions and other expenses          | \$ 284 | \$ 249 | 14%    |
| DAC and VOBA Deferrals                        |        |        |        |
| As a percentage of sales                      | 122.8% | 104.0% |        |

Commissions and costs that result directly from and are essential to successful acquisition of new or renewal business are deferred to the extent recoverable and for our interest-sensitive products are generally amortized over the life of the contracts in relation to EGPs. For our traditional products, DAC and VOBA are amortized on either a straight-line basis or as a level percent of premium of the related contracts, depending on the block of business. When comparing DAC and VOBA deferrals as a percentage of sales for 2014 and 2013, respectively, the increase was primarily a result of changes in sales mix to products with higher commission rates.

## RESULTS OF GROUP PROTECTION

## Income (Loss) from Operations

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

|  | For the Three<br>Months Ended<br>March 31, |        |        |
|--|--|--------|--------|
|  | 2014                                       | 2013   | Change |
| Operating Revenues                         |  |        |        |
| Insurance premiums                         | \$ 562                                     | \$ 508 | 11%    |
| Net investment income                      | 45   | 39     | 15%    |
| Other revenues                             | 3  | 3      | 0%     |
| Total operating revenues                   | 610  | 550    | 11%    |
| Operating Expenses                         |  |        |        |
| Interest credited                          | 1  | 1      | 0%     |
| Benefits                                   | 423  | 384    | 10%    |
| Commissions and other expenses             | 156  | 143    | 9%     |
| Total operating expenses                   | 580  | 528    | 10%    |
| Income (loss) from operations before taxes | 30   | 22     | 36%    |
| Federal income tax expense (benefit)       | 10   | 8      | 25%    |
| Income (loss) from operations              | \$ 20                                      | \$ 14  | 43%    |

|  | For the<br>Three<br>Months<br>Ended<br>March 31, |         |        |
|--|--|---------|--------|
|  | 2014   | 2013    | Change |
| Income (Loss) from Operations by<br>Product Line |  |         |        |
| Life   | \$ 5   | \$ (1 ) | NM     |
| Disability                                       | 13   | 14      | -7%    |

|                               |       |       |     |
|-------------------------------|-------|-------|-----|
| Dental                        | 1     | -     | NM  |
| Total non-medical             | 19    | 13    | 46% |
| Medical                       | 1     | 1     | 0%  |
| Income (loss) from operations | \$ 20 | \$ 14 | 43% |

#### Comparison of the Three Months Ended March 31, 2014 to 2013

Income from operations for this segment increased due primarily to higher insurance premiums driven by business growth in our non-medical products.

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

- Higher benefits due to an increase in business and unfavorable long-term disability incidence net of lower average reserves on new claims; and
- Higher commissions and other expenses attributable to an increase in business as well as strategic investments in technology platforms and distribution expansion efforts.

We provide information about this segment's operating revenue and operating expense line items, the period in which amounts are recognized, key drivers of changes and historical details underlying the line items and their associated drivers below.

#### Additional Information

Management compares trends in actual loss ratios to pricing expectations because group-underwriting risks change over time. We expect normal fluctuations in our composite non-medical loss ratios of this segment, as claims experience is inherently uncertain. During the first quarter of 2014, our total non-medical loss ratio of 74.8% was above our long-term expectation of 71% to 74% due primarily to elevated long-term disability incidence which was partially offset by lower average reserves on new disability claims. Non-medical loss ratios in general are likely to remain at the high end of our long-term expectation of 71% to 74% during 2014. For every one percent increase in the loss ratio, we would expect an approximate annual \$13 million to \$15 million decrease to income from operations.

We continue to evaluate the potential effects that health care reform may have on the value and profitability of this segment's products and income from operations, including, but not limited to, potential changes to traditional sources of income for our brokers who may seek additional portfolio options and/or modification to compensation structures.

For information on the effects of current interest rates on our long-term disability claim reserves, see "Item 3. Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk."

For factors that could cause actual results to differ materially from those set forth in this section, see "Forward-Looking Statements – Cautionary Language" above and "Part I – Item 1A. Risk Factors" in our 2013 Form 10-K.

### Insurance Premiums

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

|                                    | For the Three<br>Months Ended<br>March 31, |        |        |
|------------------------------------|--|--------|--------|
|                                    | 2014                                       | 2013   | Change |
| Insurance Premiums by Product Line |  |        |        |
| Life                               | \$ 237                                     | \$ 205 | 16%    |
| Disability                         | 239  | 219    | 9%     |
| Dental                             | 57   | 51     | 12%    |
| Total non-medical                  | 533  | 475    | 12%    |
| Medical                            | 29   | 33     | -12%   |
| Total insurance premiums           | \$ 562                                     | \$ 508 | 11%    |
| Sales                              | \$ 64                                      | \$ 71  | -10%   |

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

Sales relate to new contract holders and new programs sold to existing contract holders. We believe that the trend in sales is an important indicator of development of business in force over time. Sales in the table above are the combined annualized premiums for our life, disability and dental products. We continue to shift the business mix to employee-paid blocks of business, which we expect will improve the overall profitability of the business.

#### Net Investment Income

We use our investment income to offset the earnings effect of the associated build of our policy reserves, which are a function of our insurance premiums and the yields on our invested assets.

## Benefits and Interest Credited

Details underlying benefits and interest credited (in millions) and loss ratios by product line were as follows:

|   | For the Three<br>Months Ended<br>March 31, |        | Change |
|---|--|--------|--------|
|   | 2014                                       | 2013   |        |
| Benefits and Interest Credited by<br>Product Line |  |        |        |
| Life  | \$ 181                                     | \$ 165 | 10%    |
| Disability  | 176  | 151    | 17%    |
| Dental  | 42   | 39     | 8%     |
| Total non-medical                                 | 399  | 355    | 12%    |
| Medical   | 25   | 30     | -17%   |
| Total benefits and interest credited              | \$ 424                                     | \$ 385 | 10%    |

## Loss Ratios by Product Line

|                   |       |       |
|-------------------|-------|-------|
| Life              | 76.1% | 80.1% |
| Disability        | 73.6% | 69.1% |
| Dental            | 74.0% | 77.4% |
| Total non-medical | 74.8% | 74.8% |
| Medical           | 87.6% | 89.3% |

## Commissions and Other Expenses

Details underlying commissions and other expenses (in millions) were as follows:

|                                | For the Three<br>Months Ended<br>March 31, |       | Change |
|--------------------------------|--|-------|--------|
|                                | 2014                                       | 2013  |        |
| Commissions and Other Expenses |  |       |        |
| Commissions                    | \$ 66                                      | \$ 63 | 5%     |



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|   |        |        |     |
|---|--------|--------|-----|
| General and administrative expenses           | 72     | 67     | 7%  |
| Taxes, licenses and fees                      | 15     | 13     | 15% |
| Total expenses incurred                       | 153    | 143    | 7%  |
| DAC deferrals                                 | (16 )  | (15 )  | -7% |
| Total expenses recognized before amortization | 137    | 128    | 7%  |
| DAC and VOBA amortization, net of interest    | 19     | 15     | 27% |
| Total commissions and other expenses          | \$ 156 | \$ 143 | 9%  |

DAC Deferrals

|                                       |      |      |
|---------------------------------------|------|------|
| As a percentage of insurance premiums | 2.8% | 3.0% |
|---------------------------------------|------|------|

Commissions and other costs that result directly from and are essential to the successful acquisition of new or renewal business are deferred to the extent recoverable and are amortized in relation to the revenues of the related contracts. Certain broker commissions that vary with and are related to paid premiums are expensed as incurred. The level of expenses is an important driver of profitability for this segment as group insurance contracts are offered within an environment that competes on the basis of price and service.

## RESULTS OF OTHER OPERATIONS

## Income (Loss) from Operations

Details underlying the results for Other Operations (in millions) were as follows:

|   | For the Three<br>Months<br>Ended<br>March 31, |          |        |
|---|---|----------|--------|
|   | 2014  | 2013     | Change |
| Operating Revenues  |   |          |        |
| Net investment income   | \$ 73   | \$ 66    | 11%    |
| Amortization of deferred gain on<br>business sold through reinsurance | 18  | 18       | 0%     |
| Media revenues (net)  | 15  | 17       | -12%   |
| Other revenues  | -   | 1        | -100%  |
| Total operating revenues  | 106   | 102      | 4%     |
| Operating Expenses  |   |          |        |
| Interest credited   | 27  | 27       | 0%     |
| Benefits  | 30  | 27       | 11%    |
| Media expenses  | 14  | 15       | -7%    |
| Other expenses  | 14  | 25       | -44%   |
| Interest and debt expense   | 67  | 64       | 5%     |
| Total operating expenses  | 152   | 158      | -4%    |
| Income (loss) from operations before taxes                            | (46 )   | (56 )    | 18%    |
| Federal income tax expense (benefit)                                  | (16 )   | (21 )    | 24%    |
| Income (loss) from operations   | \$ (30 )                                      | \$ (35 ) | 14%    |

## Comparison of the Three Months Ended March 31, 2014 to 2013

Loss from operations for Other Operations decreased due primarily to the following:

- Lower other expenses attributable to the effect of changes in our stock price on our deferred compensations plans, as our stock price modestly decreased during the first quarter of 2014 compared to significantly increasing during the first quarter of 2013 (see “Other Expenses” below for more information); and

- Higher net investment income, net of interest credited, related to higher average invested assets driven by distributable earnings received from our insurance segments, partially offset by repurchases of common stock.

We provide information about Other Operations' operating revenue and operating expense line items, the period in which amounts are recognized, key drivers of changes and historical details underlying the line items and their associated drivers below.

#### Additional Information

For factors that could cause actual results to differ materially from those set forth in this section, see "Forward-Looking Statements – Cautionary Language" above and "Part I – Item 1A. Risk Factors" in our 2013 Form 10-K.

#### Net Investment Income and Interest Credited

We utilize an internal formula to determine the amount of capital that is allocated to our business segments. Investment income on capital in excess of the calculated amounts is reported in Other Operations. If regulations require increases in our insurance segments' statutory reserves and surplus, the amount of capital retained by Other Operations would decrease and net investment income would be negatively affected.

Write-downs for other-than-temporary impairment ("OTTI") decrease the recorded value of our invested assets owned by our business segments. These write-downs are not included in the income from operations of our operating segments. When impairment occurs, assets are transferred to the business segments' portfolios and will reduce the future net investment income for Other Operations, but should not have an effect on a consolidated basis unless the impairments are related to defaulted securities. Statutory reserve adjustments for our business segments can also cause allocations of invested assets between the affected segments and Other Operations.

The majority of our interest credited relates to our reinsurance operations sold to Swiss Re in 2001. A substantial amount of the business was sold through indemnity reinsurance transactions, which is still recorded in our consolidated financial statements. The interest credited corresponds to investment income earnings on the assets we continue to hold for this business. There is no effect to income or

loss in Other Operations or on a consolidated basis for these amounts because interest earned on the blocks that continue to be reinsured is passed through to Swiss Re in the form of interest credited.

## Benefits

Benefits are recognized when incurred for Institutional Pension products and disability income business.

## Other Expenses

Details underlying other expenses (in millions) were as follows:

|  | For the<br>Three<br>Months<br>Ended<br>March 31, |       |        |
|--|--|-------|--------|
|  | 2014   | 2013  | Change |
| General and administrative expenses:   |  |       |        |
| Legal  | \$ 1   | \$ -  | NM     |
| Branding   | 5  | 3     | 67%    |
| Other (1)  | 8  | 23    | -65%   |
| Total general and administrative expenses  | 14   | 26    | -46%   |
| Restructuring charges  | -  | 1     | -100%  |
| Taxes, licenses and fees   | 3  | 1     | 200%   |
| Inter-segment reimbursement associated with reserve financing and LOC expenses (2) | (3 )   | (3 )  | 0%     |
| Total other expenses   | \$ 14  | \$ 25 | -44%   |

(1) Includes expenses that are corporate in nature including charitable contributions, the portion of our deferred compensation plan expense attributable to participants' selection of LNC stock as the measure for their investment return and other expenses not allocated to our business segments.

(2)

Consists of reimbursements to Other Operations from the Life Insurance segment for the use of proceeds from certain issuances of senior notes that were used as long-term structured solutions, net of expenses incurred by Other Operations for its use of LOCs.

