

LINCOLN NATIONAL CORP  
Form 10-Q  
August 09, 2007

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D. C. 20549**

\_\_\_\_\_  
**FORM 10-Q**  
\_\_\_\_\_

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended June 30, 2007.

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

Commission File Number 1-6028

\_\_\_\_\_  
**LINCOLN NATIONAL CORPORATION**

(Exact name of registrant as specified in its charter)

\_\_\_\_\_  
**Indiana**  
(State or other jurisdiction of

incorporation or organization)

\_\_\_\_\_  
**35-1140070**  
(I.R.S. Employer

Identification No.)

**1500 Market Street, Suite 3900, Philadelphia, Pennsylvania**  
(Address of principal executive offices)

**19102-2112**  
(Zip Code)

**(215) 448-1400**

Registrant's telephone number, including area code

**Not Applicable**

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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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

(Check one): Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of August 1, 2007, there were 271,283,405 shares of the registrant's common stock outstanding.

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## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

## LINCOLN NATIONAL CORPORATION

## CONSOLIDATED BALANCE SHEETS

|  | June 30,<br>2007<br>(Unaudited) | December 31,<br>2006 |
|--|---------------------------------|----------------------|
|  | (in millions)                   |                      |
| <b>ASSETS</b>  |                                 |                      |
| Investments:   |                                 |                      |
| Securities available-for-sale, at fair value:              |                                 |                      |
| Fixed maturity (cost: 2007-\$55,555; 2006-\$54,960)        | \$ 55,447                       | \$ 55,853            |
| Equity (cost: 2007-\$670; 2006-\$681)                      | 687                             | 701                  |
| Trading securities   | 2,818                           | 3,036                |
| Mortgage loans on real estate                              | 7,311                           | 7,384                |
| Real estate  | 388                             | 421                  |
| Policy loans   | 2,787                           | 2,760                |
| Derivative investments                                     | 376                             | 415                  |
| Other investments  | 1,054                           | 918                  |
| Total investments  | 70,868                          | 71,488               |
| Cash and invested cash                                     | 989                             | 1,621                |
| Deferred acquisition costs and value of business acquired  | 9,101                           | 8,420                |
| Premiums and fees receivable                               | 432                             | 356                  |
| Accrued investment income                                  | 861                             | 866                  |
| Amounts recoverable from reinsurers                        | 8,179                           | 7,939                |
| Goodwill   | 4,521                           | 4,500                |
| Other assets   | 3,202                           | 2,770                |
| Assets held in separate accounts                           | 89,497                          | 80,534               |
| Total assets   | \$ 187,650                      | \$ 178,494           |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                |                                 |                      |
| <b>Liabilities</b>   |                                 |                      |
| Insurance and investment contract liabilities:             |                                 |                      |
| Insurance policy and claim reserves                        | \$ 15,032                       | \$ 14,771            |
| Investment contract and policyholder funds                 | 59,136                          | 58,817               |
| Total insurance and investment contract liabilities        | 74,168                          | 73,588               |
| Short-term debt  | 230                             | 658                  |
| Long-term debt:  |                                 |                      |
| Senior notes   | 2,382                           | 2,231                |
| Junior subordinated debentures issued to affiliated trusts | 155                             | 155                  |
| Capital securities   | 1,571                           | 1,072                |
| Reinsurance related derivative liability                   | 158                             | 229                  |
| Funds withheld reinsurance liabilities                     | 2,155                           | 2,094                |
| Deferred gain on indemnity reinsurance                     | 734                             | 760                  |
| Other liabilities  | 4,764                           | 4,972                |
| Liabilities related to separate accounts                   | 89,497                          | 80,534               |
| Total liabilities  | 175,814                         | 166,293              |

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

**Shareholders' Equity**

|  |                   |                   |
|--|-------------------|-------------------|
| Series A preferred stock-10,000,000 shares authorized (2007 liquidation value-\$1)                               | 1                 | 1                 |
| Common stock-800,000,000 shares authorized (shares issued and outstanding: 2007- 271,441,613; 2006- 275,752,668) | 7,363             | 7,449             |
| Retained earnings  | 4,323             | 4,138             |
| Accumulated other comprehensive income   | 149               | 613               |
| <b>Total shareholders' equity</b>  | <b>11,836</b>     | <b>12,201</b>     |
| <b>Total liabilities and shareholders' equity</b>  | <b>\$ 187,650</b> | <b>\$ 178,494</b> |

See accompanying Notes to Consolidated Financial Statements

**LINCOLN NATIONAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**

|   | Three Months Ended<br>June 30,          |               | Six Months Ended<br>June 30, |               |
|---|---|---------------|------------------------------|---------------|
|   | 2007                                    | 2006          | 2007                         | 2006          |
|   | (Unaudited)                             |               |                              |               |
|   | (in millions, except per share amounts) |               |                              |               |
| <b>Revenue</b>  |   |               |                              |               |
| Insurance premiums                                      | \$ 489                                  | \$ 454        | \$ 948                       | \$ 533        |
| Insurance fees  | 758                                     | 692           | 1,537                        | 1,167         |
| Investment advisory fees                                | 93                                      | 81            | 183                          | 159           |
| Communications revenue (net)                            | 57                                      | 58            | 125                          | 58            |
| Net investment income                                   | 1,170                                   | 1,068         | 2,259                        | 1,747         |
| Realized gain (loss)                                    | (5)                                     | (5)           | 22                           | (6)           |
| Amortization of deferred gain on indemnity reinsurance  | 26                                      | 19            | 45                           | 38            |
| Other revenue and fees                                  | 152                                     | 129           | 292                          | 221           |
| <b>Total revenue</b>                                    | <b>2,740</b>                            | <b>2,496</b>  | <b>5,411</b>                 | <b>3,917</b>  |
| <b>Benefits and Expenses</b>                            |   |               |                              |               |
| Benefits  | 1,287                                   | 1,179         | 2,481                        | 1,760         |
| Underwriting, acquisition, insurance and other expenses | 815                                     | 717           | 1,620                        | 1,220         |
| Communications expense                                  | 31                                      | 30            | 72                           | 30            |
| Interest and debt expense                               | 73                                      | 65            | 134                          | 87            |
| <b>Total benefits and expenses</b>                      | <b>2,206</b>                            | <b>1,991</b>  | <b>4,307</b>                 | <b>3,097</b>  |
| Income before taxes                                     | 534                                     | 505           | 1,104                        | 820           |
| Federal income taxes                                    | 158                                     | 156           | 332                          | 250           |
| <b>Net income</b>                                       | <b>\$ 376</b>                           | <b>\$ 349</b> | <b>\$ 772</b>                | <b>\$ 570</b> |
| <b>Net Income Per Common Share</b>                      |   |               |                              |               |
| Basic   | \$ 1.39                                 | \$ 1.25       | \$ 2.83                      | \$ 2.51       |
| Diluted   | \$ 1.37                                 | \$ 1.23       | \$ 2.79                      | \$ 2.47       |

See accompanying Notes to Consolidated Financial Statements

## LINCOLN NATIONAL CORPORATION

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

|  | Six Months Ended                        |                  |
|--|---|------------------|
|  | 2007                                    | June 30,<br>2006 |
|  | (Unaudited)                             |                  |
|  | (in millions, except for share amounts) |                  |
| <b>Series A Preferred Stock</b>  |   |                  |
| Balance at beginning-of-year   | \$ 1                                    | \$ 1             |
| Balance at end-of-period   | 1                                       | 1                |
| <b>Common Stock</b>  |   |                  |
| Balance at beginning-of-year   | 7,449                                   | 1,775            |
| Issued for acquisition   | 20                                      | 5,632            |
| Stock compensation/issued for benefit plans  | 85                                      | 92               |
| Deferred compensation payable in stock   | 4                                       | 9                |
| Retirement of common stock   | (195)                                   | (82)             |
| Balance at end-of-period   | 7,363                                   | 7,426            |
| <b>Retained Earnings</b>   |   |                  |
| Balance at beginning-of-year   | 4,138                                   | 4,081            |
| Cumulative effect of adoption of SOP 05-1  | (41)                                    |                  |
| Cumulative effect of adoption of FIN 48  | (15)                                    |                  |
| Comprehensive income   | 308                                     | 7                |
| Less other comprehensive income (loss) (net of Federal income tax):                      |   |                  |
| Net unrealized loss on securities available-for-sale, net of reclassification adjustment | (476)                                   | (648)            |
| Net unrealized gain (loss) on derivative instruments                                     | (4)                                     | 44               |
| Foreign currency translation adjustment  | 16                                      | 45               |
| Amortization of actuarial net loss   |   | (4)              |
| Net income   | 772                                     | 570              |
| Retirement of common stock   | (317)                                   | (423)            |
| Dividends declared:  |   |                  |
| Common (2007-\$.79; 2006-\$.76)  | (214)                                   | (215)            |
| Balance at end-of-period   | 4,323                                   | 4,013            |
| <b>Net Unrealized Gain (Loss) on Securities Available-for-Sale</b>                       |   |                  |
| Balance at beginning-of-year   | 493                                     | 497              |
| Change during the period   | (476)                                   | (648)            |
| Balance at end-of-period   | 17                                      | (151)            |
| <b>Net Unrealized Gain on Derivative Instruments</b>                                     |   |                  |
| Balance at beginning-of-year   | 39                                      | 7                |
| Change during the period   | (4)                                     | 44               |
| Balance at end-of-period   | 35                                      | 51               |
| <b>Foreign Currency Translation Adjustment</b>   |   |                  |

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|  |           |           |
|--|-----------|-----------|
| Balance at beginning-of-year                   | 165       | 83        |
| Change during the period                       | 16        | 45        |
| Balance at end-of-period                       | 181       | 128       |
| <b>Minimum Pension Liability Adjustment</b>    |           |           |
| Balance at beginning-of-year                   |           | (60)      |
| Change during the period                       |           | (4)       |
| Balance at end-of-period                       |           | (64)      |
| <b>Funded Status of Employee Benefit Plans</b> |           |           |
| Balance at beginning-of-year                   | (84)      |           |
| Balance at end-of-period                       | (84)      |           |
| Total shareholders' equity at end-of-period    | \$ 11,836 | \$ 11,404 |

See accompanying Notes to Consolidated Financial Statements

## LINCOLN NATIONAL CORPORATION

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

-CONTINUED-

|   | Six Months Ended                              |             |
|---|---|-------------|
|   | 2007  | 2006        |
|   | June 30,<br>(Unaudited)<br>(Number of Shares) |             |
| <b>Series A Preferred Stock</b>                 |   |             |
| Balance at beginning-of-year                    | 12,706  | 15,515      |
| Conversion into common stock                    | (345)   | (987)       |
| Balance at end-of-period                        | 12,361  | 14,528      |
| <b>Common Stock</b>                             |   |             |
| Balance at beginning-of-year                    | 275,752,668                                   | 173,768,078 |
| Issued for acquisition                          |   | 112,301,906 |
| Conversion of series A preferred stock          | 5,520   | 15,792      |
| Stock compensation/issued for benefit plans     | 2,829,181                                     | 3,353,059   |
| Deferred compensation payable in stock          | 69,161  | 158,342     |
| Retirement of common stock                      | (7,214,917)                                   | (8,060,131) |
| Balance issued and outstanding at end-of-period | 271,441,613                                   | 281,537,046 |
| Common stock at end-of-period:                  |   |             |
| Assuming conversion of preferred stock          | 271,639,389                                   | 281,769,494 |
| Diluted basis                                   | 274,489,187                                   | 284,958,226 |

See accompanying Notes to Consolidated Financial Statements



## LINCOLN NATIONAL CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Six Months Ended<br>June 30, |         |
|---|------------------------------|---------|
|   | 2007                         | 2006    |
|   | (Unaudited)<br>(in millions) |         |
| <b>Cash Flows from Operating Activities</b>                                       |                              |         |
| Net income  | \$ 772                       | \$ 570  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |         |
| Deferred acquisition costs and value of business acquired                         | (466)                        | (249)   |
| Premiums and fees receivable  | (76)                         | 61      |
| Accrued investment income   | 5                            | 2       |
| Policy liabilities and accruals   | 147                          | (277)   |
| Net trading securities purchases, sales and maturities                            | 218                          | (20)    |
| Loss on reinsurance embedded derivative/trading securities                        | (5)                          | (8)     |
| Contractholder funds  | 905                          | 533     |
| Pension plan contribution   | (4)                          |         |
| Amounts recoverable from reinsurers   | (120)                        | 255     |
| Federal income taxes  | 296                          | 52      |
| Stock-based compensation expense  | 29                           | 30      |
| Depreciation  | 15                           | 30      |
| Increase in funds withheld liability  | 61                           | 59      |
| Realized gain (loss) on investments and derivative instruments                    | (17)                         | 14      |
| Amortization of deferred gain on indemnity reinsurance                            | (45)                         | (38)    |
| Other   | (326)                        | (92)    |
| Net adjustments   | 617                          | 352     |
| Net cash provided by operating activities   | 1,389                        | 922     |
| <b>Cash Flows from Investing Activities</b>                                       |                              |         |
| Securities-available-for-sale:  |                              |         |
| Purchases   | (7,995)                      | (3,718) |
| Sales   | 5,206                        | 2,565   |
| Maturities  | 2,125                        | 1,348   |
| Purchase of other investments   | (1,251)                      | (697)   |
| Sale or maturity of other investments   | 1,157                        | 449     |
| Increase in cash collateral on loaned securities                                  | (132)                        | 133     |
| Purchase of Jefferson-Pilot stock, net of cash acquired of \$39                   |                              | (1,847) |
| Other   | 10                           | (123)   |
| Net cash used in investing activities   | (880)                        | (1,890) |
| <b>Cash Flows from Financing Activities</b>                                       |                              |         |
| Payment of long-term debt   | (553)                        |         |
| Issuance of long-term debt  | 750                          | 2,045   |
| Net increase (decrease) in short-term debt  | 30                           | (557)   |
| Universal life and investment contract deposits                                   | 4,500                        | 3,136   |
| Universal life and investment contract withdrawals                                | (4,071)                      | (3,004) |
| Investment contract transfers   | (1,131)                      | (817)   |
| Common stock issued for benefit plans and excess tax benefits                     | 62                           | 71      |
| Retirement of common stock  | (512)                        | (503)   |
| Dividends paid to shareholders  | (216)                        | (215)   |

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|   |         |          |
|---|---------|----------|
| Net cash provided by (used in) financing activities | (1,141) | 156      |
| Net decrease in cash and invested cash              | (632)   | (812)    |
| Cash and invested cash at beginning-of-year         | 1,621   | 2,312    |
| Cash and invested cash at end-of-period             | \$ 989  | \$ 1,500 |

See accompanying Notes to Consolidated Financial Statements

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LINCOLN NATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**1. Basis of Presentation**

Lincoln National Corporation and its majority-owned subsidiaries ( LNC or the Company, which also may be referred to as we, our or us ) operate multiple insurance and investment management businesses as well as a broadcasting and sports programming business through seven business segments (see Note 10). The collective group of businesses uses Lincoln Financial Group as its marketing identity. Through our business segments, we sell a wide range of wealth protection, accumulation and retirement income products and solutions. These products include institutional and/or retail fixed and indexed annuities, variable annuities, universal life insurance, variable universal life insurance, term life insurance, mutual funds and managed accounts.