#### Interest and Debt Expense

Our current level of interest expense may not be indicative of the future due to, among other things, the timing of the use of cash, the availability of funds from our inter-company cash management program and the future cost of capital. For additional information on our financing activities, see “Review of Consolidated Financial Condition – Liquidity and Capital Resources – Sources of Liquidity and Cash Flow – Financing Activities” below.

## REALIZED GAIN (LOSS) AND BENEFIT RATIO UNLOCKING

Details underlying realized gain (loss), after-DAC (1) and benefit ratio unlocking (in millions) were as follows:

|  | For the Three<br>Months<br>Ended<br>March 31, |         |        |
|--|---|---------|--------|
|  | 2014  | 2013    | Change |
| <b>Components of Realized Gain (Loss), Pre-Tax</b>   |   |         |        |
| Total operating realized gain (loss)   | \$ 40   | \$ 32   | 25%    |
| Total excluded realized gain (loss)  | (58)  | (91)    | 36%    |
| Total realized gain (loss), pre-tax  | \$ (18)                                       | \$ (59) | 69%    |
| <b>Reconciliation of Excluded Realized Gain (Loss)<br/>Net of Benefit Ratio Unlocking, After-Tax</b> |   |         |        |
| Total excluded realized gain (loss)  | \$ (38)                                       | \$ (60) | 37%    |
| Benefit ratio unlocking  | 2   | 14      | -86%   |
| Excluded realized gain (loss) net of benefit ratio<br>unlocking, after-tax                           | \$ (36)                                       | \$ (46) | 22%    |
| <b>Components of Excluded Realized Gain (Loss)<br/>Net of Benefit Ratio Unlocking, After-Tax</b>     |   |         |        |
| Realized gain (loss) related to certain investments  | \$ (4 )                                       | \$ (10) | 60%    |
| Gain (loss) on the mark-to-market on certain instruments   | (13)  | 6       | NM     |
| <b>Variable annuity net derivatives results:</b>   |   |         |        |
| Hedge program performance, including unlocking for   |   |         |        |
| GLB reserves hedged  | (14)  | 1       | NM     |
| GLB NPR component  | 7   | (35)    | 120%   |
| Total variable annuity net derivatives results   | (7 )  | (34)    | 79%    |
| Indexed annuity forward-starting option  | (12)  | (8 )    | -50%   |
| Excluded realized gain (loss) net of benefit ratio<br>unlocking, after-tax                           | \$ (36)                                       | \$ (46) | 22%    |

(1) DAC refers to the associated amortization of DAC, VOBA, DSI and DFEL and changes in other contract holder funds and funds withheld reinsurance assets and liabilities.

For factors that could cause actual results to differ materially from those set forth in this section, see “Forward-Looking Statements – Cautionary Language” above and “Part I – Item 1A. Risk Factors” in our 2013 Form 10-K.

For information on our counterparty exposure, see “Part I – Item 3. Quantitative and Qualitative Disclosures About Market Risk.”

#### Comparison of the Three Months Ended March 31, 2014 to 2013

We had lower realized losses during 2014 as compared to 2013 driven primarily by the following components of excluded realized gain (loss), which we have described net of benefit ratio unlocking, after-tax:

- Lower losses on variable annuity net derivatives results during 2014 attributable to a favorable GLB NPR component due to our associated reserves increasing and less narrowing of our credit spreads during 2014. These losses were partially offset by unfavorable hedge program performance due to more volatile capital markets during 2014.
- General improvements in the credit markets during 2014 leading to a decline in OTTI.
- Lower gross realized losses related to certain investments during 2014 originating from asset sales to reposition the investment portfolio.

The lower realized losses were partially offset by losses on the mark-to-market on certain instruments during 2014 as compared to gains during 2013 attributable to losses on derivative investments (not including those associated with our variable annuity net derivatives results) and reinsurance related embedded derivatives, partially offset by an increase in the value of our trading securities due to a decrease in interest rates.

See “Realized Gain (Loss) and Benefit Ratio Unlocking – Variable Annuity Net Derivatives Results” in our 2013 Form 10-K for a discussion of how our NPR adjustment is determined.

Operating Realized Gain (Loss)

See “Realized Gain (Loss) and Benefit Ratio Unlocking – Operating Realized Gain (Loss)” in our 2013 Form 10-K for a discussion of our operating realized gain (loss).

Realized Gain (Loss) Related to Certain Investments

See “Consolidated Investments – Realized Gain (Loss) Related to Certain Investments” below.

Gain (Loss) on the Mark-to-Market on Certain Instruments

See “Realized Gain (Loss) and Benefit Ratio Unlocking – Gain (Loss) on the Mark-to-Market on Certain Instruments” in our 2013 Form 10-K for a discussion of the mark-to-market on certain instruments and Note 3 for information about consolidated variable interest entities (“VIEs”).

Variable Annuity Net Derivatives Results

See “Realized Gain (Loss) and Benefit Ratio Unlocking – Variable Annuity Net Derivatives Results” in our 2013 Form 10-K for a discussion of our variable annuity net derivatives results.

Details underlying our variable annuity hedging program (dollars in millions) were as follows:

|   | As of<br>March 31,<br>2014 | As of<br>December<br>31,<br>2013 | As of<br>September<br>30,<br>2013 | As of<br>June 30,<br>2013 | As of<br>March 31,<br>2013 |
|---|----------------------------|----------------------------------|-----------------------------------|---------------------------|----------------------------|
| Variable annuity hedge program assets (liabilities) | \$ 335                     | \$ (49 )                         | \$ 445                            | \$ 811                    | \$ 1,240                   |

Variable annuity reserves – asset (liability):



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|   |          |          |        |        |           |
|---|----------|----------|--------|--------|-----------|
| Embedded derivative reserves, pre-NPR (1)           | \$ 1,067 | \$ 1,345 | \$ 780 | \$ 318 | \$ (200 ) |
| NPR   | (88 )    | (101 )   | (69 )  | (26 )  | 1         |
| Embedded derivative reserves                        | 979      | 1,244    | 711    | 292    | (199 )    |
| Insurance benefit reserves                          | (258 )   | (236 )   | (233 ) | (226 ) | (204 )    |
| Total variable annuity reserves – asset (liability) | \$ 721   | \$ 1,008 | \$ 478 | \$ 66  | \$ (403 ) |
| 10-year credit default swap ("CDS") spread          | 1.27%    | 1.46%    | 1.74%  | 1.89%  | 1.86%     |
| NPR factor related to 10-year CDS spread            | 0.13%    | 0.15%    | 0.18%  | 0.21%  | 0.19%     |

(1) Embedded derivative reserves in an asset (liability) position indicate that we estimate the present value of future benefits to be less (greater) than the present value of future net valuation premiums.

The following shows the approximate hypothetical effect to net income, pre-DAC (1), pre-tax (in millions) for changes in the NPR factor along all points on the spread curve as of March 31, 2014:

|                              | Hypothetical<br>Effect |
|------------------------------|------------------------|
| NPR factor:                  |                        |
| Down 13 basis points to zero | \$ (115 )              |
| Up 20 basis points           | 40                     |

(1) DAC refers to the associated amortization of DAC, VOBA, DSI and DFEL and changes in other contract holder funds and funds withheld reinsurance assets and liabilities.

See “Critical Accounting Policies and Estimates – Derivatives – Guaranteed Living Benefits” above for additional information about our guaranteed benefits.

#### Indexed Annuity Forward-Starting Option

See “Realized Gain (Loss) and Benefit Ratio Unlocking – Indexed Annuity Forward-Starting Option” in our 2013 Form 10-K for a discussion of our indexed annuity forward-starting option.



## CONSOLIDATED INVESTMENTS

Details underlying our consolidated investment balances (in millions) were as follows:

|                               | As of<br>March 31,<br>2014 | As of<br>December<br>31,<br>2013 | Percentage of<br>Total Investments |                                  |
|-------------------------------|----------------------------|----------------------------------|------------------------------------|----------------------------------|
|                               |                            |                                  | As of<br>March 31,<br>2014         | As of<br>December<br>31,<br>2013 |
| Investments                   |                            |                                  |                                    |                                  |
| AFS securities:               |                            |                                  |                                    |                                  |
| Fixed maturity                | \$ 82,988                  | \$ 80,078                        | 84.5%                              | 84.0%                            |
| VIEs' fixed maturity          | 597                        | 697                              | 0.6%                               | 0.7%                             |
| Total fixed maturity          | 83,585                     | 80,775                           | 85.1%                              | 84.7%                            |
| Equity                        | 207                        | 201                              | 0.2%                               | 0.2%                             |
| Trading securities            | 2,316                      | 2,282                            | 2.4%                               | 2.4%                             |
| Mortgage loans on real estate | 7,089                      | 7,210                            | 7.2%                               | 7.6%                             |
| Real estate                   | 42                         | 47                               | 0.0%                               | 0.0%                             |
| Policy loans                  | 2,687                      | 2,677                            | 2.7%                               | 2.8%                             |
| Derivative investments        | 1,044                      | 881                              | 1.1%                               | 0.9%                             |
| Alternative investments       | 1,052                      | 1,002                            | 1.1%                               | 1.1%                             |
| Other investments             | 185                        | 216                              | 0.2%                               | 0.3%                             |
| Total investments             | \$ 98,207                  | \$ 95,291                        | 100.0%                             | 100.0%                           |

## Investment Objective

Invested assets are an integral part of our operations. We follow a balanced approach to investing for both current income and prudent risk management, with an emphasis on generating sufficient current income, net of income tax, to meet our obligations to customers, as well as other general liabilities. This balanced approach requires the evaluation of expected return and risk of each asset class utilized, while still meeting our income objectives. This approach is important to our asset-liability management because decisions can be made based upon both the economic and current investment income considerations affecting assets and liabilities. For a discussion of our risk management process, see "Part II – Item 7A. Quantitative and Qualitative Disclosures About Market Risk" in our 2013 Form 10-K.

## Investment Portfolio Composition and Diversification

Fundamental to our investment policy is diversification across asset classes. Our investment portfolio, excluding cash and invested cash, is composed of fixed maturity securities, mortgage loans on real estate, real estate (either wholly-owned or in joint ventures) and other long-term investments. We purchase investments for our segmented portfolios that have yield, duration and other characteristics that take into account the liabilities of the products being supported.

We have the ability to maintain our investment holdings throughout credit cycles because of our capital position, the long-term nature of our liabilities and the matching of our portfolios of investment assets with the liabilities of our various products.

#### Fixed Maturity and Equity Securities Portfolios

Fixed maturity securities and equity securities consist of portfolios classified as AFS and trading. Mortgage-backed and private securities are included in both of the AFS and trading portfolios.

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Details underlying our fixed maturity and equity securities portfolios by industry classification (in millions) are presented in the tables below. These tables agree in total with the presentation of AFS securities in Note 4; however, the categories below represent a more detailed breakout of the AFS portfolio. Therefore, the investment classifications listed below do not agree to the investment categories provided in Note 4.

|  | As of March 31, 2014 |                  |            |               |               |
|--|----------------------|------------------|------------|---------------|---------------|
|  | Amortized            | Gross Unrealized | Losses     | Fair          | %             |
|  | Cost                 | Gains            | and OTTI   | Value         | Fair Value    |
| <b>Fixed Maturity AFS Securities</b>                           |                      |                  |            |               |               |
| <b>Industry corporate bonds:</b>                               |                      |                  |            |               |               |
| Financial services   | \$ 9,655             | \$ 845           | \$ 67      | \$ 10,433     | 12.5%         |
| Basic industry   | 4,871                | 270              | 74         | 5,067         | 6.1%          |
| Capital goods  | 4,728                | 356              | 36         | 5,048         | 6.0%          |
| Communications   | 4,008                | 384              | 43         | 4,349         | 5.2%          |
| Consumer cyclical  | 4,485                | 336              | 79         | 4,742         | 5.7%          |
| Consumer non-cyclical  | 9,973                | 908              | 68         | 10,813        | 12.9%         |
| Energy   | 6,651                | 588              | 59         | 7,180         | 8.6%          |
| Technology   | 2,675                | 157              | 42         | 2,790         | 3.3%          |
| Transportation   | 1,927                | 137              | 7          | 2,057         | 2.5%          |
| Industrial other   | 910                  | 64               | 3          | 971           | 1.2%          |
| Utilities  | 13,384               | 1,188            | 127        | 14,445        | 17.3%         |
| <b>Collateralized mortgage and other obligations ("CMOs"):</b> |                      |                  |            |               |               |
| Agency backed  | 1,560                | 147              | -          | 1,707         | 2.0%          |
| Non-agency backed  | 1,004                | 45               | 19         | 1,030         | 1.2%          |
| <b>Mortgage pass through securities ("MPTS"):</b>              |                      |                  |            |               |               |
| Agency backed  | 1,438                | 74               | 9          | 1,503         | 1.8%          |
| Non-agency backed  | 1                    | -                | -          | 1             | 0.0%          |
| <b>Commercial mortgage-backed securities ("CMBS"):</b>         |                      |                  |            |               |               |
| Non-agency backed  | 685                  | 36               | 18         | 703           | 0.8%          |
| <b>Asset-backed securities ("ABS"):</b>                        |                      |                  |            |               |               |
| Collateralized loan obligations ("CLOs")                       | 225                  | 1                | 4          | 222           | 0.3%          |
| Commercial real estate ("CRE") CDOs                            | 21                   | -                | 2          | 19            | 0.0%          |
| Credit card  | 673                  | 29               | -          | 702           | 0.8%          |
| Home equity  | 669                  | 27               | 61         | 635           | 0.8%          |
| Manufactured housing   | 57                   | 5                | -          | 62            | 0.1%          |
| Auto loan  | 1                    | -                | -          | 1             | 0.0%          |
| Other  | 373                  | 20               | 3          | 390           | 0.5%          |
| <b>Municipals:</b>   |                      |                  |            |               |               |
| Taxable  | 3,613                | 521              | 11         | 4,123         | 4.9%          |
| Tax-exempt   | 80                   | 2                | 1          | 81            | 0.1%          |
| <b>Government and government agencies:</b>                     |                      |                  |            |               |               |
| United States  | 1,325                | 125              | 12         | 1,438         | 1.7%          |
| Foreign  | 1,937                | 179              | 14         | 2,102         | 2.5%          |
| Hybrid and redeemable preferred securities                     | 917                  | 97               | 43         | 971           | 1.2%          |
| <b>Total fixed maturity AFS securities</b>                     | <b>77,846</b>        | <b>6,541</b>     | <b>802</b> | <b>83,585</b> | <b>100.0%</b> |

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|                                  |           |          |        |           |
|----------------------------------|-----------|----------|--------|-----------|
| Equity AFS Securities            | 186       | 21       | -      | 207       |
| Total AFS securities             | 78,032    | 6,562    | 802    | 83,792    |
| Trading Securities (1)           | 2,030     | 296      | 10     | 2,316     |
| Total AFS and trading securities | \$ 80,062 | \$ 6,858 | \$ 812 | \$ 86,108 |

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|  | As of December 31, 2013 |                  |                       |               |                    |
|--|-------------------------|------------------|-----------------------|---------------|--------------------|
|  | Amortized<br>Cost       | Gross Unrealized |                       | Fair<br>Value | %<br>Fair<br>Value |
|  |                         | Gains            | Losses<br>and<br>OTTI |               |                    |
| Fixed Maturity AFS Securities              |                         |                  |                       |               |                    |
| Industry corporate bonds:                  |                         |                  |                       |               |                    |
| Financial services                         | \$ 9,542                | \$ 695           | \$ 112                | \$ 10,125     | 12.5%              |
| Basic industry                             | 4,771                   | 216              | 141                   | 4,846         | 6.0%               |
| Capital goods                              | 4,720                   | 283              | 73                    | 4,930         | 6.1%               |
| Communications                             | 3,933                   | 291              | 79                    | 4,145         | 5.1%               |
| Consumer cyclical                          | 4,401                   | 271              | 121                   | 4,551         | 5.6%               |
| Consumer non-cyclical                      | 9,938                   | 719              | 145                   | 10,512        | 13.0%              |
| Energy                                     | 6,503                   | 485              | 124                   | 6,864         | 8.5%               |
| Technology                                 | 2,634                   | 117              | 72                    | 2,679         | 3.3%               |
| Transportation                             | 1,925                   | 107              | 12                    | 2,020         | 2.5%               |
| Industrial other                           | 938                     | 57               | 10                    | 985           | 1.2%               |
| Utilities                                  | 12,997                  | 903              | 247                   | 13,653        | 16.9%              |
| CMOs:                                      |                         |                  |                       |               |                    |
| Agency backed                              | 1,671                   | 151              | -                     | 1,822         | 2.3%               |
| Non-agency backed                          | 988                     | 36               | 27                    | 997           | 1.2%               |
| MPTS:                                      |                         |                  |                       |               |                    |
| Agency backed                              | 1,475                   | 69               | 14                    | 1,530         | 1.9%               |
| Non-agency backed                          | 1                       | -                | -                     | 1             | 0.0%               |
| CMBS:                                      |                         |                  |                       |               |                    |
| Non-agency backed                          | 713                     | 36               | 21                    | 728           | 0.9%               |
| ABS:                                       |                         |                  |                       |               |                    |
| CLOs                                       | 209                     | -                | 4                     | 205           | 0.3%               |
| CRE CDOs                                   | 23                      | -                | 3                     | 20            | 0.0%               |
| Credit card                                | 672                     | 24               | -                     | 696           | 0.9%               |
| Home equity                                | 690                     | 25               | 74                    | 641           | 0.8%               |
| Manufactured housing                       | 59                      | 5                | -                     | 64            | 0.1%               |
| Auto loan                                  | 1                       | -                | -                     | 1             | 0.0%               |
| Other                                      | 377                     | 21               | 6                     | 392           | 0.5%               |
| Municipals:                                |                         |                  |                       |               |                    |
| Taxable                                    | 3,587                   | 308              | 25                    | 3,870         | 4.8%               |
| Tax-exempt                                 | 51                      | -                | 2                     | 49            | 0.1%               |
| Government and government agencies:        |                         |                  |                       |               |                    |
| United States                              | 1,426                   | 113              | 23                    | 1,516         | 1.9%               |
| Foreign                                    | 1,823                   | 128              | 23                    | 1,928         | 2.4%               |
| Hybrid and redeemable preferred securities | 967                     | 89               | 51                    | 1,005         | 1.2%               |
| Total fixed maturity AFS securities        | 77,035                  | 5,149            | 1,409                 | 80,775        | 100.0%             |
| Equity AFS Securities                      | 182                     | 19               | -                     | 201           |                    |
| Total AFS securities                       | 77,217                  | 5,168            | 1,409                 | 80,976        |                    |
| Trading Securities (1)                     | 2,027                   | 270              | 15                    | 2,282         |                    |
| Total AFS and trading securities           | \$ 79,244               | \$ 5,438         | \$ 1,424              | \$ 83,258     |                    |

- (1) Certain of our trading securities support our modified coinsurance arrangements (“Modco”), and the investment results are passed directly to the reinsurers. Refer to “Part II – Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Consolidated Investments – Fixed Maturity and Equity Securities Portfolios – Trading Securities” in our 2013 Form 10-K for further details.

#### AFS Securities

In accordance with the AFS accounting guidance, we reflect stockholders’ equity as if unrealized gains and losses were actually recognized, and consider all related accounting adjustments that would occur upon such a hypothetical recognition of unrealized gains and losses. Such related balance sheet effects include adjustments to the balances of DAC, VOBA, DFEL, future contract benefits, other contract holder funds and deferred income taxes. Adjustments to each of these balances are charged or credited to accumulated other comprehensive income (loss) (“AOCI”). For instance, DAC is adjusted upon the recognition of unrealized gains or losses because the



amortization of DAC is based upon an assumed emergence of gross profits on certain insurance business. Deferred income tax balances are also adjusted because unrealized gains or losses do not affect actual taxes currently paid.

The quality of our AFS fixed maturity securities portfolio, as measured at estimated fair value and by the percentage of fixed maturity AFS securities invested in various ratings categories, relative to the entire fixed maturity AFS security portfolio (in millions) was as follows:

| NAIC Designation (1)   | Rating Agency Equivalent Designation (1) | As of March 31, 2014 |            |            | As of December 31, 2013 |            |            |
|--|--|----------------------|------------|------------|-------------------------|------------|------------|
|  |  | Amortized Cost       | Fair Value | % of Total | Amortized Cost          | Fair Value | % of Total |
| <b>Investment Grade Securities</b>   |  |                      |            |            |                         |            |            |
| 1  | Aaa / Aa / A                             | \$ 41,992            | \$ 45,842  | 54.9%      | \$ 41,483               | \$ 44,129  | 54.6%      |
| 2  | Baa                                      | 32,130               | 34,035     | 40.7%      | 31,897                  | 33,060     | 41.0%      |
| Total investment grade securities  |  | 74,122               | 79,877     | 95.6%      | 73,380                  | 77,189     | 95.6%      |
| <b>Below Investment Grade Securities</b>   |  |                      |            |            |                         |            |            |
| 3  | Ba                                       | 2,716                | 2,778      | 3.3%       | 2,603                   | 2,627      | 3.3%       |
| 4  | B  | 662                  | 632        | 0.8%       | 701                     | 668        | 0.8%       |
| 5  | Caa and lower                            | 308                  | 269        | 0.3%       | 314                     | 262        | 0.3%       |
| 6  | In or near default                       | 38                   | 29         | 0.0%       | 37                      | 29         | 0.0%       |
| Total below investment grade securities  |  | 3,724                | 3,708      | 4.4%       | 3,655                   | 3,586      | 4.4%       |
| Total fixed maturity AFS securities  |  | \$ 77,846            | \$ 83,585  | 100.0%     | \$ 77,035               | \$ 80,775  | 100.0%     |
| Total securities below investment grade as a percentage of total fixed maturity AFS securities |  | 4.8%                 | 4.4%       |            | 4.7%                    | 4.4%       |            |

(1) Based upon the rating designations determined and provided by the NAIC or the major credit rating agencies (Fitch Ratings (“Fitch”), Moody’s Investors Service (“Moody’s”) and Standard & Poor’s (“S&P”)). For securities where the ratings assigned by the major credit agencies are not equivalent, the second highest rating assigned is used. For those securities where ratings by the major credit rating agencies are not available, which does not represent a significant amount of our total fixed maturity AFS securities, we base the ratings disclosed upon internal ratings.

Comparisons between the NAIC ratings and rating agency designations are published by the NAIC. The NAIC assigns securities quality ratings and uniform valuations, which are used by insurers when preparing their annual statements. The NAIC ratings are similar to the rating agency designations of the Nationally Recognized Statistical Rating Organizations for marketable bonds. NAIC ratings 1 and 2 include bonds generally considered investment grade (rated Baa3 or higher by Moody’s, or rated BBB- or higher by S&P and Fitch), by such ratings organizations. However, securities rated NAIC 1 and NAIC 2 could be deemed below investment grade by the rating agencies as a result of the current RBC rules for residential mortgage-backed securities (“RMBS”) and CMBS for statutory reporting. NAIC ratings 3 through 6 include bonds generally considered below investment grade (rated Ba1

or lower by Moody's, or rated BB+ or lower by S&P and Fitch).

We have identified select countries in Europe that are continuing to experience stress in the credit markets, notably Greece, Ireland, Italy, Portugal, Spain and Cyprus. These countries were identified due to above average credit spreads and political or economic uncertainty. Our investments by country as of March 31, 2014, are presented below (in millions):

|          | Amortized Cost |           |           | Fair Value |           |           |           |        |
|----------|----------------|-----------|-----------|------------|-----------|-----------|-----------|--------|
|          | Sovereign      | Financial | Other (1) | Total      | Sovereign | Financial | Other (1) | Total  |
| Spain    | \$ -           | \$ -      | \$ 295    | \$ 295     | \$ -      | \$ -      | \$ 329    | \$ 329 |
| Italy    | 3              | -         | 115       | 118        | 3         | -         | 129       | 132    |
| Ireland  | -              | 7         | 106       | 113        | -         | 11        | 104       | 115    |
| Portugal | -              | -         | 40        | 40         | -         | -         | 42        | 42     |
| Total    | \$ 3           | \$ 7      | \$ 556    | \$ 566     | \$ 3      | \$ 11     | \$ 604    | \$ 618 |

(1) Includes primarily investments in utilities and industrial securities.