The accompanying unaudited consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) for interim financial information and with the instructions for the Securities and Exchange Commission 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, 2006 ( 2006 Form 10-K ) should be referred to in connection with the reading of these interim unaudited consolidated financial statements.

On April 3, 2006, we completed our merger with Jefferson-Pilot Corporation ( Jefferson-Pilot ), and have included the results of operations and financial condition of Jefferson-Pilot in our consolidated financial statements beginning on April 3, 2006.

On June 7, 2007, we announced plans to explore strategic options for Lincoln Financial Media. We are evaluating a range of options including, but not limited to, divestiture strategies. At this time, there have been no decisions from this strategic review, and a transaction may or may not result from the completion of this evaluation.

In the opinion of management, these statements include all normal recurring adjustments necessary for a fair presentation of the results. Operating results for the three and six month periods ended June 30, 2007 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2007. All material intercompany accounts and transactions have been eliminated in consolidation.

Certain amounts reported in prior periods' unaudited consolidated financial statements have been reclassified to conform to the 2007 presentation. These reclassifications have no effect on net income or shareholders' equity of the prior periods.

**2. Changes in Accounting Principles and Changes in Estimates**

**Statement of Position 05-1 Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts.** In September 2005, the American Institute of Certified Public Accountants ( AICPA ) issued Statement of Position ( SOP ) 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts ( SOP 05-1 ). SOP 05-1 provides guidance on accounting for deferred acquisition costs ( DAC ) on internal replacements of insurance and investment contracts. An internal replacement, defined by SOP 05-1, is a modification in product benefits, features, rights or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement or rider to a contract, or by the election of a feature or coverage within a contract. Contract modifications that result in a substantially unchanged contract will be accounted for as a continuation of the replaced contract. Contract modifications that result in a substantially changed contract should be accounted for as an extinguishment of the replaced contract. Unamortized DAC, unearned revenue and deferred sales inducements from the replaced contract must be written-off. SOP 05-1 is effective for internal replacements occurring in fiscal years beginning after December 15, 2006.

We adopted SOP 05-1 effective January 1, 2007 by recording decreases to the following categories in our Consolidated Balance Sheets:

(in millions)

**Assets**

|   |       |
|---|-------|
| Deferred acquisition costs                | \$ 31 |
| Value of business acquired                | 35    |
| Other assets - deferred sales inducements | 3     |

|                     |              |
|---------------------|--------------|
| <b>Total assets</b> | <b>\$ 69</b> |
|---------------------|--------------|

**Liabilities and Shareholders' Equity**

|   |      |
|---|------|
| Investment contract and policyholder funds - deferred front end loads                   | \$ 2 |
| Insurance policy and claim reserves - guaranteed minimum death benefit annuity reserves | 4    |
| Other liabilities - income tax liabilities  | 22   |

|                          |           |
|--------------------------|-----------|
| <b>Total liabilities</b> | <b>28</b> |
|--------------------------|-----------|

|                          |           |
|--------------------------|-----------|
| <b>Retained earnings</b> | <b>41</b> |
|--------------------------|-----------|

|   |              |
|---|--------------|
| <b>Total liabilities and shareholders' equity</b> | <b>\$ 69</b> |
|---|--------------|

The adoption of this new guidance primarily impacts our Individual Markets Annuities and Employer Markets Group Protection businesses, and our accounting policies regarding the assumptions for lapsation used in the amortization of DAC and value of business acquired ( VOBA ). In addition, the adoption of SOP 05-1 resulted in a \$4 million and \$10 million pre-tax increase to underwriting, acquisition, insurance and other expenses on our Consolidated Statements of Income in the three and six month periods ended June 30, 2007, which was attributable to changes in DAC and VOBA amortization.

**FASB Interpretation No. 48 - Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109.** In July 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 ( FIN 48 ). FIN 48 requires an entity to determine whether it is more likely than not that an individual tax position will be sustained upon examination by the appropriate taxing authority prior to any part of the benefit being recognized in the financial statements. The amount recognized would be the largest amount of tax benefit that is greater than fifty percent likely of being realized upon ultimate settlement, along with any related interest and penalties (if applicable). Upon adoption of FIN 48, the guidance will be applied to all tax positions, and only those tax positions meeting the more likely than not threshold will be recognized or continue to be recognized in the financial statements. In addition, FIN 48 expands disclosure requirements to include additional information related to unrecognized tax benefits, including accrued interest and penalties, and uncertain tax positions where the estimate of the tax benefit may change significantly in the next twelve months. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted FIN 48 effective January 1, 2007 by recording an increase in the liability for unrecognized tax benefits of \$15 million in our Consolidated Balance Sheets, offset by a reduction to the beginning balance of retained earnings. See Note 4 for more information regarding our adoption of FIN 48.

**SFAS No. 155 - Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140.** In February 2006, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 155, Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140 ( SFAS 155 ), which permits fair value remeasurement for a hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. Under SFAS 155, an entity may make an irrevocable election to measure a hybrid financial instrument at fair value, in its entirety, with changes in fair value recognized in earnings. SFAS 155 also: (a) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ); (b) eliminates the interim guidance in SFAS 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets, and establishes a requirement to evaluate beneficial interests in securitized financial assets to identify interests that are either freestanding derivatives or hybrid financial instruments that contain an embedded derivative requiring bifurcation; (c) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and (d) eliminates restrictions on a qualifying special-purpose entity's ability to hold passive derivative financial instruments that pertain to beneficial interests that are or contain a derivative financial instrument.

In December 2006, the FASB issued Derivative Implementation Group Statement 133 Implementation Issue No. B40,



Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets ( DIG B40 ). Since SFAS 155 eliminated the interim guidance related to securitized financial assets, DIG B40 provides a narrow scope exception for securitized interests that contain only an embedded derivative related to prepayment risk. Under DIG B40, a securitized interest in prepayable financial assets would not be subject to bifurcation if: (a) the right to accelerate the settlement of the securitized interest cannot be controlled by the investor and (b) the securitized interest itself does not contain an embedded derivative for which bifurcation would be required other than an embedded derivative that results solely from the embedded call options in the underlying financial assets. Any other terms in the securitized financial asset that may affect cash flow in a manner similar to a derivative instrument would be subject to the requirements of paragraph 13(b) of SFAS 133. The guidance in DIG B40 is to be applied upon the adoption of SFAS 155.

We adopted the provisions SFAS 155 and DIG B40 on January 1, 2007. Prior period restatement was not permitted. The adoption of SFAS 155 did not have a material impact on our consolidated financial condition or results of operations.

**SFAS No. 157 Fair Value Measurements.** In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS 157 ), which establishes a framework for measuring fair value under current accounting pronouncements that require or permit fair value measurement. SFAS 157 retains the exchange price notion, but clarifies that exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the most advantageous market for that asset or liability. Fair value measurement is based on assumptions used by market participants in pricing the asset or liability, which may include inherent risk, restrictions on the sale or use of an asset, or nonperformance risk which would include the reporting entity's own credit risk. SFAS 157 establishes a three-level fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value. The highest priority is given to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs in situations where there is little or no market activity for the asset or liability. In addition, SFAS 157 expands the disclosure requirements for annual and interim reporting to focus on the inputs used to measure fair value, including those measurements using significant unobservable inputs, and the effects of the measurements on earnings. SFAS 157 will be applied prospectively and is effective for fiscal years beginning after November 15, 2007. Retrospective application is required for certain financial instruments as a cumulative effect adjustment to the opening balance of retained earnings. We expect to adopt SFAS 157 effective January 1, 2008, and are currently evaluating the effects of SFAS 157 on our consolidated financial condition and results of operations.

**SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities.** In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ), which allows an entity to make an irrevocable election, on specific election dates, to measure eligible items at fair value. The election to measure an item at fair value may be determined on an instrument by instrument basis, with certain exceptions. If the fair value option is elected, unrealized gains and losses will be recognized in earnings at each subsequent reporting date, and any upfront costs and fees related to the item will be recognized in earnings as incurred. In addition, the presentation and disclosure requirements of SFAS 159 are designed to assist in the comparison between entities that select different measurement attributes for similar types of assets and liabilities. SFAS 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS 157. At the effective date, the fair value option may be elected for eligible items that exist on that date. The effect of the first remeasurement to fair value shall be reported as a cumulative effect adjustment to the opening balance of retained earnings. We expect to adopt SFAS 159 effective January 1, 2008, and are currently evaluating the items to which we may apply the fair value option and the effect on our consolidated financial condition and results of operations.

**SOP 07-1 Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies.** In June 2007, the AICPA issued SOP 07-1, Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies ( SOP 07-1 ). SOP 07-1 provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide, *Investment Companies* ( the Guide ). For those entities that are deemed to be investment companies, this SOP also addresses whether the specialized industry accounting principles of the Guide ( investment company accounting ) should be retained by a parent company in consolidation or by an investor that has the ability to exercise significant influence over the investment company and applies the equity method of accounting to its investment in the entity ( equity method investor ). In addition, this SOP includes certain disclosure requirements for parent companies and equity method investors in investment companies that retain investment company accounting in the parent company's consolidated financial statements or the financial statements of an equity method investor. This SOP may cause companies to no longer be considered investment companies or investors in investment companies to no longer be able to retain the specialized industry accounting of an investee in their own financial statements. However, it may be possible for these entities or investors to elect, upon transition, to report certain noncontrolling investments at fair value under SFAS 159. SOP 07-1 applies to fiscal years beginning on or after December 15, 2007. We expect to adopt SOP 07-1 effective January 1, 2008, and are currently evaluating the effects of SOP 07-1 on our consolidated financial condition and results of operations.

### 3. Business Combination

On April 3, 2006, we completed our merger with Jefferson-Pilot by acquiring 100% of the outstanding shares of Jefferson-Pilot in a transaction accounted for under the purchase method of accounting prescribed by SFAS No. 141, Business Combinations ( SFAS 141 ). Jefferson-Pilot's results of operations are included in our results of operations beginning April 3, 2006. As a result of the merger, our product portfolio was expanded, and we now offer fixed and variable universal life, fixed annuities, including indexed annuities, variable annuities, mutual funds and institutional accounts, 401(k) and 403(b) offerings, and group life, disability and dental insurance products. We also own and operate television and radio stations in selected markets in the Southeastern and Western United States and produce and distribute sports programming.

SFAS 141 requires that the total purchase price be allocated to the assets acquired and liabilities assumed based on their fair values at the merger date.

The aggregate consideration paid for the merger was as follows:

| (in millions, except share data)                            | Share<br>Amounts |                 |
|---|------------------|-----------------|
| LNC common shares issued                                    | 112,301,906      |                 |
| Purchase price per share of LNC common share <sup>(1)</sup> | \$ 48.98         |                 |
| Fair value of common shares issued                          |                  | \$ 5,501        |
| Cash paid to Jefferson-Pilot shareholders                   |                  | 1,800           |
| Fair value of Jefferson-Pilot stock options <sup>(2)</sup>  |                  | 151             |
| Transaction costs   |                  | 66              |
| <b>Total purchase price</b>                                 |                  | <b>\$ 7,518</b> |

<sup>(1)</sup> The value of the shares of LNC common stock exchanged with Jefferson-Pilot shareholders was based upon the average of the closing prices of LNC common stock for the five day trading period ranging from two days before, to two days after, October 10, 2005, the date the merger was announced.

<sup>(2)</sup> Includes certain stock options that vested immediately upon the consummation of the merger. Any future income tax deduction related to these vested stock options will be recognized on the option exercise date as an adjustment to the purchase price and recorded to goodwill. The fair value of Jefferson-Pilot's specifically identifiable net assets acquired in the merger was \$4.2 billion. Goodwill of \$3.3 billion resulted from the excess of purchase price over the fair value of Jefferson-Pilot's net assets. The amount of goodwill that is expected to be deductible for tax purposes is approximately \$24 million. We paid a premium over the fair value of Jefferson-Pilot's net assets for a number of potential strategic and financial benefits that are expected to be realized as a result of the merger including, but not limited to, the following:

Greater size and scale with improved earnings diversification and strong financial flexibility;

Broader, more balanced product portfolio;

Larger distribution organization; and

Value creation opportunities through expense savings and revenue enhancements across business units.

The following table summarizes the fair values of the net assets acquired as of the acquisition date:

| (in millions)                                    | Fair Value   |
|--|--------------|
| Investments                                      | \$ 27,910    |
| Due from reinsurers                              | 1,296        |
| Value of business acquired                       | 2,486        |
| Goodwill   | 3,324        |
| Other assets                                     | 1,693        |
| Assets held in separate accounts                 | 2,574        |
| Insurance and investment contract liabilities    | (26,641)     |
| Long-term debt                                   | (905)        |
| Income tax liabilities                           | (782)        |
| Accounts payable, accruals and other liabilities | (863)        |
| Liabilities related to separate accounts         | (2,574)      |
| <br>Total purchase price                         | <br>\$ 7,518 |

The goodwill resulting from the merger was allocated to the following segments <sup>(1)</sup>:

| (in millions)                      |              |
|------------------------------------|--------------|
| Individual Markets:                |              |
| Life Insurance                     | \$ 1,346     |
| Annuities                          | 1,002        |
| <br>Total Individual Markets       | <br>2,348    |
| Employer Markets: Group Protection | 274          |
| Lincoln Financial Media            | 702          |
| <br>Total goodwill                 | <br>\$ 3,324 |

<sup>(1)</sup> In the second quarter of 2007, we reclassified an immaterial amount of goodwill between segments to correct the presentation of the final allocation of goodwill by segment. This change had no impact to total goodwill.