We have no exposure to any issuers in Greece or Cyprus.

We manage European and other investment risks through our internal investment department and outside asset managers. The risk management is focused on monitoring spreads, pricing and monitoring of global economic developments.

As of March 31, 2014, and December 31, 2013, 91.4% and 92.9%, respectively, of the total publicly traded and private securities in an unrealized loss status were rated as investment grade. Our gross unrealized losses, including the portion of OTTI recognized in other

comprehensive income (loss) (“OCI”), on AFS securities as of March 31, 2014, decreased by \$607 million. As more fully described in Note 1 in our 2013 Form 10-K, we regularly review our investment holdings for OTTI. We believe the unrealized loss position as of March 31, 2014, does not represent OTTI as: (i) we do not intend to sell the debt securities; (ii) it is not more likely than not that we will be required to sell the debt securities before recovery of their amortized cost basis; (iii) the estimated future cash flows are equal to or greater than the amortized cost basis of the debt securities; and (iv) we have the ability and intent to hold the equity securities for a period of time sufficient for recovery. For further information on our unrealized losses on AFS securities, see “Composition by Industry Categories of our Unrealized Losses on AFS Securities” below.

Selected information for certain AFS securities in a gross unrealized loss position (dollars in millions) as of March 31, 2014, was as follows:

|  | Fair Value | Gross Unrealized Losses and OTTI | Estimated Years Until Call or Maturity | Estimated Average Years Until Recovery | Subordination Current | Level Origination |
|--|------------|----------------------------------|--|--|-----------------------|-------------------|
| CMBS                                       | \$ 172     | \$ 18                            | 1 to 39                                | 17                                     | 8.1%                  | 7.1%              |
| Hybrid and redeemable preferred securities | 221        | 43                               | 1 to 52                                | 21                                     | N/A                   | N/A               |

As provided in the table above, many of the securities in these categories are long-dated with some of the preferred securities being perpetual. This is purposeful as it matches the long-term nature of our liabilities associated with our life insurance and annuity products. See “Part II – Item 7A. Quantitative and Qualitative Disclosures About Market Risk” in our 2013 Form 10-K where we present information related to maturities of securities and the expected cash flows for rate sensitive liabilities and maturities of our holding company debt, which also demonstrates the long-term nature of the cash flows associated with these items. Because of this relationship, we do not believe it will be necessary to sell these securities before they recover or mature. For these securities, the estimated range and average period until recovery is the call or maturity period. It is difficult to predict or project when the securities will recover as it is dependent upon a number of factors including the overall economic climate. We do not believe it is necessary to impair these securities as long as the expected future cash flows are projected to be sufficient to recover the amortized cost of these securities.

The actual range and period until recovery could vary significantly depending on a variety of factors, many of which are out of our control. There are several items that could affect the length of the period until recovery, such as the pace of economic recovery, level of delinquencies, performance of the underlying collateral, changes in market interest rates, exposures to various industry or geographic conditions, market behavior and other market conditions.

We concluded that it is not more likely than not that we will be required to sell the fixed maturity AFS securities before recovery of their amortized cost basis, that the estimated future cash flows are equal to or greater than the amortized cost basis of the debt securities, and that we have the ability to hold the equity AFS securities for a period

of time sufficient for recovery. This conclusion is consistent with our asset-liability management process. Management considers the following as part of the evaluation:

- The current economic environment and market conditions;
- Our business strategy and current business plans;
- The nature and type of security, including expected maturities and exposure to general credit, liquidity, market and interest rate risk;
- Our analysis of data from financial models and other internal and industry sources to evaluate the current effectiveness of our hedging and overall risk management strategies;
- The current and expected timing of contractual maturities of our assets and liabilities, expectations of prepayments on investments and expectations for surrenders and withdrawals of life insurance policies and annuity contracts;
- The capital risk limits approved by management; and
- Our current financial condition and liquidity demands.

To determine the recoverability of a debt security, we consider the facts and circumstances surrounding the underlying issuer including, but not limited to, the following:

- Historical and implied volatility of the security;
- Length of time and extent to which the fair value has been less than amortized cost;
- Adverse conditions specifically related to the security or to specific conditions in an industry or geographic area;
- Failure, if any, of the issuer of the security to make scheduled payments; and
- Recoveries or additional declines in fair value subsequent to the balance sheet date.

As reported on our Consolidated Balance Sheets, we had \$100 billion of investments and cash, which exceeded the liabilities for our future obligations under insurance policies and contracts, net of amounts recoverable from reinsurers, which totaled \$87.5 billion as of March 31, 2014. If it were necessary to liquidate investments prior to maturity or call to meet cash flow needs, we would first look to AFS securities that are in an unrealized gain position, which had a fair value of \$68.8 billion, excluding consolidated VIEs in the amount of \$597 million, as of March 31, 2014, rather than selling securities in an unrealized loss position. The amount of cash that we have on

hand takes into account our liquidity needs in the future, other sources of cash, such as the maturities of investments, interest and dividends we earn on our investments and the on-going cash flows from new and existing business.

See “AFS Securities – Evaluation for Recovery of Amortized Cost” in Note 1 in our 2013 Form 10-K and Note 4 for additional discussion.

As of March 31, 2014, and December 31, 2013, the estimated fair value for all private placement securities was \$13.8 billion and \$13.3 billion, respectively, representing 14% of total invested assets.

For information regarding our VIEs’ fixed maturity securities, see Note 3 in this report and Note 4 in our 2013 Form 10-K.

Mortgage-Backed Securities (“MBS”) (Included in AFS and Trading Securities)

See “Consolidated Investments – Mortgage-Backed Securities” in our 2013 Form 10-K for a discussion of our MBS.

Our ABS home equity and RMBS had a market value of \$4.4 billion and an unrealized gain of \$248 million, or 6%, as of March 31, 2014.

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The market value of AFS securities and trading securities backed by subprime loans was \$447 million and represented less than 1% of our total investment portfolio as of March 31, 2014. AFS securities represented \$434 million, or 97%, and trading securities represented \$13 million, or 3%, of the subprime exposure as of March 31, 2014. The table below summarizes our investments in AFS securities backed by pools of residential mortgages (in millions) as of March 31, 2014:

| Type   | Prime Agency |                | Prime/<br>Non-Agency |                | Alt-A      |                | Subprime/<br>Option ARM<br>(1) |                | Total      |                |
|--|--------------|----------------|----------------------|----------------|------------|----------------|--------------------------------|----------------|------------|----------------|
|  | Fair Value   | Amortized Cost | Fair Value           | Amortized Cost | Fair Value | Amortized Cost | Fair Value                     | Amortized Cost | Fair Value | Amortized Cost |
| RMBS   | \$ 3,207     | \$ 2,996       | \$ 557               | \$ 537         | \$ 419     | \$ 414         | \$ 58                          | \$ 56          | \$ 4,241   | \$ 4,003       |
| ABS home equity  | 3            | 3              | -                    | -              | 198        | 204            | 434                            | 462            | 635        | 669            |
| Total by type (2)(3)   | \$ 3,210     | \$ 2,999       | \$ 557               | \$ 537         | \$ 617     | \$ 618         | \$ 492                         | \$ 518         | \$ 4,876   | \$ 4,672       |
| Rating   |              |                |                      |                |            |                |                                |                |            |                |
| AAA  | \$ 3,168     | \$ 2,960       | \$ 1                 | \$ 1           | \$ -       | \$ -           | \$ 13                          | \$ 13          | \$ 3,182   | \$ 2,974       |
| AA   | 31           | 30             | 1                    | 1              | 6          | 6              | 18                             | 18             | 56         | 55             |
| A  | 11           | 9              | 9                    | 9              | 26         | 25             | 58                             | 58             | 104        | 101            |
| BBB  | -            | -              | 56                   | 54             | 39         | 37             | 21                             | 21             | 116        | 112            |
| BB and below   | -            | -              | 490                  | 472            | 546        | 550            | 382                            | 408            | 1,418      | 1,430          |
| Total by rating<br>(2)(3)(4)                                   | \$ 3,210     | \$ 2,999       | \$ 557               | \$ 537         | \$ 617     | \$ 618         | \$ 492                         | \$ 518         | \$ 4,876   | \$ 4,672       |
| Origination Year   |              |                |                      |                |            |                |                                |                |            |                |
| 2004 and prior   | \$ 580       | \$ 532         | \$ 94                | \$ 92          | \$ 178     | \$ 180         | \$ 172                         | \$ 182         | \$ 1,024   | \$ 986         |
| 2005   | 476          | 434            | 103                  | 103            | 207        | 201            | 192                            | 204            | 978        | 942            |
| 2006   | 97           | 88             | 116                  | 106            | 178        | 183            | 91                             | 96             | 482        | 473            |
| 2007   | 519          | 472            | 244                  | 236            | 54         | 54             | 34                             | 34             | 851        | 796            |
| 2008   | 85           | 77             | -                    | -              | -          | -              | -                              | -              | 85         | 77             |
| 2009   | 540          | 505            | -                    | -              | -          | -              | 3                              | 2              | 543        | 507            |
| 2010   | 518          | 494            | -                    | -              | -          | -              | -                              | -              | 518        | 494            |
| 2011   | 243          | 238            | -                    | -              | -          | -              | -                              | -              | 243        | 238            |
| 2012   | 85           | 90             | -                    | -              | -          | -              | -                              | -              | 85         | 90             |
| 2013   | 67           | 69             | -                    | -              | -          | -              | -                              | -              | 67         | 69             |
| Total by origination<br>year (2)(3)                            | \$ 3,210     | \$ 2,999       | \$ 557               | \$ 537         | \$ 617     | \$ 618         | \$ 492                         | \$ 518         | \$ 4,876   | \$ 4,672       |
| Total AFS RMBS as a<br>percentage of total<br>AFS securities   |              |                |                      |                |            |                |                                |                | 5.8%       | 6.0%           |
| Total<br>prime/non-agency,<br>Alt-A and<br>subprime/option ARM |              |                |                      |                |            |                |                                |                |            |                |

as a percentage of  
total AFS securities

2.0% 2.1%

- (1) Includes the fair value and amortized cost of option adjustable rate mortgages (“ARM”) within RMBS, totaling \$57 million and \$56 million, respectively.
- (2) Does not include the fair value of trading securities totaling \$170 million, which support our Modco reinsurance agreements because investment results for these agreements are passed directly to the reinsurers. The \$170 million in trading securities consisted of \$148 million prime, \$9 million Alt-A and \$13 million subprime.
  - (3) Does not include the amortized cost of trading securities totaling \$162 million, which support our Modco reinsurance agreements because investment results for these agreements are passed directly to the reinsurers. The \$162 million in trading securities consisted of \$140 million prime, \$9 million Alt-A and \$13 million subprime.
- (4) Based upon the rating designations determined and provided by the major credit rating agencies (Fitch, Moody’s and S&P). For securities where the ratings assigned by the major credit agencies are not equivalent, the second highest rating assigned is used. For those securities where ratings by the major credit rating agencies are not available, which does not represent a significant amount of our total fixed maturity AFS securities, we base the ratings disclosed upon internal ratings.

None of these investments included any direct investments in subprime lenders or mortgages. We are not aware of material exposure to subprime loans in our alternative asset portfolio.