The following table summarizes the fair value of identifiable intangible assets acquired in the merger and reported in other assets.

| (in millions)                      |         | Weighted<br>Average<br>Amortization<br>Period |
|------------------------------------|---------|---|
| Lincoln Financial Media:           |         |   |
| FCC licenses                       | \$ 638  | N/A   |
| Sports production rights           | 11      | 5 years                                       |
| Network affiliation agreements     | 10      | 21 years                                      |
| Other                              | 11      | 16 years                                      |
| <br>Total Lincoln Financial Media  | <br>670 |   |
| Individual Markets Life Insurance: |         |   |
| Sales force                        | 100     | 25 years                                      |



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|  |        |          |
|--|--------|----------|
| Total identifiable intangibles                       | \$ 770 |          |
| Identifiable intangibles not subject to amortization | \$ 638 | N/A      |
| Identifiable intangibles subject to amortization     | 132    | 22 years |
| Total identifiable intangibles                       | \$ 770 |          |

**4. Federal Income Taxes**

The effective tax rate was 29.6% and 30.9% for the three months ended June 30, 2007 and 2006, respectively. The effective tax rate for the six months ended June 30, 2007 and 2006 was 30.1% and 30.5%, respectively. Differences in the effective rates and the U.S. statutory rate of 35% are the result of certain tax preferred investment income, foreign tax credits and other tax preference items.

We are required to establish a valuation allowance for any gross deferred tax assets that are unlikely to reduce taxes payable in future years tax returns. At June 30, 2007, we believe that it is more likely than not that all gross deferred tax assets will reduce taxes payable in future years.

As discussed in Note 2, we adopted FIN 48 on January 1, 2007, and as of this date we had unrecognized tax benefits of \$349 million of which \$143 million, if recognized, would impact the effective tax rate. Also, as of the adoption date, we had accrued interest expense related to the unrecognized tax benefits of \$51 million. We recognize interest and penalties, if any, accrued related to unrecognized tax benefits as a component of tax expense.

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

We are currently under audit by the Internal Revenue Service ( IRS ). LNC is currently under audit by the IRS for years 2003 and 2004. For the former Jefferson-Pilot Corporation and its subsidiaries, the IRS is examining the years 2004 and 2005. During the first quarter of 2006, the IRS completed its examination for the tax years 1999 through 2002 with assessments resulting in a payment that was not material to our consolidated results of operations. In addition to taxes assessed and interest, the payment included a deposit relating to a portion of the assessment, which we continue to challenge. We believe that this portion of the assessment is inconsistent with existing law and are protesting it through the established IRS appeals process. We do not anticipate that any adjustments that might result from such audits would be material to our consolidated results of operations or financial condition. It is likely that the IRS appeals process for the tax years 1996 to 1998 will conclude within the next twelve months. It is reasonably possible that a reduction in the unrecognized tax benefits may occur; however, quantification of an estimated range cannot be made at this time.

**5. Supplemental Financial Data**

A rollforward of DAC is as follows:

| (in millions)  | Six Months Ended<br>June 30, |          |
|--|------------------------------|----------|
|  | 2007                         | 2006     |
| Balance at beginning-of-year   | \$ 5,116                     | \$ 4,164 |
| Cumulative effect of adoption of SOP 05-1  | (31)                         |          |
| Deferral   | 968                          | 595      |
| Amortization   | (368)                        | (293)    |
| Adjustment related to realized gains on securities available-for-sale and derivatives    | (13)                         | (30)     |
| Adjustment related to unrealized losses on securities available-for-sale and derivatives | 188                          | 348      |
| Foreign currency translation adjustment  | 13                           | 37       |
| Balance at end-of-period   | \$ 5,873                     | \$ 4,821 |

A rollforward of VOBA is as follows:

| (in millions)  | Six Months Ended<br>June 30, |          |
|--|------------------------------|----------|
|  | 2007                         | 2006     |
| Balance at beginning-of-year   | \$ 3,304                     | \$ 999   |
| Cumulative effect of adoption of SOP 05-1  | (35)                         |          |
| Business acquired  | 14                           | 2,474    |
| Deferral of commissions  | 24                           | 41       |
| Amortization   | (228)                        | (144)    |
| Accretion of interest  | 70                           | 50       |
| Adjustment related to realized gains on securities available-for-sale and derivatives    | (7)                          |          |
| Adjustment related to unrealized losses on securities available-for-sale and derivatives | 78                           | 68       |
| Foreign currency translation adjustment  | 8                            | 19       |
| Balance at end-of-period   | \$ 3,228                     | \$ 3,507 |

Realized gains and losses on investments and derivative instruments on the Consolidated Statements of Income for the six months ended June 30, 2007 and 2006 are net of amounts amortized against DAC and VOBA of \$20 million and \$30 million, respectively. In addition, realized gains and losses for the six months ended June 30, 2007 and 2006 are net of adjustments made to policyholder reserves of \$(2) million and \$(3) million, respectively. We have either a contractual obligation or a consistent historical practice of making allocations of investment gains or losses to certain policyholders and to certain reinsurance arrangements.

A rollforward of deferred sales inducements, which is included in other assets on the Consolidated Balance Sheets, is as follows:

| (in millions)                             | Six Months Ended<br>June 30, |        |
|---|------------------------------|--------|
|   | 2007                         | 2006   |
| Balance at beginning-of-year              | \$ 194                       | \$ 129 |
| Cumulative effect of adoption of SOP 05-1 | (3)                          |        |
| Deferral                                  | 51                           | 36     |
| Amortization                              | (17)                         | (10)   |
| Balance at end-of-period                  | \$ 225                       | \$ 155 |

Details underlying underwriting, acquisition, insurance and other expenses on the Consolidated Statements of Income are as follows:

| (in millions)                               | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |          |
|---|--------------------------------|--------|------------------------------|----------|
|   | 2007                           | 2006   | 2007                         | 2006     |
| Commissions                                 | \$ 536                         | \$ 421 | \$ 1,050                     | \$ 663   |
| General and administrative expenses         | 475                            | 401    | 900                          | 707      |
| DAC and VOBA deferrals, net of amortization | (260)                          | (169)  | (466)                        | (249)    |
| Other intangibles amortization              | 3                              | 7      | 7                            | 8        |
| Taxes, licenses and fees                    | 52                             | 47     | 119                          | 81       |
| Restructuring charges                       | 9                              | 10     | 10                           | 10       |
| Total                                       | \$ 815                         | \$ 717 | \$ 1,620                     | \$ 1,220 |

As discussed in Note 3, the excess of the purchase price for the Jefferson-Pilot merger over the fair value of net assets acquired totaled \$3.3 billion.



The following summarizes the changes in the carrying amount of goodwill by reportable segment for the six months ended June 30, 2007:

| (in millions)              | Balance at<br>December 31, 2006 | Purchase<br>Accounting and<br>Other Adjustments | Balance at<br>June 30, 2007 |
|----------------------------|---------------------------------|---|-----------------------------|
| <b>Individual Markets:</b> |                                 |   |                             |
| Life Insurance             | \$ 2,181                        | \$ 20   | \$ 2,201                    |
| Annuities                  | 1,032                           | 13  | 1,045                       |
| <b>Employer Markets:</b>   |                                 |   |                             |
| Retirement Products        | 20                              |   | 20                          |
| Group Protection           | 281                             | (7)   | 274                         |
| Investment Management      | 262                             |   | 262                         |
| Lincoln Financial Media    | 707                             | (5)   | 702                         |
| Lincoln UK                 | 17                              |   | 17                          |
| <b>Total</b>               | <b>\$ 4,500</b>                 | <b>\$ 21</b>                                    | <b>\$ 4,521</b>             |

Details of investment contract and policyholder funds on the Consolidated Balance Sheets are as follows:

| (in millions)                                    | June 30,<br>2007 | December 31,<br>2006 |
|--|------------------|----------------------|
| Premium deposit funds                            | \$ 20,201        | \$ 20,541            |
| Other policyholder funds                         | 37,742           | 37,197               |
| Deferred front end loads                         | 1,106            | 977                  |
| Undistributed earnings on participating business | 87               | 102                  |
| <b>Total</b>                                     | <b>\$ 59,136</b> | <b>\$ 58,817</b>     |

## 6. Insurance Benefit Reserves

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

The following table provides information on the GMDB features outstanding at June 30, 2007 and December 31, 2006. (Note that our variable contracts with guarantees may offer more than one type of guarantee in each contract; therefore, the amounts listed are not mutually exclusive). The net amount at risk is defined as the current guaranteed minimum death benefit in excess of the current account balance at the balance sheet date.

| (dollars in billions)   | In Event of Death |                      |
|---|-------------------|----------------------|
|   | June 30,<br>2007  | December 31,<br>2006 |
| <b>Return of Net Deposit</b>  |                   |                      |
| Account value   | \$ 42.7           | \$ 38.3              |
| Net amount at risk  | 0.1               | 0.1                  |
| Average attained age of contractholders   | 55                | 54                   |
| <b>Return of Net Deposits Plus a Minimum Return</b>                                   |                   |                      |
| Account value   | \$ 0.4            | \$ 0.4               |
| Net amount at risk  |                   |                      |
| Average attained age of contractholders   | 67                | 67                   |
| Guaranteed minimum return   | 5%                | 5%                   |
| <b>Highest Specified Anniversary Account Value Minus Withdrawals Post Anniversary</b> |                   |                      |
| Account value   | \$ 24.8           | \$ 22.5              |
| Net amount at risk  | 0.2               | 0.2                  |
| Average attained age of contractholders   | 64                | 64                   |

The determination of the GMDB 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 liabilities for GMDB, which is recorded in insurance policy and claim reserves on our Consolidated Balance Sheets:

| (in millions)                             | Six Months Ended<br>June 30, |       |
|---|------------------------------|-------|
|   | 2007                         | 2006  |
| Balance at beginning-of-year              | \$ 23                        | \$ 15 |
| Cumulative effect of adoption of SOP 05-1 | (4)                          |       |
| Changes in reserves                       | 10                           | 11    |
| Benefits paid                             | (3)                          | (3)   |
| Balance at end-of-period                  | \$ 26                        | \$ 23 |

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

Also included in benefits are the results of the hedging program, which included losses of \$1 million and \$2 million for GMDB for the three and six months ended June 30, 2007, respectively, and a loss of \$2 million for the six months ended June 30, 2006.

Separate account balances attributable to variable annuity contracts with guarantees are as follows:

| (in billions)   | June 30,<br>2007 | December 31,<br>2006 |
|---|------------------|----------------------|
| <b>Asset Type</b>   |                  |                      |
| Domestic equity   | \$ 43.8          | \$ 39.3              |
| International equity                                      | 7.2              | 5.9                  |
| Bonds   | 7.3              | 6.4                  |
| <b>Total</b>  | <b>58.3</b>      | <b>51.6</b>          |
| Money market  | 6.3              | 5.6                  |
| <b>Total</b>  | <b>\$ 64.6</b>   | <b>\$ 57.2</b>       |
| Percent of total variable annuity separate account values | 88%              | 87%                  |

### Credit-Linked Notes

As of June 30, 2007 and December 31, 2006, we had \$1.2 billion and \$700 million outstanding in funding agreements, which is classified in investment contract and policyholder funds on our Consolidated Balance Sheets. We invested proceeds of \$850 million from three funding agreements issued in 2006 and 2007 into three separate credit-linked notes originated by third-party companies. We earn a spread between the coupon received on the credit-linked notes and the interest credited on the funding agreements. Our credit-linked notes were created using a trust that combined a high quality asset with a credit default swap to produce multi-class structured securities. Consistent with other debt market instruments, we are exposed to credit losses within the structure of the credit-linked notes, which could result in principal losses to our investments. However, we have insulated our investments from credit losses due to the multi-tiered class structure of the credit-linked note, which requires the subordinated classes of the investment pool to absorb all of the initial credit losses. Our affiliate, Delaware Investments, manages the investments in the underlying portfolio. We will not incur credit losses until after the subordinated classes are retired and additional credit losses are incurred in the underlying credit-linked note structure. Similar to other debt market instruments, our maximum principal loss is limited to our original investment of \$850 million as of June 30, 2007.

The statutory surplus of our insurance subsidiaries is impacted by changes in the market value of these investments. The market values of these investments are sensitive to credit spreads. Sustained declines in the market value of these investments, such as widening credit spreads, would reduce the surplus and may negatively impact the dividend capacity of our insurance subsidiaries.

The table below summarizes information regarding our investments in these securities:

| (dollars in millions)      | Amount and Date of Issuance    |                             |                             |
|----------------------------|--------------------------------|-----------------------------|-----------------------------|
|                            | \$400 million<br>December 2006 | \$200 million<br>April 2007 | \$250 million<br>April 2007 |
| Amount of subordination*   | \$ 2,220                       | \$ 410                      | \$ 1,167                    |
| Total amount of pool       | \$ 40,000                      | \$ 20,000                   | \$ 25,000                   |
| Maturity                   | 12/20/16                       | 3/20/17                     | 6/20/17                     |
| Current rating of tranche* | AA                             | Aa2                         | AA                          |
| Number of entities*        | 125                            | 100                         | 102                         |
| Number of countries*       | 19                             | 21                          | 15                          |
| Number of industries*      | 36                             | 27                          | 30                          |

\* As of August 2, 2007

We are not aware of any significant realized credit losses in the above investments as of June 30, 2007. We have determined that we are not the primary beneficiary, as we do not hold the majority of the risk of loss.

## 7. Employee Benefit Plans

### Pension and Other Postretirement Benefit Plans

As a result of our merger with Jefferson-Pilot, we maintain funded defined benefit pension plans for the former U.S. employees and agents of Jefferson-Pilot. The components of net defined benefit pension plan and postretirement benefit plan expense are as follows:

| (in millions)                           | Pension Benefits   |               | Other Postretirement Benefits |               |      |
|---|--------------------|---------------|-------------------------------|---------------|------|
|   | Three Months Ended |               | Three Months Ended            |               |      |
|   | 2007               | June 30, 2006 | 2007                          | June 30, 2006 | 2006 |
| <b>U.S. Plans</b>                       |                    |               |                               |               |      |
| Service cost                            | \$ 7               | \$ 9          | \$ 1                          |               | \$ 1 |
| Interest cost                           | 14                 | 15            | 2                             |               | 2    |
| Expected return on plan assets          | (20)               | (19)          |                               |               |      |
| Amortization of prior service cost      | (1)                |               |                               |               |      |
| Recognized net actuarial (gains) losses |                    | 1             | (1)                           |               |      |
| Net periodic benefit expense            | \$                 | \$ 6          | \$ 2                          |               | \$ 3 |

#### Non-U.S. Plans

|                                 |      |      |  |  |  |
|---------------------------------|------|------|--|--|--|
| Interest cost                   | \$ 5 | \$ 4 |  |  |  |
| Expected return on plan assets  | (5)  | (4)  |  |  |  |
| Recognized net actuarial losses | 1    | 1    |  |  |  |
| Net periodic benefit expense    | \$ 1 | \$ 1 |  |  |  |

| (in millions)                           | Pension Benefits |               | Other Postretirement Benefits |               |      |
|---|------------------|---------------|-------------------------------|---------------|------|
|   | Six Months Ended |               | Six Months Ended              |               |      |
|   | 2007             | June 30, 2006 | 2007                          | June 30, 2006 | 2006 |
| <b>U.S. Plans</b>                       |                  |               |                               |               |      |
| Service cost                            | \$ 16            | \$ 14         | \$ 2                          |               | \$ 1 |
| Interest cost                           | 30               | 23            | 4                             |               | 3    |
| Expected return on plan assets          | (40)             | (30)          | (1)                           |               |      |
| Amortization of prior service cost      | (1)              |               |                               |               |      |
| Recognized net actuarial (gains) losses |                  | 2             | (1)                           |               | 1    |
| Net periodic benefit expense            | \$ 5             | \$ 9          | \$ 4                          |               | \$ 5 |
| <b>Non-U.S. Plans</b>                   |                  |               |                               |               |      |
| Service cost                            | \$ 1             | \$            |                               |               |      |
| Interest cost                           | 9                | 8             |                               |               |      |
| Expected return on plan assets          | (10)             | (8)           |                               |               |      |
| Recognized net actuarial losses         | 2                | 2             |                               |               |      |
| Net periodic benefit expense            | \$ 2             | \$ 2          |                               |               |      |

On May 1, 2007, we announced plans to change the retirement benefits provided to employees, which include replacing our traditional pension retirement benefits with a new defined contribution plan beginning January 1, 2008. This prospective change in benefits will not impact any of the pension retirement benefits that have already accrued to employees. On January 1, 2008, retirement benefits for employees will begin accruing through the new defined contribution plan. This change is not expected to be material to our future earnings, but resulted in a one-time curtailment gain of \$9 million (\$6 million after-tax) in the second quarter of 2007, which is reported within Other Operations.



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See Note 8 to the consolidated financial statements in our 2006 Form 10-K for a detailed discussion of our other benefit plans.

## 8. Stock-Based Incentive Compensation Plans

See Note 9 to the consolidated financial statements in our 2006 Form 10-K for a detailed discussion of stock and incentive compensation.

We have various incentive plans for our employees, agents and directors and our subsidiaries that provide for the issuance of stock options, stock incentive awards, stock appreciation rights, restricted stock awards, restricted stock units ( performance shares ), and deferred stock units. Delaware Investments U.S., Inc. ( DIUS ) has a separate stock option incentive plan.

In the first quarter of 2007, a performance period from 2007-2009 was approved for our executive officers by the Compensation Committee. Executive officers participating in this performance period received one-half of their award in 10-year LNC or DIUS stock options, with the remainder of the award in a combination of either: 100% performance shares or 75% performance shares and 25% cash. LNC stock options granted for this performance period vest ratably over the three-year period, based solely on a service condition. DIUS stock options granted for this performance period vest ratably over a four-year period, based solely on a service condition and were granted only to employees of DIUS. Depending on the performance, the actual amount of performance shares could range from zero to 200% of the granted amount. Under the 2007-2009 plan, a total of 725,161 LNC stock options were granted; 12,237 DIUS stock options were granted; and 126,879 LNC performance shares were granted.

In addition to the stock-based grants noted above, various other LNC stock-based awards were granted in the three and six months ended June 30, 2007, which are summarized in the tables below:

|                                     | Three Months Ended<br>June 30, 2007 | Six Months Ended<br>June 30, 2007 |
|-------------------------------------|-------------------------------------|-----------------------------------|
| <b>Awards</b>                       |                                     |                                   |
| 10-year LNC stock options           | 72,439                              | 421,327                           |
| Non-employee director stock options | 30,070                              | 30,070                            |
| Non-employee agent stock options    | 915                                 | 158,990                           |
| Restricted stock units              | 10,589                              | 233,245                           |
| Stock appreciation rights           |                                     | 187,750                           |

## 9. Restrictions, Commitments and Contingencies

See Restrictions, Commitments and Contingencies in Note 10 to the consolidated financial statements in our 2006 Form 10-K for a discussion of restrictions, commitments and contingencies, which information is incorporated herein by reference.

### Statutory Information and Restrictions

Our insurance subsidiaries are subject to certain insurance department regulatory restrictions as to the transfer of funds and payment of dividends to the holding company. Generally, these restrictions pose no short-term liquidity concerns for the holding company. For example, under Indiana laws and regulations, our Indiana insurance subsidiaries, including one of our major insurance subsidiaries, The Lincoln National Life Insurance Company ( LNL ), may pay dividends to LNC only from unassigned surplus, without prior approval of the Indiana Insurance Commissioner (the Commissioner ), or must receive prior approval of the Commissioner to pay a dividend if such dividend, along with all other dividends paid within the preceding twelve consecutive months, would exceed the statutory limitation. The current statutory limitation is the greater of (i) 10% of the insurer's policyholders' surplus, as shown on its last annual statement on file with the Commissioner or (ii) the insurer's statutory net gain from operations for the previous twelve months, but in no event to exceed statutory unassigned surplus. Indiana law gives the Commissioner broad discretion to disapprove requests for dividends in excess of these limits. Our Jefferson-Pilot Life Insurance Company subsidiary, domiciled in North Carolina, and our Jefferson Pilot Financial Insurance Company subsidiary, domiciled in Nebraska, were merged with and into LNL, our Indiana domiciled subsidiary. Our Jefferson Pilot LifeAmerica Insurance Company subsidiary was redomiciled from New Jersey to New York, and our New York domiciled company subsidiary, Lincoln Life & Annuity Company of New York, was subsequently merged with and into it. The merged company retains the name Lincoln Life & Annuity Company of New York ( LLANY ). LLANY is a wholly owned subsidiary of LNL. LLANY is subject to similar, but not identical, regulatory restrictions with regard to the transfer of funds and payment of dividends as our Indiana domiciled subsidiaries. Ownership of our other Indiana domiciled subsidiary, First Penn Pacific Life Insurance Company, was transferred by extraordinary dividend payment from LNL to LNC. As a result of that transfer, any transfer of funds and payment of dividends from our Indiana domiciled insurance companies are subject to the prior approval of the Indiana Insurance Commissioner for the remainder of 2007.

### Reinsurance Contingencies

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Our amounts recoverable from reinsurers represent receivables from and reserves ceded to reinsurers. We obtain reinsurance from a diverse group of reinsurers, and we monitor concentration as well as financial strength ratings of our principal reinsurers. Swiss Re Life & Health America, Inc. ( Swiss Re ) represents our largest reinsurance exposure. In the second quarter of 2007, we recognized a reserve increase on the personal accident business that was sold to Swiss Re through an indemnity reinsurance transaction in 2001, at which time we recognized a deferred gain that is being amortized into income at the rate that earnings are expected to emerge within a 15 year period. This adjustment resulted in a non-cash charge of \$13 million, after-tax, to increase reserves, which was partially offset by a cumulative catch-up adjustment to the deferred gain amortization of \$5 million, after-tax, for a total decrease to net income of \$8 million. The impact of the accounting for reserve adjustments related to this reinsurance treaty is excluded from our definition of income from operations. Because Swiss Re is responsible for paying the underlying claims to the ceding companies corresponding to the reserve increase, we record an increase in the reinsurance recoverable in the period of the change. The amount of the additional increase to the deferred gain above the cumulative amortization catch-up adjustment will be amortized into income in future periods over the remaining period of expected run-off of the underlying business.

### **Media Commitments**

Lincoln Financial Media has commitments to purchase future sports programming rights, and for employment contracts, leases and syndicated television programming of approximately \$264 million through 2012 and \$16 million thereafter. We have offset the purchase of these programming rights by receiving commitments from other entities to purchase a portion of our sports

programming rights of approximately \$119 million through 2011, as well as by entering into advertising contracts with customers for the airing of commercials. These commitments are not reflected as an asset or liability in our Consolidated Balance Sheets because the programs are not currently available for use.

#### **10. Segment Information**

In the quarter ended June 30, 2006, we completed our merger with Jefferson-Pilot and realigned our reporting segments to reflect the current manner by which our chief operating decision makers view and manage the business. We provide products and services in five operating businesses: (1) Individual Markets, (2) Employer Markets, (3) Investment Management, (4) Lincoln UK and (5) Lincoln Financial Media, and report results through seven business segments.

We also have Other Operations, which includes the financial data for operations that are not directly related to the business segments, unallocated corporate items (such as investment income on investments related to the amount of statutory surplus in our insurance subsidiaries that is not allocated to our business units and other corporate investments, interest expense on short-term and long-term borrowings, and certain expenses, including restructuring and merger-related expenses), along with the ongoing amortization of deferred gain on the indemnity reinsurance portion of the transaction with Swiss Re. Other Operations also includes the eliminations of intercompany transactions and the inter-segment elimination of the investment advisory fees for asset management services the Investment Management segment provides to Individual Markets and Employer Markets.

Segment operating revenue 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. Operating revenue is GAAP revenue excluding realized gains and losses on investments and derivative instruments, gains and losses on reinsurance embedded derivative/trading securities, gains and losses on sale of subsidiaries/businesses and the amortization of deferred gain arising from reserve development on business sold through reinsurance. Income (loss) from operations is GAAP net income excluding net realized investment gains and losses, losses on early retirement of debt, reserve development net of related amortization on business sold through reinsurance and cumulative effect of accounting changes. Our management and Board of Directors believe that operating revenue 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 net realized investment gains and losses, reserve development net of related amortization on business sold through reinsurance and cumulative effect of accounting changes are unpredictable and not necessarily indicative of current operating fundamentals or future performance of the business segments, and in many instances, decisions regarding these items do not necessarily relate to the operations of the individual segments. Operating revenue and income (loss) from operations do not replace revenues and net income as the GAAP measures of our consolidated results of operations.

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The following tables show financial data by segment:

| (in millions)   | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|---|--------------------------------|----------|------------------------------|----------|
|   | 2007                           | 2006     | 2007                         | 2006     |
| <b>Revenue</b>  |                                |          |                              |          |
| Segment operating revenue   |                                |          |                              |          |
| Individual Markets:   |                                |          |                              |          |
| Annuities   | \$ 675                         | \$ 552   | \$ 1,281                     | \$ 927   |
| Life Insurance  | 957                            | 901      | 1,929                        | 1,402    |
| Total Individual Markets  | 1,632                          | 1,453    | 3,210                        | 2,329    |
| Employer Markets:   |                                |          |                              |          |
| Retirement Products   | 367                            | 350      | 726                          | 656      |
| Group Protection  | 391                            | 355      | 751                          | 355      |
| Total Employer Markets  | 758                            | 705      | 1,477                        | 1,011    |
| Investment Management <sup>(1)</sup>  |                                |          |                              |          |
| Lincoln UK  | 93                             | 81       | 183                          | 151      |
| Lincoln Financial Media <sup>(2)</sup>  | 57                             | 58       | 125                          | 58       |
| Other Operations  | 80                             | 98       | 154                          | 157      |
| Consolidating adjustments   | (34)                           | (29)     | (69)                         | (57)     |
| Net realized investment results <sup>(3)</sup>  | (5)                            | (5)      | 22                           | (6)      |
| Amortization of deferred gain on indemnity reinsurance  | 8                              |          | 8                            |          |
| Total revenue   | \$ 2,740                       | \$ 2,496 | \$ 5,411                     | \$ 3,917 |
| <b>Net Income</b>   |                                |          |                              |          |
| Segment operating income  |                                |          |                              |          |
| Individual Markets:   |                                |          |                              |          |
| Annuities   | \$ 130                         | \$ 89    | \$ 251                       | \$ 155   |
| Life Insurance  | 176                            | 147      | 343                          | 216      |
| Total Individual Markets  | 306                            | 236      | 594                          | 371      |
| Employer Markets:   |                                |          |                              |          |
| Retirement Products   | 61                             | 70       | 125                          | 131      |
| Group Protection  | 29                             | 37       | 52                           | 37       |
| Total Employer Markets  | 90                             | 107      | 177                          | 168      |
| Investment Management   |                                |          |                              |          |
| Lincoln UK  | 11                             | 12       | 28                           | 27       |
| Lincoln UK  | 12                             | 10       | 23                           | 21       |
| Lincoln Financial Media   | 14                             | 12       | 26                           | 12       |
| Other Operations  | (46)                           | (26)     | (83)                         | (26)     |
| Net realized investment results <sup>(4)</sup>  | (3)                            | (2)      | 15                           | (3)      |
| Reserve development, net of related amortization on business sold through indemnity reinsurance | (8)                            |          | (8)                          |          |
| Net income  | \$ 376                         | \$ 349   | \$ 772                       | \$ 570   |

<sup>(1)</sup> Revenues for the Investment Management segment include inter-segment revenues for asset management services provided to our other segments. These inter-segment revenues totaled \$20 million and \$24 million for the three months ended June 30, 2007 and 2006,

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respectively, and \$44 million and \$49 million for the six months ended June 30, 2007 and 2006, respectively.