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The following summarizes our investments in AFS securities backed by pools of commercial mortgages (in millions) as of March 31, 2014:

| Type   | Multiple Property |                | Single Property |                | CRE CDOs   |                | Total      |                |  |
|--|-------------------|----------------|-----------------|----------------|------------|----------------|------------|----------------|--|
|  | Fair Value        | Amortized Cost | Fair Value      | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost |  |
| CMBS   | \$ 689            | \$ 673         | \$ 14           | \$ 12          | \$ -       | \$ -           | \$ 703     | \$ 685         |  |
| CRE CDOs   | -                 | -              | -               | -              | 19         | 21             | 19         | 21             |  |
| Total by type (1)(2)   | \$ 689            | \$ 673         | \$ 14           | \$ 12          | \$ 19      | \$ 21          | \$ 722     | \$ 706         |  |
| Rating   |                   |                |                 |                |            |                |            |                |  |
| AAA  | \$ 403            | \$ 389         | \$ -            | \$ -           | \$ -       | \$ -           | \$ 403     | \$ 389         |  |
| AA   | 57                | 55             | -               | -              | -          | -              | 57         | 55             |  |
| A  | 98                | 92             | 14              | 12             | -          | -              | 112        | 104            |  |
| BBB  | 63                | 61             | -               | -              | 6          | 6              | 69         | 67             |  |
| BB and below   | 68                | 76             | -               | -              | 13         | 15             | 81         | 91             |  |
| Total by rating (1)(2)(3)  | \$ 689            | \$ 673         | \$ 14           | \$ 12          | \$ 19      | \$ 21          | \$ 722     | \$ 706         |  |
| Origination Year   |                   |                |                 |                |            |                |            |                |  |
| 2004 and prior   | \$ 116            | \$ 114         | \$ -            | \$ -           | \$ 1       | \$ 1           | \$ 117     | \$ 115         |  |
| 2005   | 246               | 246            | 14              | 12             | 6          | 6              | 266        | 264            |  |
| 2006   | 105               | 99             | -               | -              | 12         | 14             | 117        | 113            |  |
| 2007   | 53                | 45             | -               | -              | -          | -              | 53         | 45             |  |
| 2010   | 58                | 54             | -               | -              | -          | -              | 58         | 54             |  |
| 2013   | 111               | 115            | -               | -              | -          | -              | 111        | 115            |  |
| Total by origination year (1)(2)   | \$ 689            | \$ 673         | \$ 14           | \$ 12          | \$ 19      | \$ 21          | \$ 722     | \$ 706         |  |
| Total AFS securities backed by pools of commercial mortgages as a percentage of total AFS securities |                   |                |                 |                |            |                | 0.9%       | 0.9%           |  |

- (1) Does not include the fair value of trading securities totaling \$8 million, which support our Modco reinsurance agreements because investment results for these agreements are passed directly to the reinsurers. The \$8 million in trading securities consisted of \$7 million CMBS and \$1 million CRE CDOs.
- (2) Does not include the amortized cost of trading securities totaling \$7 million, which support our Modco reinsurance agreements because investment results for these agreements are passed directly to the reinsurers. The \$7 million in trading securities consisted of \$6 million CMBS and \$1 million CRE CDOs.
- (3) Based upon the rating designations determined and provided by the major credit rating agencies (Fitch, Moody's and S&P). For securities where the ratings assigned by the major credit agencies are not equivalent, the second highest rating assigned is used. For those securities where ratings by the major credit rating agencies are not available, which does not represent a significant amount of our total fixed maturity AFS securities, we base the ratings disclosed upon internal ratings.



As of March 31, 2014, the amortized cost and fair value of our AFS exposure to Monoline insurers was \$520 million and \$539 million, respectively.

#### Composition by Industry Categories of our Unrealized Losses on AFS Securities

When considering unrealized gain and loss information, it is important to recognize that the information relates to the status of securities at a particular point in time and may not be indicative of the status of our investment portfolios subsequent to the balance sheet date. Further, because the timing of the recognition of realized investment gains and losses through the selection of which securities are sold is largely at management's discretion, it is important to consider the information provided below within the context of the overall unrealized gain or loss position of our investment portfolios. These are important considerations that should be included in any evaluation of the potential effect of unrealized loss securities on our future earnings.

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The composition by industry categories of all securities in unrealized loss status (in millions) as of March 31, 2014, was as follows:

|   | Fair Value | % Fair Value | Amortized Cost | % Amortized Cost | Gross Unrealized Losses and OTTI | % Gross Unrealized Losses and OTTI |
|---|------------|--------------|----------------|------------------|----------------------------------|------------------------------------|
| Electric  | \$ 1,592   | 11.0%        | \$ 1,672       | 11.0%            | \$ 80                            | 10.0%                              |
| Banking   | 669        | 4.6%         | 742            | 4.9%             | 73                               | 9.1%                               |
| ABS   | 671        | 4.7%         | 741            | 4.9%             | 70                               | 8.7%                               |
| Technology  | 804        | 5.6%         | 845            | 5.6%             | 41                               | 5.1%                               |
| Metals and mining   | 647        | 4.5%         | 683            | 4.5%             | 36                               | 4.5%                               |
| Food and beverage   | 539        | 3.7%         | 570            | 3.7%             | 31                               | 3.9%                               |
| Retailers   | 293        | 2.0%         | 323            | 2.1%             | 30                               | 3.7%                               |
| Chemicals   | 693        | 4.8%         | 721            | 4.7%             | 28                               | 3.5%                               |
| CMO   | 512        | 3.6%         | 538            | 3.5%             | 26                               | 3.2%                               |
| Independent   | 720        | 5.0%         | 742            | 4.9%             | 22                               | 2.7%                               |
| Pipelines   | 381        | 2.6%         | 402            | 2.6%             | 21                               | 2.6%                               |
| Property and casualty                                     | 158        | 1.1%         | 177            | 1.2%             | 19                               | 2.4%                               |
| CMBS  | 176        | 1.2%         | 195            | 1.3%             | 19                               | 2.4%                               |
| Integrated  | 406        | 2.8%         | 425            | 2.8%             | 19                               | 2.4%                               |
| Entertainment   | 285        | 2.0%         | 304            | 2.0%             | 19                               | 2.4%                               |
| Media – cable   | 249        | 1.7%         | 266            | 1.7%             | 17                               | 2.1%                               |
| Diversified manufacturing                                 | 463        | 3.2%         | 480            | 3.2%             | 17                               | 2.1%                               |
| Distributors  | 299        | 2.1%         | 315            | 2.1%             | 16                               | 2.0%                               |
| Media – non-cable   | 373        | 2.6%         | 388            | 2.6%             | 15                               | 1.9%                               |
| Industries with unrealized losses less than \$15 million  | 4,482      | 31.2%        | 4,685          | 30.7%            | 203                              | 25.3%                              |
| Total by industry   | \$ 14,412  | 100.0%       | \$ 15,214      | 100.0%           | \$ 802                           | 100.0%                             |
| Total by industry as a percentage of total AFS securities |            | 17.2%        |                | 19.5%            |                                  | 100.0%                             |

As of March 31, 2014, the amortized cost and fair value of securities subject to enhanced analysis and monitoring for potential changes in unrealized loss status was \$450 million and \$356 million, respectively.

Mortgage Loans on Real Estate

The following tables summarize key information on mortgage loans on real estate (in millions):

| Credit Quality Indicator            | As of March 31,<br>2014 |        | As of December<br>31, 2013 |        |
|-------------------------------------|-------------------------|--------|----------------------------|--------|
|                                     | Carrying<br>Value       | %      | Carrying<br>Value          | %      |
| Current                             | \$ 7,083                | 99.9%  | \$ 7,202                   | 99.9%  |
| Delinquent and in foreclosure (1)   | 6                       | 0.1%   | 8                          | 0.1%   |
| Total mortgage loans on real estate | \$ 7,089                | 100.0% | \$ 7,210                   | 100.0% |

(1) As of March 31, 2014, and December 31, 2013, there were three mortgage loans on real estate that were delinquent and in foreclosure.

|                                     | As of<br>March<br>31,<br>2014 | As of<br>December<br>31,<br>2013 |
|-------------------------------------|-------------------------------|----------------------------------|
| By Segment                          |                               |                                  |
| Annuities                           | \$ 1,419                      | \$ 1,451                         |
| Retirement Plan Services            | 1,411                         | 1,434                            |
| Life Insurance                      | 3,656                         | 3,731                            |
| Group Protection                    | 271                           | 278                              |
| Other Operations                    | 332                           | 316                              |
| Total mortgage loans on real estate | \$ 7,089                      | \$ 7,210                         |

| Property Type      | As of March 31,<br>2014 |        | State Exposure        | As of March 31,<br>2014 |        |
|--------------------|-------------------------|--------|-----------------------|-------------------------|--------|
|                    | Carrying<br>Value       | %      |                       | Carrying<br>Value       | %      |
| Office building    | \$ 1,956                | 27.6%  | CA                    | \$ 1,656                | 23.3%  |
| Industrial         | 1,638                   | 23.1%  | TX                    | 625                     | 8.7%   |
| Apartment          | 1,568                   | 22.1%  | MD                    | 401                     | 5.7%   |
| Retail             | 1,525                   | 21.5%  | NY                    | 387                     | 5.5%   |
| Mixed use          | 205                     | 2.9%   | NC                    | 333                     | 4.7%   |
| Other commercial   | 142                     | 2.0%   | VA                    | 298                     | 4.2%   |
| Hotel/motel        | 55                      | 0.8%   | GA                    | 273                     | 3.9%   |
| Total              | \$ 7,089                | 100.0% | FL                    | 268                     | 3.8%   |
| Geographic Region  |                         |        | OH                    | 244                     | 3.4%   |
| Pacific            | \$ 2,050                | 28.8%  | WA                    | 241                     | 3.4%   |
| South Atlantic     | 1,684                   | 23.8%  | TN                    | 240                     | 3.4%   |
| East North Central | 734                     | 10.4%  | AZ                    | 217                     | 3.1%   |
| Middle Atlantic    | 660                     | 9.3%   | PA                    | 209                     | 2.9%   |
| West South Central | 635                     | 9.0%   | IN                    | 186                     | 2.6%   |
| Mountain           | 514                     | 7.2%   | MN                    | 155                     | 2.2%   |
| East South Central | 395                     | 5.6%   | OR                    | 154                     | 2.2%   |
| West North Central | 338                     | 4.8%   | IL                    | 142                     | 2.0%   |
| New England        | 79                      | 1.1%   | Other states under 2% | 1,060                   | 15.0%  |
| Total              | \$ 7,089                | 100.0% | Total                 | \$ 7,089                | 100.0% |

| Origination Year | As of March 31, 2014 |        | Future<br>Principal<br>Payments | As of March 31, 2014 |        |
|------------------|----------------------|--------|---------------------------------|----------------------|--------|
|                  | Principal<br>Amount  | %      |                                 | Principal<br>Amount  | %      |
| 2004 and prior   | \$ 1,187             | 16.7%  | 2014                            | \$ 169               | 2.4%   |
| 2005             | 621                  | 8.8%   | 2015                            | 417                  | 5.9%   |
| 2006             | 522                  | 7.4%   | 2016                            | 458                  | 6.5%   |
| 2007             | 762                  | 10.8%  | 2017                            | 651                  | 9.2%   |
| 2008             | 715                  | 10.1%  | 2018                            | 753                  | 10.6%  |
| 2009             | 140                  | 2.0%   | 2019 and<br>thereafter          | 4,638                | 65.4%  |
| 2010             | 290                  | 4.1%   | Total                           | \$ 7,086             | 100.0% |
| 2011             | 832                  | 11.7%  |                                 |                      |        |
| 2012             | 873                  | 12.3%  |                                 |                      |        |
| 2013             | 1,092                | 15.4%  |                                 |                      |        |
| 2014             | 52                   | 0.7%   |                                 |                      |        |
| Total            | \$ 7,086             | 100.0% |                                 |                      |        |

The global financial markets and credit market conditions experienced a period of extreme volatility and disruption that began in the second half of 2007 and continued and substantially increased throughout 2008 that led to a decrease in the overall liquidity and availability of capital in the mortgage loan market, and in particular a decrease in activity by securitization lenders. These conditions and the overall economic downturn put pressure on the fundamentals of mortgage loans through rising vacancies, falling rents and falling property values.

See Note 4 for information regarding our loan-to-value and debt-service coverage ratios and our allowance for loan losses.

As of March 31, 2014, and December 31, 2013, there were three impaired mortgage loans on real estate, or less than 1% of the total dollar amount of mortgage loans on real estate. The carrying value of the mortgage loans on real estate that were two or more payments delinquent as of March 31, 2014, and December 31, 2013, was \$3 million and \$8 million, respectively, or less than 1% of total mortgage loans on real estate. The total principal and interest past due on the mortgage loans on real estate that were two or more payments delinquent as of March 31, 2014, and December 31, 2013, was \$1 million and \$5 million, respectively. See Note 1 in our 2013 Form 10-K for more information regarding our accounting policy relating to the impairment of mortgage loans on real estate.

### Alternative Investments

Investment income (loss) on alternative investments by business segment (in millions) was as follows:

|                          | For the<br>Three<br>Months<br>Ended<br>March 31, |      |        |
|--------------------------|--|------|--------|
|                          | 2014   | 2013 | Change |
| Annuities                | \$ 10  | \$ 2 | NM     |
| Retirement Plan Services | 5  | 1    | NM     |
| Life Insurance           | 25   | 2    | NM     |
| Group Protection         | 4  | 1    | 300%   |
| Total (1)                | \$ 44  | \$ 6 | NM     |

(1) Includes net investment income on the alternative investments supporting the required statutory surplus of our insurance businesses.

As of March 31, 2014, and December 31, 2013, alternative investments included investments in 126 and 121 different partnerships, respectively, and the portfolio represented approximately 1% of our overall invested assets. The partnerships do not represent off-balance sheet financing and generally involve several third-party partners. Some of our partnerships contain capital calls, which require us to contribute capital upon notification by the general partner. These capital calls are contemplated during the initial investment decision and are planned for well in advance of the call date. The capital calls are not material in size and are not material to our liquidity. Alternative investments are accounted for using the equity method of accounting and are included in other investments on our Consolidated Balance Sheets.

Non-Income Producing Investments

As of March 31, 2014, and December 31, 2013, the carrying amount of fixed maturity securities, mortgage loans on real estate and real estate that were non-income producing was \$8 million and \$9 million, respectively.

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## Net Investment Income

Details underlying net investment income (in millions) and our investment yield were as follows:

|   | For the Three<br>Months Ended<br>March 31, |          |        |
|---|--|----------|--------|
|   | 2014                                       | 2013     | Change |
| Fixed maturity AFS securities   | \$ 1,011                                   | \$ 987   | 2%     |
| Equity AFS securities   | 2  | 2        | 0%     |
| Trading securities  | 33   | 34       | -3%    |
| Mortgage loans on real estate   | 95   | 99       | -4%    |
| Real estate   | 3  | 3        | 0%     |
| Policy loans  | 39   | 38       | 3%     |
| Invested cash   | 1  | 1        | 0%     |
| Commercial mortgage loan prepayment<br>and bond make-whole premiums (1) | 16   | 12       | 33%    |
| Alternative investments (2)   | 44   | 6        | NM     |
| Consent fees  | -  | 1        | -100%  |
| Other investments   | (6 )                                       | (4 )     | -50%   |
| Investment income   | 1,238                                      | 1,179    | 5%     |
| Investment expense  | (30 )                                      | (29 )    | -3%    |
| Net investment income   | \$ 1,208                                   | \$ 1,150 | 5%     |

(1) See “Commercial Mortgage Loan Prepayment and Bond Make-Whole Premiums” below for additional information.

(2) See “Alternative Investments” above for additional information.

|  | For the Three<br>Months Ended<br>March 31, |       |                          |
|--|--|-------|--------------------------|
|  | 2014                                       | 2013  | Basis<br>Point<br>Change |
| Interest Rate Yield  |  |       |                          |
| Fixed maturity securities, mortgage loans on<br>real estate and other, net of investment<br>expenses | 5.05%                                      | 5.17% | (12 )                    |
| Commercial mortgage loan prepayment and<br>bond make-whole premiums                                  | 0.07%                                      | 0.05% | 2                        |
| Alternative investments  | 0.19%                                      | 0.03% | 16                       |
| Net investment income yield on invested<br>assets  | 5.31%                                      | 5.25% | 6                        |



|   | For the Three<br>Months Ended<br>March 31, |           |        |
|---|--|-----------|--------|
|   | 2014                                       | 2013      | Change |
| Average invested assets at amortized cost | \$ 91,027                                  | \$ 87,690 | 4%     |

We earn investment income on our general account assets supporting fixed annuity, term life, whole life, UL, interest-sensitive whole life and fixed portion of retirement plan and VUL products. The profitability of our fixed annuity and life insurance products is affected by our ability to achieve target spreads, or margins, between the interest income earned on the general account assets and the interest credited to the contract holder on our average fixed account values, including the fixed portion of variable. Net investment income and the interest rate yield table each include commercial mortgage loan prepayments and bond make-whole premiums, alternative investments and contingent interest and standby real estate equity commitments. These items can vary significantly from period to period due to a number of factors and, therefore, can provide results that are not indicative of the underlying trends.

#### Commercial Mortgage Loan Prepayment and Bond Make-Whole Premiums

Prepayment and make-whole premiums are collected when borrowers elect to call or prepay their debt prior to the stated maturity. A prepayment or make-whole premium allows investors to attain the same yield as if the borrower made all scheduled interest payments until maturity. These premiums are designed to make investors indifferent to prepayment.

The increase in prepayment and make-whole premiums when comparing 2014 to 2013 was attributable primarily to increased refinancing activity.

### Realized Gain (Loss) Related to Certain Investments

Details of the realized gain (loss) related to certain investments (in millions) were as follows:

|  | For the<br>Three<br>Months<br>Ended<br>March 31, |          |        |
|--|--|----------|--------|
|  | 2014   | 2013     | Change |
| Fixed maturity AFS securities:   |  |          |        |
| Gross gains  | \$ 8   | \$ 7     | 14%    |
| Gross losses   | (6 )   | (19 )    | 68%    |
| Equity AFS securities:   |  |          |        |
| Gross gains  | -  | 6        | -100%  |
| Gross losses   | -  | -        | NM     |
| Gain (loss) on other investments   | -  | (1 )     | 100%   |
| Associated amortization of DAC, VOBA,<br>DSI, and DFEL and changes in other<br>contract holder funds | (7 )   | (7 )     | 0%     |
| Total realized gain (loss) related to<br>certain investments, pre-tax                                | \$ (5 )  | \$ (14 ) | 64%    |

Amortization of DAC, VOBA, DSI and DFEL and changes in other contract holder funds reflect an assumption for an expected level of credit-related investment losses. When actual credit-related investment losses are realized, we recognize a true-up to our DAC, VOBA, DSI and DFEL amortization and changes in other contract holder funds within realized loss reflecting the incremental effect of actual versus expected credit-related investment losses. These actual to expected amortization adjustments could create volatility in net realized gains and losses. The write-down for impairments includes both credit-related and interest rate-related impairments.

Realized gains and losses generally originate from asset sales to reposition the portfolio or to respond to product experience. During the first three months of 2014 and 2013, we sold securities for gains and losses. In the process of evaluating whether a security with an unrealized loss reflects declines that are other-than-temporary, we consider our ability and intent to sell the security prior to a recovery of value. However, subsequent decisions on securities sales are made within the context of overall risk monitoring, assessing value relative to other comparable securities and overall portfolio maintenance. Although our portfolio managers may, at a given point in time, believe that the preferred course of action is to hold securities with unrealized losses that are considered temporary until such losses

are recovered, the dynamic nature of portfolio management may result in a subsequent decision to sell. These subsequent decisions are consistent with the classification of our investment portfolio as AFS. We expect to continue to manage all non-trading invested assets within our portfolios in a manner that is consistent with the AFS classification.

We consider economic factors and circumstances within countries and industries where recent write-downs have occurred in our assessment of the status of securities we own of similarly situated issuers. While it is possible for realized or unrealized losses on a particular investment to affect other investments, our risk management has been designed to identify correlation risks and other risks inherent in managing an investment portfolio. Once identified, strategies and procedures are developed to effectively monitor and manage these risks. The areas of risk correlation that we pay particular attention to are risks that may be correlated within specific financial and business markets, risks within specific industries and risks associated with related parties.

When the detailed analysis by our external asset managers and investment portfolio managers leads us to the conclusion that a security's decline in fair value is other-than-temporary, the security is written down to estimated recovery value. In instances where declines are considered temporary, the security will continue to be carefully monitored. See "Critical Accounting Policies and Estimates – Investments – Write-downs for OTTI and Allowance for Losses" in our 2013 Form 10-K for additional information on our portfolio management strategy.

Details underlying write-downs taken as a result of OTTI (in millions) were as follows:

|   | For the<br>Three<br>Months<br>Ended<br>March 31,<br>2014 2013 Change |          |      |
|---|--|----------|------|
| OTTI Recognized in Net Income (Loss)                  |  |          |      |
| Fixed maturity securities:                            |  |          |      |
| Corporate bonds                                       | \$ (3 )  | \$ (3 )  | 0%   |
| RMBS  | (2 )   | (11 )    | 82%  |
| CMBS  | -  | (2 )     | 100% |
| CRE CDOs  | -  | (1 )     | 100% |
| Gross OTTI recognized in net income (loss)            | (5 )   | (17 )    | 71%  |
| Associated amortization of DAC, VOBA,<br>DSI and DFEL | 2  | 3        | -33% |
| Net OTTI recognized in net income<br>(loss), pre-tax  | \$ (3 )  | \$ (14 ) | 79%  |
| Portion of OTTI Recognized in OCI                     |  |          |      |
| Gross OTTI recognized in OCI                          | \$ 7   | \$ 7     | 0%   |
| Change in DAC, VOBA, DSI and DFEL                     | -  | (1 )     | 100% |
| Net portion of OTTI recognized in OCI,<br>pre-tax     | \$ 7   | \$ 6     | 17%  |

The decrease in write-downs for OTTI when comparing the first three months of 2014 to the corresponding period in 2013 was attributable to declines in write-downs for OTTI on corporate bonds and structured holdings. The improvements of the write-downs for OTTI on our RMBS and CMBS holdings were primarily attributable to gradual recovery in both residential and commercial real estate markets.

The \$12 million of impairments taken during the first three months of 2014 were split between \$5 million of credit-related impairments and \$7 million of noncredit-related impairments. The credit-related impairments were largely attributable to our RMBS holdings primarily as a result of weakness within select residential real estate securities. The noncredit-related impairments were due to declines in values of securities for which we do not have an intent to sell or it is not more likely than not that we will be required to sell the securities before recovery.

## REINSURANCE

Certain reinsurers have sought rate increases on certain yearly renewable term treaties. We dispute the requested rate increases under these policies. We have initiated and will initiate arbitration proceedings, as necessary, under these policies in order to protect our contractual rights. We do not believe the outcome of these disputes will have a material adverse effect on our financial condition.

See “Part II – Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Reinsurance” in our 2013 Form 10-K for a detailed discussion regarding our counterparty risk with our reinsurers, including collateral securing our reinsurance recoverable, which information is incorporated herein by reference. For more information about reinsurance, see Note 9 in our 2013 Form 10-K.

## REVIEW OF CONSOLIDATED FINANCIAL CONDITION

### Liquidity and Capital Resources

#### Sources of Liquidity and Cash Flow

Liquidity refers to the ability of an enterprise to generate adequate amounts of cash from its normal operations to meet cash requirements with a prudent margin of safety. Our principal sources of cash flow from operating activities are insurance premiums and fees and investment income, while sources of cash flows from investing activities result from maturities and sales of invested assets. Our operating activities provided (used) cash of \$263 million for the first three months of 2014 compared to \$(251) million for the corresponding period in 2013, which was attributable primarily to timing of cash receipts and payments. When considering our liquidity and cash flow, it is important to distinguish between the needs of our insurance subsidiaries and the needs of the holding company, LNC. As a holding company with no operations of its own, LNC derives its cash primarily from its operating subsidiaries.

The sources of liquidity of the holding company are principally comprised of dividends and interest payments from subsidiaries, augmented by holding company short-term investments, bank lines of credit and the ongoing availability of long-term public financing

under an SEC-filed shelf registration statement. These sources of liquidity and cash flow support the general corporate needs of the holding company, including its common stock dividends, interest and debt service, funding of callable securities, securities repurchases, acquisitions and investment in core businesses. Our cash flows associated with collateral received from and posted with counterparties change as the market value of the underlying derivative contract changes. As the value of a derivative asset declines (or increases), the collateral required to be posted by our counterparties would also decline (or increase). Likewise, when the value of a derivative liability declines (or increases), the collateral we are required to post to our counterparties would also decline (or increase). During the first three months of 2014, our payables for collateral on derivative investments increased by \$308 million as falling interest rates and equity markets and more volatility increased the fair values of the associated derivative investments. For additional information, see "Credit Risk" in Note 5.