- (2) Lincoln Financial Media revenues are net of \$9 million of commissions paid to agencies for both the three months ended June 30, 2007 and 2006, and \$17 million and \$9 million for the six months ended June 30, 2007 and 2006, respectively.
- (3) Includes realized losses on investments of \$13 million and \$7 million for the three months ended June 30, 2007 and 2006,

respectively; realized gains on derivative instruments of \$4 million for the three months ended June 30, 2007; and gains on reinsurance embedded derivative/trading securities of \$4 million and \$2 million for the three months ended June 30, 2007 and 2006, respectively. Includes realized gains (losses) on investments of \$14 million and \$(18) million for the six months ended June 30, 2007 and 2006, respectively; realized gains on derivative instruments of \$4 million for both the six months ended June 30, 2007 and 2006; and gains on reinsurance embedded derivative/trading securities of \$4 million and \$8 million for the six months ended June 30, 2007 and 2006, respectively.

- (4) Includes realized losses on investments of \$7 million and \$3 million for the three months ended June 30, 2007 and 2006, respectively; realized gains on derivative instruments of \$2 million and \$1 million for the three months ended June 30, 2007; and gains on reinsurance embedded derivative/trading securities of \$2 million and \$1 million for the three months ended June 30, 2007 and 2006, respectively. Includes realized gains (losses) on investments of \$10 million and \$(10) million for the six months ended June 30, 2007 and 2006, respectively; realized gains on derivative instruments of \$3 million and \$2 million for the six months ended June 30, 2007 and 2006, respectively; and gains on reinsurance embedded derivative/trading securities of \$2 million and \$5 million for the six months ended June 30, 2007 and 2006, respectively.

## 11. Earnings Per Share

The income used in the calculation of our diluted earnings per share is our income before cumulative effect of accounting change and net income, reduced by minority interest adjustments related to outstanding stock options under the DIUS stock option incentive plan of less than \$1 million for all periods presented.

A reconciliation of the denominator in the calculations of basic and diluted net income and income before cumulative effect of accounting change per share is as follows:

|   | Three Months Ended |                    | Six Months Ended   |                    |
|---|--------------------|--------------------|--------------------|--------------------|
|   | June 30,           |                    | June 30,           |                    |
|   | 2007               | 2006               | 2007               | 2006               |
| <b>Denominator: [number of shares]</b>  |                    |                    |                    |                    |
| Weighted-average shares, as used in basic calculation   | 270,566,521        | 279,117,917        | 272,716,140        | 227,136,449        |
| Shares to cover conversion of preferred stock   | 199,012            | 235,656            | 199,980            | 239,492            |
| Shares to cover non-vested stock  | 354,054            | 1,112,575          | 751,427            | 1,336,800          |
| Average stock options outstanding during the period   | 13,307,765         | 16,716,416         | 13,815,359         | 12,783,702         |
| Assumed acquisition of shares with assumed proceeds and benefits from exercising stock options (at average market price for the year) | (11,111,321)       | (14,253,642)       | (11,613,259)       | (11,047,731)       |
| Shares repurchaseable from measured but unrecognized stock option expense   | (257,704)          | (1,552,553)        | (256,675)          | (1,188,658)        |
| Average deferred compensation shares  | 1,345,246          | 1,243,972          | 1,326,853          | 1,272,201          |
| <b>Weighted-average shares, as used in diluted calculation</b>  | <b>274,403,573</b> | <b>282,620,341</b> | <b>276,939,825</b> | <b>230,532,255</b> |

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

**12. Restructuring Charges***2006 Restructuring Plan*

Upon completion of the merger with Jefferson-Pilot, we implemented a restructuring plan relating to the integration of our legacy operations with those of Jefferson-Pilot. The realignment will enhance productivity, efficiency and scalability while positioning us for future growth.

The following is the detail of the reserve for restructuring charges:

| (in millions)  | Total |
|--|-------|
| Restructuring reserve at December 31, 2006   | \$ 8  |
| Amounts incurred in the first six months of 2007   |       |
| Employee severance and termination benefits  | 4     |
| Other  | 6     |
| Total 2007 restructuring charges   | 10    |
| Amounts expended in the first six months of 2007   | (12)  |
| Restructuring reserve at June 30, 2007   | \$ 6  |
| Additional amounts expended in the first six months of 2007 that do not qualify as restructuring charges | \$ 34 |
| Total expected costs   | 180   |

Expected completion date

4th Quarter 2009

The total expected costs include both restructuring charges and additional expenses that do not qualify as restructuring charges that are associated with the integration activities. In addition, involuntary employee termination benefits were recorded in goodwill as part of the purchase price allocation (see Note 3). Merger integration costs relating to employee severance and termination benefits of \$13 million were included in other liabilities in the purchase price allocation in 2006. The remaining liability balance at December 31, 2006 was \$3 million. In the first quarter of 2007, an additional \$8 million was recorded to goodwill and other liabilities as part of the final adjustment to the purchase price allocation related to employee severance and termination benefits. Through June 30, 2007 approximately \$13 million of these costs were incurred and the remaining liability balance at June 30, 2007 was \$8 million.

Restructuring charges for this plan in the first six months of 2007 were included in underwriting, acquisition, insurance and other expenses within Other Operations on the Consolidated Statements of Income.

**13. Subsequent Event**

On July 9, 2007, we announced an agreement with an unaffiliated investment management company involving certain members of our fixed income team and related institutional separate account business. The transaction is expected to close during the fourth quarter of 2007. The maximum institutional separate accounts involved in the transaction is approximately \$14 billion. However, the amount of assets included in the transaction is dependent on individual clients' decisions to transfer their relationship to the unaffiliated company. This change does not impact the fixed income team that manages our fixed income mutual funds or general account assets. This transaction will not be material to our results of operations, liquidity or capital resources.



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

The following is a discussion of the financial condition of Lincoln National Corporation and its consolidated subsidiaries ( LNC or the Company which also may be referred to as we or us ) as of June 30, 2007, compared with December 31, 2006, and the results of operations of LNC for the three and six months ended June 30, 2007 and 2006. On April 3, 2006, LNC completed its merger with Jefferson-Pilot Corporation (Jefferson-Pilot). Beginning on April 3, 2006, the results of operations and financial condition of Jefferson-Pilot, after being adjusted for the effects of purchase accounting, were consolidated with LNC's. Accordingly, the financial information presented herein for the six months ended June 30, 2006, reflects the accounts of Jefferson-Pilot for only the three months ended June 30, 2006. The balance sheet information presented below is as of June 30, 2007 and December 31, 2006. The statement of operations information is for the three and six months ended June 30, 2007 and 2006.

For more information regarding the completion of the merger, including the calculation and allocation of the purchase price, see Note 3 to the consolidated financial statements in this Form 10-Q.

This discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto presented in Item 1 ( consolidated financial statements ) of this Form 10-Q and in conjunction with Item 7 Management's Discussion and Analysis of Financial Condition, Results of Operations ( MD&A ), Item 1A Risk Factors and Item 8 Consolidated Financial Statements of our latest annual report on Form 10-K for the year ended December 31, 2006 ( 2006 Form 10-K ).

This report contains certain financial information determined by methods other than in conformity with accounting principles generally accepted in the United States of America ( GAAP ). In addition to providing consolidated revenues and net income (loss), we also provide segment operating revenue and income (loss) from operations because we believe they are meaningful measures of revenues and the profit or loss generated by our operating segments. Operating revenue is GAAP revenue excluding realized gains and losses on investments and derivative instruments, gains and losses on reinsurance embedded derivative/trading securities, gains and losses on sale of subsidiaries/businesses and the amortization of deferred gains arising from reserve development on business sold through reinsurance. Income (loss) from operations is GAAP net income excluding net realized investment gains and losses, losses on early retirement of debt, reserve development net of related amortization on business sold through reinsurance and cumulative effect of accounting changes. Operating revenue and income (loss) from operations are the financial performance measures we use to evaluate and assess the results of our segments. Accordingly, we report operating revenue and income (loss) from operations by segment in Note 10 to our unaudited consolidated financial statements. Our management and Board of Directors believe that operating revenue 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 net realized investment gains and losses, reserve development net of related amortization on business sold through reinsurance and cumulative effect of accounting changes are unpredictable and not necessarily indicative of current operating fundamentals or future performance of the business segments, and in many instances, decisions regarding these items do not necessarily relate to the operations of the individual segments. Operating revenue and income (loss) from operations do not replace revenues and net income as the GAAP measures of our consolidated results of operations.

Certain reclassifications have been made to prior periods' financial information to conform to the 2007 presentation.

**Forward-Looking Statements Cautionary Language**

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

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

Problems arising with the ability to successfully integrate our and Jefferson-Pilot's businesses, which may affect our ability to operate as effectively and efficiently as expected or to achieve the expected synergies from the merger or to achieve such synergies within our expected timeframe;



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

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

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

A decline in the equity markets causing a reduction in the sales of Lincoln's products, a reduction of asset fees that Lincoln charges on various investment and insurance products, an acceleration of amortization of deferred acquisition costs, value of business acquired, deferred sales inducements and deferred front-end loads and an increase in liabilities related to guaranteed benefit features of Lincoln's variable annuity products;

Ineffectiveness of Lincoln's various hedging strategies used to offset the impact of declines in and volatility of the equity markets;

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

Changes in accounting principles generally accepted in the United States that may result in unanticipated changes to Lincoln's net income, including the impact of the applications of Statement of Position 07-1 and Statements of Financial Accounting Standards 157 and 159;

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

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

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

The impact of acquisitions and divestitures, restructurings, product withdrawals and other unusual items, including Lincoln's ability to integrate acquisitions and to obtain the anticipated results and synergies from acquisitions;

The adequacy and collectibility of reinsurance that Lincoln has purchased;

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

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

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

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

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

The risks included here are not exhaustive. Lincoln's annual report on Form 10-K, quarterly reports on Form 10-Q, current

reports on Form 8-K and other documents filed with the SEC include additional factors which could impact Lincoln's business and financial performance. Moreover, Lincoln operates in a rapidly changing and competitive environment. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors.

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

## INTRODUCTION

### *Executive Summary*

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

We provide products and services in five operating businesses: (1) Individual Markets, (2) Employer Markets, (3) Investment Management, (4) Lincoln UK and (5) Lincoln Financial Media, and are reporting results through seven business segments. These operating businesses and their segments are described in Part I Item 1 Business of the 2006 Form 10-K.

Our strategic intent is to be *the* Retirement Income Security Company. Retirement income security represents all of the risks at various stages of the wealth management cycle, not just the risk of outliving income during retirement. We believe that the baby-boomer generation reaching retirement age will present an emerging opportunity for companies like ours that offer products allowing baby-boomers to better manage their wealth accumulation, retirement income and wealth transfer needs.

On April 2, 2007, we launched a larger, fixed life insurance and fixed/indexed annuity unified product suite available to our distribution force. To facilitate this unified product suite and as discussed further below under Recent Developments, we reorganized our insurance subsidiaries by merging several insurance subsidiaries. On May 21, 2007, we launched a unified fund line-up in our variable life insurance products, and on June 4, 2007, we launched a unified fund line-up in our variable annuity products. On July 9, 2007, we launched our unified term life insurance products and we have plans in place to launch our unified variable life insurance products after receiving appropriate regulatory approvals.

During 2007 we expect our major challenges to include:

The continued, successful integration of the Jefferson-Pilot businesses and the success of our new unified product portfolio.

While recent increases in long-term rates have eased pressure on spreads, a continuation of the low interest rate environment creates a challenge for our products that generate investment margin profits, such as fixed annuities and universal life insurance.

The ability to generate tangible results from Retirement Income Security Ventures (RISV).

The continued, successful expansion of our wholesale distribution businesses.

The ability to improve financial results and sales growth in Employer Markets.

The continuation of competitive pressures in the life insurance marketplace, increased regulatory scrutiny of the life and annuity industry, which may lead to higher product costs and negative perceptions about the industry.

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The market volatility caused by disruption in the subprime loan markets and overall poor liquidity in the fixed income markets.

Continued focus by the government on tax reform, which may impact our products.

In the face of these challenges, there are three key themes that will continue to influence our actions and decisions throughout 2007:

**Taking market share.** We are making sizeable investments in distribution throughout the organization, recognizing that sales growth is driven by our ability to maintain a strong presence in our key accounts and distribution channels. At June 30, 2007, we had 584 wholesalers in Lincoln Financial Distributors ( LFD ) compared to 529 at December 31, 2006.

**Jumpstarting our RISV.** The focus of this cadre of insurance professionals is to rethink the products, delivery systems and customer servicing that will address the emerging needs of the baby boomers.

**Embedding financial and execution discipline in our operations.** We are making significant investments in operating efficiencies while integrating and consolidating systems and processes across the organization. Investment decisions will be evaluated based on a comprehensive metrics-based approach.

#### ***Recent Developments***

On April 2, 2007, we announced the introduction of the first phase of our new UPP, a wide array of fixed life insurance and fixed/indexed annuity products. On May 21, 2007, we launched a unified fund line-up in our variable life insurance products and on June 4, 2007, we launched the unified fund line-up in our variable annuity products. On July 9, 2007, we launched our unified term life insurance products and we have plans in place to launch our unified variable life insurance products after receiving appropriate regulatory approvals. Our linked benefit products were largely unaffected by the integration since Jefferson-Pilot did not offer these types of products pre-merger. Our new comprehensive product portfolio will offer solutions to baby boomers no matter where they may be in the wealth management cycle.

As part of our continuing merger integration and to facilitate the UPP, on April 2, 2007, we completed the merger of one of our wholly owned insurance subsidiaries, Jefferson-Pilot Life Insurance Company, a North Carolina domiciled insurer, with and into The Lincoln National Life Insurance Company ("LNL"), an Indiana domiciled insurer. We also completed the merger of Jefferson Pilot LifeAmerica Insurance Company ("JPLA"), a New Jersey domiciled insurer, and Lincoln Life & Annuity Company of New York, a New York domiciled insurer. JPLA has been redomiciled to New York and renamed Lincoln Life & Annuity Company of New York. On July 2, 2007, we completed the merger of Jefferson-Pilot Financial Insurance Company, a Nebraska domiciled insurer, with and into LNL, an Indiana domiciled insurer. LNL remains an Indiana domiciled insurer.

On June 7, 2007, we announced plans to explore strategic options for Lincoln Financial Media. We are evaluating a range of options including, but not limited to, divestiture strategies. At this time, there should be no assumption that this strategic review will result in any type of transaction. We do not intend to provide updates to the strategic review process or disclose developments or potential outcomes until and unless a definitive course of action is reached. For additional details, see Note 1 of our consolidated financial statements.