Details underlying the primary sources of our holding company cash flows (in millions) were as follows:

|  | For the Three<br>Months<br>Ended<br>March 31, |         |        |
|--|---|---------|--------|
|  | 2014  | 2013    | Change |
| Dividends from Subsidiaries  |   |         |        |
| LNL  | \$ 150  | \$ 150  | 0%     |
| Loan Repayments and Interest from<br>Subsidiaries  |   |         |        |
| Interest on inter-company notes  | 34  | 14      | 143%   |
|  | \$ 184  | \$ 164  | 12%    |
| Other Cash Flow and Liquidity Items  |   |         |        |
| Net capital received from (paid for taxes on)<br>stock option exercises and restricted stock | \$ (6 )                                       | \$ (4 ) | -50%   |

The table above focuses on significant and recurring cash flow items and excludes the effects of certain financing activities, namely the periodic issuance and retirement of debt and cash flows related to our inter-company cash management program (discussed below). Taxes have been eliminated from the analysis due to a tax sharing agreement among our primary subsidiaries resulting in a modest effect on net cash flows at the holding company. Also excluded from this analysis is the modest amount of investment income on short-term investments of the holding company.

#### Subsidiaries' Statutory Reserving and Surplus

Like other life insurers, we utilize inter-company reinsurance arrangements with our captives primarily to increase profitability and manage risk and statutory capital. Captive reinsurers are typically special purpose entities that either

by statute or by restriction in their licensing orders are limited to reinsuring business from insurance affiliates. Specifically, captives help us mitigate the capital impact of XXX and AG38 reserving guidelines. XXX and AG38 require insurers to use reserving assumptions that result in statutory reserves for term life insurance policies with long-term premium guarantees and UL policies with secondary guarantees greater than what we expect to adequately support these policies. The captive reinsurance structures we use provide a mechanism for the financing of a portion of the excess reserve amounts in a more efficient manner. This, in turn, frees up capital that the insurance subsidiaries can use for any number of purposes, including for paying dividends to the holding company. Once transferred to the holding company, it can deploy this capital for a variety of corporate purposes, including potentially for stock repurchases.

Currently, insurance companies are using a wide variety of captive reinsurance structures to support their respective businesses. The NAIC through its various committees, task forces, and working groups has been studying the use of captives and special purpose vehicles to transfer insurance risk and has been evaluating the adequacy of existing NAIC model laws and regulations applicable to captives. Although the NAIC has not completed its study, we believe that, ultimately, it will allow the continued use of captive structures, although certain types of captive structures may be limited or prohibited or the benefits of certain captive structures reduced. We also believe that existing captive structures, which have been approved by the insurance departments of both the ceding company's and captive's states of domicile, will not be affected materially by the NAIC's final actions.

It is not clear, however, to what extent the NAIC and the state regulators will require changes to future captive reinsurance structures. If we are unable to continue to implement such captive insurance structures, or if changes make the use of future structures less capital efficient, we may have lower returns on such products sold than we currently anticipate and/or raise prices or reduce our sales of these products. As a result, our insurance subsidiaries may have lower capacity to provide dividends to the holding company.

For more discussion of our strategies to lessen the burden of increased AG38 and XXX statutory reserves associated with UL products containing secondary guarantees and term products containing long-term premium guarantees on our insurance subsidiaries, see "Results of Life Insurance – Income (Loss) from Operations – Strategies to Address Statutory Reserve Strain."

## Financing Activities

Although our subsidiaries currently generate adequate cash flow to meet the needs of our normal operations, periodically we may issue debt or equity securities to maintain ratings and increase liquidity, as well as to fund internal growth, acquisitions and the retirement of our debt and equity securities.

We currently have an effective shelf registration statement, which allows us to issue, in unlimited amounts, securities, including debt securities, preferred stock, common stock, warrants, stock purchase contracts, stock purchase units, depository shares and trust preferred securities of our affiliated trusts.

Details underlying debt and financing activities (in millions) were as follows:

|  | For the Three Months Ended March 31, 2014 |          |  |                             |                   |                |
|--|---|----------|--|-----------------------------|-------------------|----------------|
|  | Beginning Balance                         | Issuance | Maturities, Repayments and Refinancing | Change in Fair Value Hedges | Other Changes (1) | Ending Balance |
| <b>Short-Term Debt</b>                         |   |          |  |                             |                   |                |
| Current maturities of long-term debt           | \$ 501                                    | \$ -     | \$ (500 )                              | \$ -                        | \$ (1 )           | \$ -           |
| <b>Long-Term Debt</b>                          |   |          |  |                             |                   |                |
| Senior notes                                   | \$ 3,609                                  | \$ -     | \$ -                                   | \$ 60                       | \$ -              | \$ 3,669       |
| Bank borrowing                                 | 250                                       | -        | -                                      | -                           | -                 | 250            |
| Federal Home Loan Bank of Indianapolis advance | 250                                       | -        | -                                      | -                           | -                 | 250            |
| Capital securities                             | 1,211                                     | -        | -                                      | -                           | -                 | 1,211          |
| Total long-term debt                           | \$ 5,320                                  | \$ -     | \$ -                                   | \$ 60                       | \$ -              | \$ 5,380       |

(1) Includes the net increase (decrease) in commercial paper, non-cash reclassification of long-term debt to current maturities of long-term debt, accretion of discounts and (amortization) of premiums, as applicable.

During the first quarter of 2014, we repaid a \$300 million 4.75% fixed-rate senior note that matured on January 30, 2014, and a \$200 million 4.75% fixed-rate senior note that matured on February 15, 2014. Our \$250 million 4.30% fixed-rate senior notes mature on June 15, 2015. The specific resources or combination of resources that we will use to meet this maturity will depend upon, among other things, the financial market conditions present at the time of maturity. As of March 31, 2014, the holding company had available liquidity of \$562 million. Available liquidity consists of cash and invested cash, excluding cash held as collateral, and certain short-term investments that can be readily converted into cash, net of commercial paper outstanding.



For more information about our short-term and long-term debt and our credit facilities and LOCs, see Note 12 in our 2013 Form 10-K.

We have not accounted for repurchase agreements, securities lending transactions, or other transactions involving the transfer of financial assets with an obligation to repurchase the transferred assets as sales and do not have any other transactions involving the transfer of financial assets with an obligation to repurchase the transferred assets. For information about our collateralized financing transactions on our investments, see “Payables for Collateral on Investments” in Note 4.

If current credit ratings and claims-paying ratings were downgraded in the future, terms in our derivative agreements may be triggered, which could negatively affect overall liquidity. For the majority of our counterparties, there is a termination event should the long-term senior debt ratings of LNC drop below BBB-/Baa3 (S&P/Moody’s). Our long-term senior debt held a rating of A-/Baa1 (S&P/Moody’s) as of March 31, 2014. In addition, contractual selling agreements with intermediaries could be negatively affected, which could have an adverse effect on overall sales of annuities, life insurance and investment products. See “Part I – Item 1A. Risk Factors – Liquidity and Capital Position – A decrease in the capital and surplus of our insurance subsidiaries may result in a downgrade to our credit and insurer financial strength ratings” and “Part I – Item 1A. Risk Factors – Covenants and Ratings – A downgrade in our financial strength or credit ratings could limit our ability to market products, increase the number or value of policies being surrendered and/or hurt our relationships with creditors” in our 2013 Form 10-K for more information. See “Part I – Item 1. Business – Financial Strength Ratings” in our 2013 Form 10-K for additional information on our current financial strength ratings.

See “Part II – Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Review of Consolidated Financial Condition – Liquidity and Capital Resources – Financing Activities” in our 2013 Form 10-K for information on our credit ratings.

#### Alternative Sources of Liquidity

In order to manage our capital more efficiently, we have an inter-company cash management program where certain subsidiaries can lend to or borrow from the holding company to meet short-term borrowing needs. The cash management program is essentially a series of

demand loans between LNC and participating affiliates that reduce overall borrowing costs by allowing LNC and its subsidiaries to access internal resources instead of incurring third-party transaction costs. As of March 31, 2014, the holding company had a net outstanding receivable of \$141 million from certain subsidiaries resulting from funds borrowed by the subsidiaries in excess of amounts placed by those subsidiaries in the inter-company cash management account. Any change in holding company cash management program balances is offset by the immediate and equal change in holding company cash and invested cash. Loans under the cash management program are permitted under applicable insurance laws subject to certain restrictions. For our Indiana-domiciled insurance subsidiaries, the borrowing and lending limit is currently 3% of the insurance company's admitted assets as of its most recent year end. For our New York-domiciled insurance subsidiary, it may borrow from LNC less than 2% of its admitted assets as of the last year end but may not lend any amounts to LNC.

Our insurance subsidiaries, by virtue of their general account fixed-income investment holdings, can access liquidity through securities lending programs and repurchase agreements. As of March 31, 2014, our insurance subsidiaries had investments with a carrying value of \$2.6 billion out on loan or subject to repurchase agreements. The cash received in our securities lending programs and repurchase agreements is typically invested in cash equivalents, short-term investments or fixed maturity securities. For additional details, see "Payables for Collateral on Investments" in Note 4.

For factors that could cause actual results to differ materially from those set forth in this section, see "Forward-Looking Statements – Cautionary Language" above and "Part I – Item 1A. Risk Factors" in our 2013 Form 10-K.

#### Divestitures

For a discussion of our divestitures, see Note 3 in our 2013 Form 10-K.

#### Uses of Capital

Our principal uses of cash are to pay policy claims and benefits, operating expenses, commissions and taxes, to purchase new investments, to purchase reinsurance, to fund policy surrenders and withdrawals, to pay dividends to our stockholders and to repurchase our stock and debt securities.

#### Return of Capital to Common Stockholders

One of the Company's primary goals is to provide a return to our common stockholders through share price accretion, dividends and stock repurchases. In determining dividends, the Board of Directors takes into consideration items such

as current and expected earnings, capital needs, rating agency considerations and requirements for financial flexibility. The amount and timing of share repurchase depends on key capital ratios, rating agency expectations, the generation of free cash flow and an evaluation of the costs and benefits associated with alternative uses of capital. Free cash flow for the holding company generally represents the amount of dividends and interest received from subsidiaries less interest paid on debt.

Details underlying this activity (in millions, except per share data), were as follows:

|                                     | For the Three<br>Months Ended<br>March 31, |          |        |
|-------------------------------------|--|----------|--------|
|                                     | 2014                                       | 2013     | Change |
| Common dividends to stockholders    | \$ 42                                      | \$ 33    | 27%    |
| Repurchase of common stock          | 150  | 100      | 50%    |
| Total cash returned to stockholders | \$ 192                                     | \$ 133   | 44%    |
| Number of shares repurchased        | 2.988                                      | 3.372    | -11%   |
| Average price per share             | \$ 50.22                                   | \$ 29.67 | 69%    |

On November 14, 2013, our Board of Directors approved an increase of the quarterly dividend on our common stock from \$0.12 to \$0.16 per share. Additionally, we expect to repurchase additional shares of common stock during 2014 depending on market conditions and alternative uses of capital. For more information regarding share repurchases, see “Part II – Item 2(c)” below.

## Other Uses of Capital

In addition to the amounts in the table above in “Return of Capital to Common Stockholders,” other uses of holding company cash flow (in millions) were as follows:

|                              | For the<br>Three<br>Months<br>Ended<br>March 31, |       |        |
|------------------------------|--|-------|--------|
|                              | 2014   | 2013  | Change |
| Debt service (interest paid) | \$ 68  | \$ 58 | 17%    |

The above table focuses on significant and recurring cash flow items and excludes the effects of certain financing activities, namely the periodic retirement of debt and cash flows related to our inter-company cash management account. Taxes have been eliminated from the analysis due to a tax sharing agreement among our primary subsidiaries resulting in a modest effect on net cash flows at the holding company.