On July 6, 2007, our Chairman of the Board of Directors and Chief Executive Officer, Jon A. Boscia, announced his plans to retire effective September 1, 2007. Dennis R. Glass, our President and Chief Operating Officer, was appointed Chief Executive Officer and J. Patrick Barrett, a long-time board member, was appointed as non-executive Chairman of the Board of Directors.

#### ***Critical Accounting Policies***

The MD&A included in our 2006 Form 10-K contains a detailed discussion of our critical accounting policies. The following information updates the critical accounting policies provided in the 2006 Form 10-K and accordingly should be read in conjunction with the critical accounting policies discussed in the 2006 Form 10-K.

#### **Deferred Acquisition Costs, Value of Business Acquired, Deferred Sales Inducements and Deferred Front-End Loads**

In September 2005, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants ( AICPA ) issued Statement of Position ( SOP ) 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts ( SOP 05-1 ). SOP 05-1 addresses the accounting for DAC on internal replacements other than those described in Statement of Financial Accounting Standards No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments ( SFAS 97 ). An internal replacement is defined by SOP 05-1 as a modification in product benefits, features, rights or coverages that occurs by (a) exchanging the contract for a new contract, (b) amending, endorsing or attaching a rider to the contract, or (c) electing a feature or coverage within a contract. Contract modifications that result in a

substantially



unchanged contract are accounted for as a continuation of the replaced contract. Contract modifications that result in a substantially changed contract are accounted for as an extinguishment of the replaced contract, and any unamortized DAC, unearned revenue and deferred sales charges are written-off. SOP 05-1 was applied prospectively on January 1, 2007.

For a detailed discussion of the cumulative effect of adoption of SOP 05-1 recorded to our January 1, 2007 Consolidated Balance Sheets, see Note 2 of our consolidated financial statements. The adoption of this new guidance primarily impacted and continues to impact our Individual Markets Annuities and Employer Markets Group Protection businesses, and our related accounting policies regarding the assumptions for lapsation used in the amortization of DAC and VOBA. In addition, we estimate that the adoption of SOP 05-1 resulted in a \$4 million and \$10 million, pre-tax, increase to underwriting, acquisition, insurance and other expenses for the three and six months ended June 30, 2007, which were attributable to changes in DAC and VOBA deferrals and amortization. The impact is expected to be approximately \$9 million, pre-tax, for the remainder of 2007. In addition, due to the changes in our GMDB annuity reserves and DSI, we expect benefits to increase by approximately \$2 million, pre-tax, for the twelve months ended December 31, 2007. The impact on amortization of DFEL is expected to be less than \$1 million.

As equity markets do not move in a systematic manner, we use a reversion to the mean ( RTM ) process to compute our best estimate long-term gross growth rate assumption. Under our current RTM process, on each valuation date, future EGPs are projected using stochastic modeling of a large number of future equity market scenarios in conjunction with best estimates of lapse rates, interest rate spreads and mortality to develop a statistical distribution of the present value of future EGPs for each of the blocks of business. Because future equity market returns are impossible to predict, the underlying premise of this process is that best estimate projections of future EGPs, as required by SFAS 97, need not be affected by random short-term and insignificant deviations from expectations in equity market returns. However, long-term or significant deviations from expected equity market returns require a change to best estimate projections of EGPs and prospective unlocking of DAC, VOBA, DSI and DFEL. The statistical distribution is designed to identify when the equity market return deviations from expected returns have become significant enough to warrant a change of the future equity return EGP assumption. As an illustration of the potential impact, given where our best estimate of EGPs for the Individual Markets Annuity and Employer Markets Defined Contribution segments were positioned in the range at June 30, 2007, if we were to reset the RTM to a gross variable account growth assumption representing the midpoint between the first of the two statistical ranges and the mean of the projections from June 30, 2007 forward in determining revised EGPs, we estimate it would result in a cumulative decrease to DAC amortization (positive DAC unlocking) of approximately \$165 million pre-tax (\$107 million after-tax). For more information about the implications of declines and advances in equity markets and our RTM process, see Part II Item 7 Critical Accounting Policies in our 2006 Form 10-K.

The table below presents the balances by business segment as of June 30, 2007.

| (in millions)               | Individual Markets |                | Employer Markets    |                  | Lincoln UK | Other Operations | Total    |
|-----------------------------|--------------------|----------------|---------------------|------------------|------------|------------------|----------|
|                             | Annuities          | Life Insurance | Retirement Products | Group Protection |            |                  |          |
| DAC and VOBA                | \$ 2,237           | \$ 5,127       | \$ 818              | \$ 111           | \$ 807     | \$ 1             | \$ 9,101 |
| DSI                         |                    | 225            |                     |                  |            |                  | 225      |
| Total DAC, VOBA and DSI     | 2,462              | 5,127          | 818                 | 111              | 807        | 1                | 9,326    |
| DFEL                        | 112                | 569            | 22                  |                  | 403        |                  | 1,106    |
| Net DAC, VOBA, DSI and DFEL | \$ 2,350           | \$ 4,558       | \$ 796              | \$ 111           | \$ 404     | \$ 1             | \$ 8,220 |

## Derivatives

### *Guaranteed Minimum Withdrawal and Guaranteed Income Benefits*

The Individual Markets Annuities segment has a hedging strategy designed to mitigate the risk and statement of income volatility caused by changes in the equity markets, interest rates, and volatility associated with the Lincoln Smart Security<sup>SM</sup> Advantage GMWB feature and, beginning in the fourth quarter of 2006, our i4LIFE<sup>®</sup> Advantage GIB feature that is available in our variable annuity products. In the second quarter of 2007, we also began hedging our 4LATER<sup>®</sup> Advantage GIB feature available in our variable annuity products. The hedging strategy is designed such that changes in the value of the hedge contracts move in the opposite direction of changes in the value of the embedded derivative of the GMWB and GIB features. This dynamic hedging strategy utilizes U.S.-based and international equity futures and options as well as interest rate futures and swaps. The notional amounts of the underlying hedge instruments are such that the magnitude of the change in the value of the hedge instruments due to changes in equity markets, interest rates, and implied volatilities is designed to offset the magnitude of the change in the fair value of the GMWB and GIB guarantees caused by those same factors. At June 30, 2007, the embedded derivatives for GMWB, i4LIFE<sup>®</sup> Advantage GIB and the 4LATER<sup>®</sup> Advantage GIB were assets valued at \$95 million, \$29 million and \$1 million,

respectively.

## Income Taxes

Management uses certain assumptions and estimates in determining income taxes payable or refundable for the current year, deferred income tax liabilities and assets for events recognized differently in its financial statements and income tax returns, and federal income tax expense. Determining these amounts requires analysis of certain transactions and interpretation of tax laws and regulations. Management exercises considerable judgment in evaluating the amount and timing of recognition of the resulting income tax liabilities and assets. These judgments and estimates are re-evaluated on a continual basis as regulatory and business factors change.

We adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement 109 ("FIN 48") effective January 1, 2007 and recorded an increase in the liability for unrecognized tax benefits of \$15 million in our Consolidated Balance Sheets, offset by a reduction to the beginning balance of retained earnings with no impact on net income. FIN 48 established criteria for recognizing or continuing to recognize only more-likely-than tax positions, which may result in federal income tax expense volatility in future periods. While we believe we have adequately provided for all tax positions, amounts asserted by taxing authorities could be greater than our accrued position. Accordingly, additional provisions on federal and foreign tax-related matters could be recorded in the future as revised estimates are made or the underlying matters are settled or otherwise resolved. For a detailed discussion of FIN 48, see Note 2 and Note 4 of our consolidated financial statements.

## RESULTS OF CONSOLIDATED OPERATIONS

| (in millions)   | Three Months Ended<br>June 30, |               |            | Six Months Ended<br>June 30, |               |            |
|---|--------------------------------|---------------|------------|------------------------------|---------------|------------|
|   | 2007                           | 2006          | Change     | 2007                         | 2006          | Change     |
| Insurance premiums                                      | \$ 489                         | \$ 454        | 8%         | \$ 948                       | \$ 533        | 78%        |
| Insurance fees  | 758                            | 692           | 10%        | 1,537                        | 1,167         | 32%        |
| Investment advisory fees                                | 93                             | 81            | 15%        | 183                          | 159           | 15%        |
| Communications revenue (net)                            | 57                             | 58            | -2%        | 125                          | 58            | 116%       |
| Net investment income                                   | 1,170                          | 1,068         | 10%        | 2,259                        | 1,747         | 29%        |
| Amortization of deferred gain on indemnity reinsurance  | 26                             | 19            | 37%        | 45                           | 38            | 18%        |
| Other revenues and fees                                 | 152                            | 129           | 18%        | 292                          | 221           | 32%        |
| Realized gain (loss)                                    | (5)                            | (5)           |            | 22                           | (6)           | NM         |
| <b>Total revenue</b>                                    | <b>2,740</b>                   | <b>2,496</b>  | <b>10%</b> | <b>5,411</b>                 | <b>3,917</b>  | <b>38%</b> |
| Benefits  | 1,287                          | 1,179         | 9%         | 2,481                        | 1,760         | 41%        |
| Underwriting, acquisition, insurance and other expenses | 815                            | 717           | 14%        | 1,620                        | 1,220         | 33%        |
| Communications expenses                                 | 31                             | 30            | 3%         | 72                           | 30            | 140%       |
| Interest and debt expenses                              | 73                             | 65            | 12%        | 134                          | 87            | 54%        |
| <b>Total benefits and expenses</b>                      | <b>2,206</b>                   | <b>1,991</b>  | <b>11%</b> | <b>4,307</b>                 | <b>3,097</b>  | <b>39%</b> |
| Income before taxes                                     | 534                            | 505           | 6%         | 1,104                        | 820           | 35%        |
| Federal income taxes                                    | 158                            | 156           | 1%         | 332                          | 250           | 33%        |
| <b>Net income</b>                                       | <b>\$ 376</b>                  | <b>\$ 349</b> | <b>8%</b>  | <b>\$ 772</b>                | <b>\$ 570</b> | <b>35%</b> |

## Items included in net income (after-tax):

|   |        |        |  |       |        |  |
|---|--------|--------|--|-------|--------|--|
| Realized gain (loss) on investments and derivative instruments                                  | \$ (5) | \$ (3) |  | \$ 12 | \$ (8) |  |
| Net gain on reinsurance embedded derivative/trading securities                                  | 2      | 1      |  | 2     | 5      |  |
| Restructuring charges   | (4)    | (6)    |  | (7)   | (6)    |  |
| Reserve development, net of related amortization on business sold through indemnity reinsurance | (8)    |        |  | (8)   |        |  |

The table below provides a detailed comparison of items included within net realized investment gains (losses).

| (in millions)   | Three Months Ended<br>June 30, |               |           | Six Months Ended<br>June 30, |               |           |
|---|--------------------------------|---------------|-----------|------------------------------|---------------|-----------|
|   | 2007                           | 2006          | Change    | 2007                         | 2006          | Change    |
| Realized gains on investments                                       | \$ 38                          | \$ 41         | -7%       | \$ 104                       | \$ 66         | 58%       |
| Realized losses on investments                                      | (49)                           | (28)          | -75%      | (68)                         | (48)          | -42%      |
| Realized gain on derivative instruments                             | 4                              |               | NM        | 4                            | 4             |           |
| Amounts amortized to balance sheet accounts                         | (2)                            | (19)          | 89%       | (20)                         | (30)          | 33%       |
| Gain on reinsurance embedded derivative/trading securities          | 4                              | 2             | 100%      | 4                            | 8             | -50%      |
| Investment expenses   |                                | (1)           | 100%      | (2)                          | (6)           | 67%       |
| <b>Net gains (losses) on investments and derivative instruments</b> | <b>\$ (5)</b>                  | <b>\$ (5)</b> | <b>NM</b> | <b>\$ 22</b>                 | <b>\$ (6)</b> | <b>NM</b> |

|   |         |        |    |         |        |    |
|---|---------|--------|----|---------|--------|----|
| Write-downs for other-than-temporary impairments included in realized losses on investments above | \$ (30) | \$ (2) | NM | \$ (34) | \$ (3) | NM |
|---|---------|--------|----|---------|--------|----|

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Following are deposits and net flows by business segment. For additional detail of deposit and net flow information, see the discussion in Results of Operations by Segment below.

| (in millions)                             | Three Months Ended<br>June 30, |                 |             | Six Months Ended<br>June 30, |                  |             |
|---|--------------------------------|-----------------|-------------|------------------------------|------------------|-------------|
|   | 2007                           | 2006            | Change      | 2007                         | 2006             | Change      |
| <b>Deposits</b>                           |                                |                 |             |                              |                  |             |
| Individual Markets:                       |                                |                 |             |                              |                  |             |
| Annuities                                 | \$ 3,277                       | \$ 2,739        | 20%         | \$ 6,098                     | \$ 4,874         | 25%         |
| Life Insurance                            | 1,005                          | 1,024           | -2%         | 2,044                        | 1,511            | 35%         |
| Employer Markets:                         |                                |                 |             |                              |                  |             |
| Retirement Products Defined Contributions | 1,274                          | 1,159           | 10%         | 2,760                        | 2,400            | 15%         |
| Retirement Products Executive Benefits    | 79                             | 77              | 3%          | 144                          | 124              | 16%         |
| Investment Management                     | 6,149                          | 6,047           | 2%          | 12,184                       | 15,111           | -19%        |
| Consolidating adjustments <sup>(1)</sup>  | (1,078)                        | (1,139)         | 5%          | (1,988)                      | (1,877)          | -6%         |
| <b>Total Deposits</b>                     | <b>\$ 10,706</b>               | <b>\$ 9,907</b> | <b>8%</b>   | <b>\$ 21,242</b>             | <b>\$ 22,143</b> | <b>-4%</b>  |
| <b>Net Flows</b>                          |                                |                 |             |                              |                  |             |
| Individual Markets:                       |                                |                 |             |                              |                  |             |
| Annuities                                 | \$ 1,138                       | \$ 699          | 63%         | \$ 1,893                     | \$ 1,468         | 29%         |
| Life Insurance                            | 586                            | 548             | 7%          | 1,284                        | 805              | 60%         |
| Employer Markets:                         |                                |                 |             |                              |                  |             |
| Retirement Products Defined Contributions | 74                             | 114             | -35%        | 295                          | 295              |             |
| Retirement Products Executive Benefits    | 26                             | 35              | -26%        | (49)                         | 75               | NM          |
| Investment Management                     | (425)                          | 1,009           | NM          | (513)                        | 5,906            | NM          |
| Consolidating adjustments <sup>(1)</sup>  | 303                            | (56)            | NM          | 346                          | (12)             | NM          |
| <b>Total Net Flows</b>                    | <b>\$ 1,702</b>                | <b>\$ 2,349</b> | <b>-28%</b> | <b>\$ 3,256</b>              | <b>\$ 8,537</b>  | <b>-62%</b> |

| (in millions)  | As of June 30, |            | As of<br>December 31,<br>2006 | Change Over<br>Prior Year | Change Over<br>Prior Quarter |
|--|----------------|------------|-------------------------------|---------------------------|------------------------------|
|  | 2007           | 2006       |                               |                           |                              |
| <b>Assets Under Management by Advisor <sup>(2)</sup></b> |                |            |                               |                           |                              |
| Investment Management:                                   |                |            |                               |                           |                              |
| External Assets  | \$ 97,725      | \$ 85,926  | \$ 97,306                     | 14%                       | 0%                           |
| Insurance-related Assets                                 | 66,423         | 65,637     | 67,067                        | 1%                        | -1%                          |
| Lincoln UK   | 10,536         | 9,171      | 10,108                        | 15%                       | 4%                           |
| Within Business Units (policy loans)                     | 2,787          | 2,716      | 2,760                         | 3%                        | 1%                           |
| By Non-LNC Entities                                      | 67,592         | 49,045     | 56,282                        | 38%                       | 20%                          |
|  | \$ 245,063     | \$ 212,495 | \$ 233,523                    | 15%                       | 5%                           |

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

<sup>(2)</sup> Assets under management by advisor provides a breakdown of assets that we manage or administer either directly or through unaffiliated third parties. These assets represent our investments, assets held in separate accounts and assets that we manage or administer for individuals or other companies. We earn insurance fees, investment advisory fees or investment income on these assets.