## Significant Trends in Sources and Uses of Cash Flow

As stated above, LNC’s cash flow, as a holding company, is largely dependent upon the dividend capacity of its insurance company subsidiaries as well as their ability to advance funds to it through inter-company borrowing arrangements, which may be affected by factors influencing the insurance subsidiaries’ RBC and statutory earnings performance. We currently expect to be able to meet the holding company’s ongoing cash needs and to have sufficient capital to offer downside protection in the event that the capital and credit markets experience another period of extreme volatility and disruption. A decline in capital market conditions, which reduces our insurance subsidiaries’ statutory surplus and RBC, may require them to retain more capital and may pressure our subsidiaries’ dividends to the holding company, which may lead us to take steps to preserve or raise additional capital. For factors that could affect our expectations for liquidity and capital, see “Part I – Item 1A. Risk Factors” in our 2013 Form 10-K.

## OTHER MATTERS

## Other Factors Affecting Our Business

In general, our businesses are subject to a changing social, economic, legal, legislative and regulatory environment. Some of the changes include initiatives to require more reserves to be carried by our insurance subsidiaries. Although the eventual effect on us of the changing environment in which we operate remains uncertain, these factors and others could have a material effect on our results of operations, liquidity and capital resources. For factors that could cause actual results to differ materially from those set forth in this section, see “Part I – Item 1A. Risk Factors” in our 2013 Form 10-K and “Forward-Looking Statements – Cautionary Language” above.

#### Recent Accounting Pronouncements

See Note 2 for a discussion of recent accounting pronouncements that have been implemented during the periods presented or that have been issued and are to be implemented in the future.

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We analyze and manage the risks arising from market exposures of financial instruments, as well as other risks, in an integrated asset-liability management process that considers diversification. By aggregating the potential effect of market and other risks on the entire enterprise, we estimate, review and in some cases manage the risk to our earnings and shareholder value. We have exposures to several market risks including interest rate risk, equity market risk, default risk, credit risk and, to a lesser extent, foreign currency exchange risk. The exposures of financial instruments to market risks, and the related risk management processes, are most important to our business where most of the invested assets support accumulation and investment-oriented insurance products. As an important element of our integrated asset-liability management processes, we use derivatives to minimize the effects of changes in interest levels, the shape of the yield curve, currency movements and volatility. In this context, derivatives serve to minimize interest rate risk by mitigating the effect of significant increases in interest rates on our earnings. Additional market exposures exist in our other general account insurance products and in our debt structure and derivatives positions. Our primary sources of market risk are substantial, relatively rapid and sustained increases or decreases in interest rates or a sharp drop in equity market values. These market risks are discussed in detail in the following pages and should be read in conjunction with our consolidated financial statements and the accompanying notes to the consolidated financial statements (“Notes”) presented in “Item 1. Financial Statements,” as well as “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations” (“MD&A”).

#### Interest Rate Risk

#### Effect of Interest Rate Sensitivity

For information about the effect of interest rate sensitivity on our income (loss) from operations, see “Part II – Item 7A. Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk – Effect of Interest Rate Sensitivity” in

our 2013 Form 10-K.

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## Interest Rate Risk on Fixed Insurance Businesses

In periods of low interest rates, we have to reinvest the cash we receive as interest or return of principal on our investments in lower yielding instruments. Moreover, borrowers may prepay fixed-income securities, commercial mortgages and mortgage-backed securities in our general accounts in order to borrow at lower market rates, which exacerbates this risk. Because we are entitled to reset the interest rates on our fixed-rate annuities only at limited, pre-established intervals, and because many of our contracts have guaranteed minimum interest or crediting rates, our spreads could decrease and potentially become negative.

Prolonged historically low rates are not healthy for our business fundamentals. However, we have recognized this risk and have been proactive in our investment strategies, product designs, crediting rate strategies and overall asset-liability practices to mitigate the risk of unfavorable consequences in this type of environment. For some time now, new products have been sold with low minimum crediting floors, and we apply disciplined asset-liability management standards, such as locking in spreads on these products at the time of issue.

The following provides detail on the percentage differences between the March 31, 2014, interest rates being credited to contract holders based on the first quarter of 2014 declared rates and the respective minimum guaranteed policy rate (in millions), broken out by contract holder account values reported within our segments:

|  | Account Values |                          |                    | Total     | % Account Values |
|--|----------------|--------------------------|--------------------|-----------|------------------|
|  | Annuities      | Retirement Plan Services | Life Insurance (1) |           |                  |
| Excess of Crediting Rates over Contract Minimums |                |                          |                    |           |                  |
| Discretionary rate setting products: (2)         |                |                          |                    |           |                  |
| Occurring within the next twelve months: (3)     |                |                          |                    |           |                  |
| No difference                                    | \$ 8,317       | \$ 9,896                 | \$ 31,113          | \$ 49,326 | 71.1%            |
| Up to 0.50%                                      | 1,834          | 455                      | 460                | 2,749     | 4.0%             |
| 0.51% to 1.00%                                   | 1,015          | 139                      | 34                 | 1,188     | 1.7%             |
| 1.01% to 1.50%                                   | 757            | 15                       | -                  | 772       | 1.1%             |
| 1.51% to 2.00%                                   | 471            | -                        | 373                | 844       | 1.2%             |
| 2.01% to 2.50%                                   | 105            | -                        | -                  | 105       | 0.2%             |
| 2.51% to 3.00%                                   | 489            | -                        | -                  | 489       | 0.7%             |
| 3.01% or greater                                 | 233            | -                        | -                  | 233       | 0.3%             |
| Occurring after the next twelve months (4)       | 6,654          | -                        | -                  | 6,654     | 9.6%             |
| Total discretionary rate setting products        | 19,875         | 10,505                   | 31,980             | 62,360    | 89.9%            |

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|   |           |           |           |           |        |
|---|-----------|-----------|-----------|-----------|--------|
| Other contracts (5)   | 2,141     | 4,892     | -         | 7,033     | 10.1%  |
| Total account values  | \$ 22,016 | \$ 15,397 | \$ 31,980 | \$ 69,393 | 100.0% |
| Percentage of discretionary rate setting product account values at minimum guaranteed rates | 41.8%     | 94.2%     | 97.3%     | 79.1%     |        |

- (1) Excludes policy loans.
- (2) Contracts currently within new money rate bands are grouped according to the corresponding portfolio rate band in which they will fall upon their first anniversary.
- (3) The average crediting rates were 40 basis points, 2 basis points and 4 basis points in excess of average minimum guaranteed rates for our Annuities, Retirement Plan Services and Life Insurance segments, respectively.
- (4) The average crediting rates were 133 basis points in excess of average minimum guaranteed rates. Of our account values for these products, 24% are scheduled to reset in more than one year but not more than two years; 24% are scheduled to reset in more than two years but not more than three years; and 52% are scheduled to reset in more than three years.
- (5) For Annuities, this amount relates primarily to income annuity and short-term dollar cost averaging business. For Retirement Plan Services, this amount relates primarily to indexed-based rate setting products in which the average crediting rates were 7 basis points in excess of average minimum guaranteed rates, and 88% of account values were already at their minimum guaranteed rates.

The maturity structure and call provisions of the related portfolios are structured to afford protection against erosion of investment portfolio yields during periods of declining interest rates. We devote extensive effort to evaluating the risks associated with falling interest rates by simulating asset and liability cash flows for a wide range of interest rate scenarios. We seek to manage these exposures by maintaining a suitable maturity structure and by limiting our exposure to call risk in each respective investment portfolio.

## Derivatives

See Note 5 for information on our derivatives used to hedge our exposure to changes in interest rates.



## Equity Market Risk

Our revenues, assets and liabilities are exposed to equity market risk that we often hedge with derivatives. Due to the use of our reversion to the mean (“RTM”) process and our hedging strategies, we expect that, in general, short-term fluctuations in the equity markets should not have a significant effect on our quarterly earnings from unlocking of assumptions for deferred acquisition costs, value of business acquired, deferred sales inducements and deferred front-end loads. However, earnings are affected by equity market movements on account values and assets under management and the related fees we earn on those assets. Refer to “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Introduction – Critical Accounting Policies and Estimates – DAC, VOBA, DSI and DFEL” in our 2013 Form 10-K for further discussion of the effects of equity markets on our RTM.

## Effect of Equity Market Sensitivity

For information about the effect of equity market sensitivity on our income (loss) operations, see “Part II – Item 7A. Quantitative and Qualitative Disclosures About Market Risk – Equity Market Risk – Effect of Equity Market Sensitivity” in our 2013 Form 10-K.

## Credit Risk

We use credit-related derivatives to minimize our exposure to credit-related events, and we also sell credit default swaps to offer credit protection to our contract holders and investors. See Note 5 for additional information.

In addition to the information provided about our counterparty exposure in Note 5, the fair value of our exposure by rating (in millions) was as follows:

|       | As of<br>March<br>31,<br>2014 | As of<br>December<br>31,<br>2013 |
|-------|-------------------------------|----------------------------------|
| AA    | \$ 17                         | \$ (3 )                          |
| A     | 41                            | 62                               |
| BBB   | 5                             | 10                               |
| Total | \$ 63                         | \$ 69                            |

See Note 5 for additional information on our credit risk.

Item 4. Controls and Procedures

Conclusions Regarding Disclosure Controls and Procedures

We maintain disclosure controls and procedures, which are designed to ensure that information required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. As of the end of the period required by this report, we, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us and our consolidated subsidiaries required to be disclosed in our periodic reports under the Exchange Act.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended March 31, 2014, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

A control system, no matter how well designed and operated, can provide only reasonable assurance that the control system's objectives will be met. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the company have been detected. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

## PART II – OTHER INFORMATION

## Item 1. Legal Proceedings

Information regarding reportable legal proceedings is contained in Note 8 in “Part I – Item 1.”

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) The following table summarizes purchases of equity securities by the issuer during the quarter ended March 31, 2014 (dollars in millions, except per share data):

| Period           | (a) Total<br>Number<br>of Shares<br>(or Units)<br>Purchased<br>(1) | (b)<br>Average<br>Price<br>Paid<br>per<br>Share<br>(or Unit) | (c) Total<br>Number<br>of Shares<br>(or Units)<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans or<br>Programs<br>(2) | (d)<br>Approximate<br>Dollar<br>Value of<br>Shares (or<br>Units) that<br>May Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs<br>(2)(3) |
|------------------|--|--|---|---|
| 1/1/14 – 1/31/14 | -  | \$ -   | -   | \$ 358  |
| 2/1/14 – 2/28/14 | 1,585,656  | 49.44  | 1,582,800   | 280   |
| 3/1/14 – 3/31/14 | 1,405,019  | 51.00  | 1,405,019   | 208   |

(1)Includes the deemed surrender of 2,856 shares of common stock to pay the exercise price in connection with the exercise of stock options. For the quarter ended March 31, 2014, there were 2,987,819 shares purchased as part of publicly announced plans or programs.

(2)On August 8, 2012, our Board of Directors authorized an increase in our securities repurchase authorization, bringing the total aggregate repurchase authorization to \$1.0 billion. As of March 31, 2014, our remaining security repurchase authorization was \$208 million. The security repurchase authorization does not have an expiration date. The amount and timing of share repurchase depends on key capital ratios, rating agency

expectations, the generation of free cash flow and an evaluation of the costs and benefits associated with alternative uses of capital.

(3)As of the last day of the applicable month.

Item 6. Exhibits

The Exhibits included in this report are listed in the Exhibit Index beginning on page E-1, which is incorporated herein by reference.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LINCOLN NATIONAL  
CORPORATION

By: /s/ RANDAL  
J. FREITAG

Randal J.  
Freitag

Executive Vice  
President and  
Chief Financial  
Officer

By: /s/ DOUGLAS  
N. MILLER

Douglas N.  
Miller

Senior Vice  
President and  
Chief  
Accounting  
Officer

Dated: May 1, 2014



LINCOLN NATIONAL CORPORATION

Exhibit Index for the Report on Form 10-Q

For the Quarter Ended March 31, 2014

- 10.1 Form of 2014-2016 Performance Cycle Agreement for the Senior Management Committee and the Corporate Leadership Group under the LNC 2009 Amended and Restated Incentive Compensation Plan, filed herewith.
- 10.2 Form of 2014-2016 Performance Cycle Agreement for the CEO under the LNC 2009 Amended and Restated Incentive Compensation Plan, filed herewith.
- 12 Historical Ratio of Earnings to Fixed Charges.
- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.