NM - Not Meaningful

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**Comparison of the Three and Six Months Ended June 30, 2007 to 2006**

Net income increased \$27 million, or 8%, and \$202 million, or 35%, for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase in net income for the three months ended June 30, 2007 is primarily driven by growth of business in-force, account value growth from favorable equity markets, positive net flows, and favorable investment results. Net income for the six months ended June 30, 2007, primarily reflects the April 2006 merger with Jefferson-Pilot and favorable investment results.

Partially offsetting the favorable trends discussed above, in our Individual Markets Life Insurance segment, we corrected account values for certain of our life insurance policies and we modified the accounting for one of our UL products with secondary guarantees related to its product features. See "Individual Markets Life Insurance" below for further discussion. Additionally, accruals for legal expenses and higher incentive compensation expense also negatively impacted the results.

In second quarter 2007, we recognized an \$8 million, after-tax increase in reserves (net of related deferred gain amortization) on the personal accident business that was sold to Swiss Re through an indemnity reinsurance transaction in 2001. These reserve changes are excluded from our definition of income from operations. Please refer to the "Reinsurance" section for further discussion.

*Revenues*

Total revenue for the three and six months ended June 30, 2007 was \$2.7 billion and \$5.4 billion compared to \$2.5 billion and \$3.9 billion for the same periods in 2006. The increase in insurance premiums for the three months ended June 30, 2007, primarily reflects organic growth in both the non-medical and medical portion of our Employer Markets Group Protection segment, elevated renewal and single premiums, offset partly by lower first year premiums. The increase in insurance fees and investment advisory fees for the three months ended June 30, 2007 reflects growth in assets under management, positive net flows, and the effects of favorable equity market performance, partially offset by the impact of the correction to account values and modification of the accounting within the Individual Markets Life Insurance segment noted above. The increase in insurance fees was primarily driven by favorable expense assessments earned on our individual variable annuities. Higher expense assessments from individual variable annuities resulted from higher average daily variable account values for the three and six months ended June 30, 2007 compared to the same period in 2006, resulting from favorable equity markets and sales growth. Average daily variable account values for the Individual Markets Annuity segment increased 30% and 26% for the three and six months ended June 30, 2007 compared to the same periods in 2006. This growth in insurance fee revenue was partially offset by the adjustments discussed above that reduced insurance fees by \$41 million, pre-DAC, and pre-tax in the second quarter of 2007. The increase in insurance premiums and fees for the six months ended June 30, 2007 primarily reflects the April 2006 merger with Jefferson-Pilot, 15% growth in assets under management, positive net flows, and the impact of favorable equity market performance on our variable account values partially offset by the adjustments described above. Excluding the impact of dividends, the S&P 500 Index® at June 30, 2007 was 18.4% higher than at June 30, 2006 and the average daily S&P 500 Index® for the three and six months ended June 30, 2007 was 16.8% and 13.9% higher than the comparable 2006 periods. Partially offsetting these increases were DFEL retrospective unlockings, which reduced insurance fees for the three and six months ended June 30, 2007 by \$7 million pre-tax (\$5 million after-tax) and \$10 million pre-tax (\$6 million after-tax) for the Individual Markets Life Insurance segment, primarily due to favorable investment results and favorable persistency.

Net investment income increased \$102 million, or 10%, and \$512 million, or 29% for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase in net investment income for the three months ended June 30, 2007 is primarily the result of in-force growth, better than expected investment income from higher commercial mortgage loan prepayments and bond makewhole premiums, increased investment income from alternative investments, and a \$51 million increase in the change in the market value of S&P 500 Index® call options used to hedge our indexed annuity product. Investment income from alternative investments, primarily related to limited partnership investments in the current quarter, increased \$51 million, pre-DAC, pre-tax in the three months ended June 30, 2007 compared to the same period in 2006. See Consolidated Investments Limited Partnership Investments below for additional information. The increase in net investment income for the six months ended June 30, 2007 primarily reflects the addition of Jefferson-Pilot investment assets, higher portfolio yields, higher alternative investment income, a \$24 million increase in the change in the market value of S&P Index® call options used to hedge our indexed annuity product and higher invested assets due to the favorable effect of asset growth from net flows. Investment income from alternative investments, increased \$58 million, pre-DAC, pre-tax in the six months ended June 30, 2007 compared to the same period in 2006 due to favorable performance in limited partnership investments. Negative fixed annuity net flows partially offset growth in our indexed and variable annuity net flows for both the three and six months ended June 30, 2007 as higher withdrawals were driven by the expiration of multi-year crediting rate guarantees on certain products we sold three to five years ago.

Included in revenues were net realized losses on investments of \$5 million and gains of \$22 million for the three and six months ended June 30, 2007 compared to losses of \$5 million and \$6 million for the comparable 2006 periods. See *Consolidated Investments* below for additional information on our investment performance.

#### *Benefits and Expenses*

Consolidated benefits increased \$108 million, or 9%, and \$721 million, or 41% for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase in benefits for the three months ended June 30, 2007 is primarily due to growth of business in-force, a \$47 million increase in the change in the indexed annuity options mark-to-market adjustment partially offset by a favorable increase in the change in the fair value of the SFAS 133 forward-starting option liability related to our indexed annuity contracts of \$12 million, less favorable Employer Market Group Protection segment loss ratio experience than that realized in the second quarter of 2006 and interest credited on the secured limited recourse notes issued in December 2006 and April 2007. For additional detail on the secured limited recourse notes see

*Consolidated Investments* *Credit-Linked Notes* below. The increase in benefits for the six months ended June 30, 2007 is primarily driven by the merger with Jefferson-Pilot. In the second quarter 2007, we recognized a \$20 million reserve increase on the personal accident business that was sold to Swiss Re through an indemnity transaction in 2001. For more information on the secured limited recourse notes see Note 6 to our consolidated financial statements. Higher benefits related to growth in our business were partially offset by the effect of spread management through lower crediting rates on interest sensitive business; the lower interest credited from lower fixed annuity account values resulting from net outflows on fixed annuities and movements from fixed to variable annuity products.

Consolidated underwriting, acquisition, insurance and other expenses for the second quarter and first six months increased \$98 million, or 14%, and \$400 million, or 33%, for the three and six month periods ended June 30, 2007. Expenses in the second quarter and first six months include \$30 million and \$44 million of integration costs in 2007 compared to \$17 million for both periods in 2006, including restructuring charges that were the result of actions undertaken by us to eliminate duplicate operations and functions as a result of the Jefferson-Pilot merger. These actions will be ongoing and are expected to be substantially complete by late 2008, with a total estimated cost of approximately \$180 million pre-tax (original cost estimates exclude amounts capitalized, recorded to goodwill and internal costs). Incentive compensation expenses were \$34 million, pre-DAC, pre-tax higher in the second quarter and first six months of 2007 compared to the same periods of 2006 as a result of actual performance exceeding our expectations. In the second quarter and first six months of 2007, broker-dealer commissions and expenses increased \$14 million and \$54 million as a result of higher sales and the impact of the merger on the first six months comparison. A \$9 million increase in legal expenses and \$5 million of expenses related to the launch of a new closed-end mutual fund also contributed to an increase in expenses in the second quarter and first six months of 2007. Partially offsetting the increase in consolidated expenses for the three and six months ended June 30, 2007 is the one-time curtailment gain of \$9 million (\$6 million after-tax) we recorded in the second quarter of 2007 related to a change in our employee benefit plans that will go into effect on January 1, 2008. The remainder of the increase in expenses is attributable to higher taxes, licenses and fees and an increase in DAC and VOBA amortization, which is discussed below. For additional information on the change in our employee benefit plans, see *Other Operations* and Note 7 to our consolidated financial statements.

DAC and VOBA amortization, which is included within underwriting, acquisition, insurance and other expenses, increased \$22 million and \$139 million for the three and six months ended June 30, 2007, with the year-to-date increase primarily driven by the merger with Jefferson-Pilot. In addition to continued growth in our insurance and annuity blocks, the change in DAC and VOBA amortization was impacted by several other items. The adoption of SOP 05-1 on January 1, 2007 resulted in a \$4 million pre-tax (\$2 million after-tax) and \$10 million pre-tax (\$6 million after-tax), increase for the three and six months ended June 30, 2007 to DAC and VOBA amortization. The adjustments discussed above, reduced DAC amortization by \$23 million, pre-tax in the second quarter of 2007. Additionally, DAC and VOBA amortization for the six months ended June 30, 2007 for the Individual Markets Life Insurance segment was increased by \$10 million (\$6 million after-tax) related to adjustments to the opening balance sheet of Jefferson-Pilot finalized in the first quarter of 2007 and was reduced for the adjustments in the second quarter of 2007 referred to above. Retrospective unlockings favorably impacted DAC and VOBA amortization for the three and six months ended June 30, 2007 by \$21 million pre-tax (\$14 million after-tax) and \$32 million pre-tax (\$21 million after-tax) for the Individual Markets Life Insurance segment, primarily due to favorable investment results and favorable persistency.

For additional information on restructuring charges, see Note 12 to our consolidated financial statements.

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**RESULTS OF OPERATIONS BY SEGMENT**

Following is a reconciliation of our revenue and our income from operations to our consolidated revenue and net income:

| (in millions)   | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|---|--------------------------------|----------|------------------------------|----------|
|   | 2007                           | 2006     | 2007                         | 2006     |
| <b>Revenue</b>  |                                |          |                              |          |
| Segment operating revenue   |                                |          |                              |          |
| Individual Markets:   |                                |          |                              |          |
| Annuities   | \$ 675                         | \$ 552   | \$ 1,281                     | \$ 927   |
| Life Insurance  | 957                            | 901      | 1,929                        | 1,402    |
| Total Individual Markets  | 1,632                          | 1,453    | 3,210                        | 2,329    |
| Employer Markets:   |                                |          |                              |          |
| Retirement Products   | 367                            | 350      | 726                          | 656      |
| Group Protection  | 391                            | 355      | 751                          | 355      |
| Total Employer Markets  | 758                            | 705      | 1,477                        | 1,011    |
| Investment Management <sup>(1)</sup>  |                                |          |                              |          |
| Lincoln UK  | 93                             | 81       | 183                          | 151      |
| Lincoln Financial Media <sup>(2)</sup>  | 57                             | 58       | 125                          | 58       |
| Other Operations  | 80                             | 98       | 154                          | 157      |
| Consolidating adjustments   | (34)                           | (29)     | (69)                         | (57)     |
| Net realized investment results <sup>(3)</sup>  | (5)                            | (5)      | 22                           | (6)      |
| Amortization of deferred gain on indemnity reinsurance  | 8                              |          | 8                            |          |
| Total revenue   | \$ 2,740                       | \$ 2,496 | \$ 5,411                     | \$ 3,917 |
| <b>Net Income</b>   |                                |          |                              |          |
| Segment operating income  |                                |          |                              |          |
| Individual Markets:   |                                |          |                              |          |
| Annuities   | \$ 130                         | \$ 89    | \$ 251                       | \$ 155   |
| Life Insurance  | 176                            | 147      | 343                          | 216      |
| Total Individual Markets  | 306                            | 236      | 594                          | 371      |
| Employer Markets:   |                                |          |                              |          |
| Retirement Products   | 61                             | 70       | 125                          | 131      |
| Group Protection  | 29                             | 37       | 52                           | 37       |
| Total Employer Markets  | 90                             | 107      | 177                          | 168      |
| Investment Management   |                                |          |                              |          |
| Lincoln UK  | 11                             | 12       | 28                           | 27       |
| Lincoln UK  | 12                             | 10       | 23                           | 21       |
| Lincoln Financial Media   | 14                             | 12       | 26                           | 12       |
| Other Operations  | (46)                           | (26)     | (83)                         | (26)     |
| Net realized investment results <sup>(4)</sup>  | (3)                            | (2)      | 15                           | (3)      |
| Reserve development, net of related amortization on business sold through indemnity reinsurance | (8)                            |          | (8)                          |          |
| Net income  | \$ 376                         | \$ 349   | \$ 772                       | \$ 570   |



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- (1) Revenues for the Investment Management segment include inter-segment revenues for asset management services provided to our other segments. These inter-segment revenues totaled \$20 million and \$24 million for the three months ended June 30, 2007 and 2006, respectively, and \$44 million and \$49 million for the six months ended June 30, 2007 and 2006, respectively.
- (2) Lincoln Financial Media revenues are net of \$9 million of commissions paid to agencies for both the three months ended June 30, 2007 and 2006, and \$17 million and \$9 million for the six months ended June 30, 2007 and 2006, respectively.

- (3) Includes realized losses on investments of \$13 million and \$7 million for the three months ended June 30, 2007 and 2006, respectively; realized gains on derivative instruments of \$4 million for the three months ended June 30, 2007; and gains on reinsurance embedded derivative/trading securities of \$4 million and \$2 million for the three months ended June 30, 2007 and 2006, respectively. Includes realized gains (losses) on investments of \$14 million and \$(18) million for the six months ended June 30, 2007 and 2006, respectively; realized gains on derivative instruments of \$4 million for both the six months ended June 30, 2007 and 2006; and gains on reinsurance embedded derivative/trading securities of \$4 million and \$8 million for the six months ended June 30, 2007 and 2006, respectively.
- (4) Includes realized losses on investments of \$7 million and \$3 million for the three months ended June 30, 2007 and 2006, respectively; realized gains on derivative instruments of \$2 million for the three months ended June 30, 2007; and gains on reinsurance embedded derivative/trading securities of \$2 million and \$1 million for the three months ended June 30, 2007 and 2006, respectively. Includes realized gains (losses) on investments of \$10 million and \$(10) million for the six months ended June 30, 2007 and 2006, respectively; realized gains on derivative instruments of \$3 million and \$2 million for the six months ended June 30, 2007 and 2006, respectively; and gains on reinsurance embedded derivative/trading securities of \$2 million and \$5 million for the six months ended June 30, 2007 and 2006, respectively.

### RESULTS OF INDIVIDUAL MARKETS

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

For factors that could cause actual results to differ materially from those set forth in this section, see Part I Item 1 Risk Factors in our 2006 Form 10-K and Forward-looking Statements Cautionary Language in this report.

#### Individual Markets Annuities

| Operating Summary (in millions)                         | Three Months Ended<br>June 30, |       |        | Six Months Ended<br>June 30, |        |        |
|---|--------------------------------|-------|--------|------------------------------|--------|--------|
|   | 2007                           | 2006  | Change | 2007                         | 2006   | Change |
| <b>Operating Revenues</b>                               |                                |       |        |                              |        |        |
| Insurance premiums                                      | \$ 17                          | \$ 15 | 13%    | \$ 29                        | \$ 24  | 21%    |
| Insurance fees  | 260                            | 192   | 35%    | 496                          | 367    | 35%    |
| Net investment income                                   | 302                            | 263   | 15%    | 569                          | 411    | 38%    |
| Other revenues and fees                                 | 96                             | 82    | 17%    | 187                          | 125    | 50%    |
| Total operating revenues                                | 675                            | 552   | 22%    | 1,281                        | 927    | 38%    |
| <b>Operating Expenses</b>                               |                                |       |        |                              |        |        |
| Insurance benefits                                      | 222                            | 214   | 4%     | 410                          | 330    | 24%    |
| Underwriting, acquisition, insurance and other expenses | 278                            | 217   | 28%    | 535                          | 389    | 38%    |
| Total operating expenses                                | 500                            | 431   | 16%    | 945                          | 719    | 31%    |
| Income from operations before taxes                     | 175                            | 121   | 45%    | 336                          | 208    | 62%    |
| Federal income taxes                                    | 45                             | 32    | 41%    | 85                           | 53     | 60%    |
| Income from operations                                  | \$ 130                         | \$ 89 | 46%    | \$ 251                       | \$ 155 | 62%    |

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| Net Flows (in millions)                          | Three Months Ended<br>June 30, |          |        | Six Months Ended<br>June 30, |          |        |
|--|--------------------------------|----------|--------|------------------------------|----------|--------|
|  | 2007                           | 2006     | Change | 2007                         | 2006     | Change |
| Variable portion of variable annuity deposits    | \$ 2,295                       | \$ 1,867 | 23%    | \$ 4,295                     | \$ 3,532 | 22%    |
| Variable portion of variable annuity withdrawals | (1,247)                        | (1,003)  | -24%   | (2,426)                      | (1,962)  | -24%   |
| Variable portion of variable annuity net flows   | 1,048                          | 864      | 21%    | 1,869                        | 1,570    | 19%    |
| Fixed portion of variable annuity deposits       | 662                            | 507      | 31%    | 1,197                        | 956      | 25%    |
| Fixed portion of variable annuity withdrawals    | (154)                          | (185)    | 17%    | (305)                        | (349)    | 13%    |
| Fixed portion of variable annuity net flows      | 508                            | 322      | 58%    | 892                          | 607      | 47%    |
| Total variable annuity deposits                  | 2,957                          | 2,374    | 25%    | 5,492                        | 4,488    | 22%    |
| Total variable annuity withdrawals               | (1,401)                        | (1,188)  | -18%   | (2,731)                      | (2,311)  | -18%   |
| Total variable annuity net flows                 | 1,556                          | 1,186    | 31%    | 2,761                        | 2,177    | 27%    |
| Indexed annuity deposits                         | 191                            | 228      | -16%   | 351                          | 228      | 54%    |
| Indexed annuity withdrawals                      | (61)                           | (47)     | -30%   | (123)                        | (47)     | NM     |
| Indexed annuity net flows                        | 130                            | 181      | -28%   | 228                          | 181      | 26%    |
| Fixed annuity deposits                           | 129                            | 137      | -6%    | 255                          | 158      | 61%    |
| Fixed annuity withdrawals                        | (677)                          | (805)    | 16%    | (1,351)                      | (1,048)  | -29%   |
| Fixed annuity net flows                          | (548)                          | (668)    | 18%    | (1,096)                      | (890)    | -23%   |
| Total annuity deposits                           | 3,277                          | 2,739    | 20%    | 6,098                        | 4,874    | 25%    |
| Total annuity withdrawals                        | (2,139)                        | (2,040)  | -5%    | (4,205)                      | (3,406)  | -23%   |
| Total annuity net flows                          | \$ 1,138                       | \$ 699   | 63%    | \$ 1,893                     | \$ 1,468 | 29%    |
| Annuities incremental deposits                   | \$ 3,241                       | \$ 2,711 | 20%    | \$ 6,034                     | \$ 4,822 | 25%    |

| Account Values (in millions)                  | As of June 30, |           |        |
|---|----------------|-----------|--------|
|   | 2007           | 2006      | Change |
| Variable annuities                            | \$ 55,171      | \$ 41,537 | 33%    |
| Fixed annuities (including indexed annuities) | 17,868         | 19,533    | -9%    |
| Fixed annuities ceded to reinsurers           | (1,598)        | (2,149)   | 26%    |
| Total fixed annuities                         | 16,270         | 17,384    | -6%    |
| Total annuities                               | \$ 71,441      | \$ 58,921 | 21%    |
| Fixed portion of variable annuities           | \$ 3,458       | \$ 4,132  | -16%   |

| Average Daily S&P 500 Index® | Three Months Ended<br>June 30, |          |        | Six Months Ended<br>June 30, |          |        |
|------------------------------|--------------------------------|----------|--------|------------------------------|----------|--------|
|                              | 2007                           | 2006     | Change | 2007                         | 2006     | Change |
| Average Daily S&P 500 Index® | 1,496.87                       | 1,282.01 | 16.8%  | 1,461.02                     | 1,282.49 | 13.9%  |



| Interest Rate Spreads   | Three Months Ended<br>June 30, |           | Basis<br>Points<br>Change | Six Months Ended<br>June 30, |           | Basis<br>Points<br>Change |
|---|--------------------------------|-----------|---------------------------|------------------------------|-----------|---------------------------|
|   | 2007                           | 2006      |                           | 2007                         | 2006      |                           |
| Net investment income yield on reserves, excluding below items  | 5.78%                          | 5.71%     | 7                         | 5.80%                        | 5.72%     | 8                         |
| Default charges   | 0.00%                          | -0.09%    | 9                         | 0.00%                        | -0.06%    | 6                         |
| Commercial mortgage loan prepayment and bond makewhole premiums | 0.08%                          | 0.02%     | 6                         | 0.06%                        | 0.04%     | 2                         |
| Net investment income yield                                     | 5.86%                          | 5.64%     | 22                        | 5.86%                        | 5.70%     | 16                        |
| Interest rate credited to policyholders, excluding below item   | 3.74%                          | 3.85%     | (11)                      | 3.68%                        | 3.87%     | (19)                      |
| SFAS 133 forward-starting option                                | -0.24%                         | 0.03%     | (27)                      | -0.07%                       | 0.02%     | (9)                       |
| Interest rate credited to policyholders                         | 3.50%                          | 3.88%     | (38)                      | 3.61%                        | 3.89%     | (28)                      |
| Interest rate spread  | 2.36%                          | 1.76%     | 60                        | 2.25%                        | 1.81%     | 44                        |
| Average fixed annuity account values (in millions)              | \$ 17,548                      | \$ 19,200 |                           | \$ 17,697                    | \$ 14,500 |                           |

| (in millions)                         | Three Months<br>Ended<br>June 30, |           |        | Six Months Ended<br>June 30, |           |        |
|---------------------------------------|-----------------------------------|-----------|--------|------------------------------|-----------|--------|
|                                       | 2007                              | 2006      | Change | 2007                         | 2006      | Change |
| Average Daily Variable Account Values | \$ 53,465                         | \$ 41,214 | 30%    | \$ 51,327                    | \$ 40,580 | 26%    |

#### Comparison of the Three and Six Months Ended June 30, 2007 to 2006

Income from operations for this segment increased \$41 million, or 46%, and \$96 million or 62% for the three and six months ended June 30, 2007, compared to the same periods in 2006, respectively. The increase is due primarily to growth in account values from positive net flows, higher investment income on surplus and favorable equity markets partially offset by higher incentive compensation and broker-dealer expenses for both the three and six months ended June 30, 2007, in addition to the impact of the merger with Jefferson-Pilot for the six months ended June 30, 2007. The adoption of SOP 05-1 on January 1, 2007, resulted in a cumulative effect reduction of \$28 million in the segment's DAC and VOBA balances. The adoption of SOP 05-1 also increased DAC and VOBA amortization by \$2 million and \$5 million for the three and six months ended June 30, 2007, compared to the same periods in 2006. The impact is expected to be approximately \$3 million, pre-tax, for the remainder of 2007.

#### Revenues

Insurance fees increased 35% for both the three and six months ended June 30, 2007, compared to the same periods in 2006. The increases were due to increases in average daily variable annuity account values, which increased 30% and 26% for the three and six months ended June 30, 2007, and an increase in average expense assessment rates. The increase in expense assessment rates is driven primarily by an increase in account values with elective riders for guarantees that we offer such as GMDB, GMWB and GIB which have additional expense assessment charges associated with them. The increase in account values reflects cumulative positive net flows and improvement in the equity markets between periods.

New deposits are an important component of our effort to grow the annuity business. Although deposits do not significantly impact current period income from operations, they are an important indicator of future profitability. In the past several years, we have concentrated our efforts on both product and distribution breadth. Annuity deposits increased 20% and 25% for the three and six months ended June 30, 2007, compared to the same periods in 2006, primarily due to growth in the variable annuity business. Indexed annuity deposits for the six months ended June 30, 2007 compared to the same period in 2006 increased \$123 million, due to six months of activity being included in net flows in 2007 compared to only three months of activity included in net flows in 2006, as this product was added to our product portfolio as a result of the merger with Jefferson-Pilot.

The growth in individual variable annuity deposits was primarily a result of continued strong sales of products with the Lincoln SmartSecurity<sup>SM</sup> Advantage and i4Life<sup>®</sup> Advantage elective riders and the expansion of the wholesaling force in LFD. Variable annuity gross deposits in our Lincoln ChoicePlus<sup>SM</sup> and American Legacy products were up 25% and 22% for the three and six months ended June 30, 2007, compared to the same periods in 2006.



The other component of net flows relates to the retention of the business. One of the key assumptions in pricing a product is the account persistency, which we refer to as the lapse rate. The lapse rate compares the amount of withdrawals to the retained account values. One way to measure a company's success in retaining assets is to look at the overall level of withdrawals from period to period. Additionally, by comparing actual lapse rates to the rates assumed in designing the annuity product, it is possible to gauge the impact of persistency on profitability. Overall lapse rates for the six months ended June 30, 2007 were 10.3% compared to 10.8% for the same period in 2006. See the discussion below for the drivers of our elevated lapse rates.

Our lapse rates have been impacted by multi-year guarantee fixed annuity products, which have fixed credited rates for a defined guarantee period before resetting to new rates. Our Step Five Fixed Annuity products have a 60-day window period following each five-year fixed guarantee period during which there is no surrender charge and where crediting rates are reset at the beginning of the window period. Account values for these products were \$1.7 billion at June 30, 2007, with approximately \$0.4 billion of account values entering the window period throughout the remainder of 2007. Amounts entering window periods after 2007 are not significant. Through June 30, 2007, approximately \$0.3 billion of account values entered the window period. Based on our emerging experience with this block of business, we expect lapse rates of approximately 50% on the Step Five Fixed Annuity products. The after-DAC, after-tax effect to the earnings of the segment is mitigated in part by a 50% coinsurance arrangement on 88% of the account values. See Reinsurance for additional information on this arrangement. Account values for our other multi-year guaranteed products were \$1.7 billion at June 30, 2007, with approximately \$0.1 billion of the account value entering the window period throughout the remainder of 2007. During the first six months of 2007, approximately \$236 million of these multi-year guarantee products reset with approximately 61% lapsing where the holder did not select another of our products. As multi-year guarantees expire, policyholders have the opportunity to renew their annuities at rates in effect at that time.

Net investment income increased \$39 million, or 15%, and \$158 million, or 38%, for the three and six months ended June 30, 2007 compared to the same periods in 2006. Overall growth in net investment income has been constrained due primarily to lower average fixed annuity account values and net outflows. The increase in net investment income for the three months ended June 30, 2007 is primarily due to changes in the market value of S&P 500 Index<sup>®</sup> call options that we use to hedge our indexed annuity products and higher investment income on surplus. The mark-to-market adjustment on S&P 500 Index<sup>®</sup> call options impacted net investment income by increases of \$37 million and \$38 million for the three and six months ended June 30, 2007 and by a decrease of \$14 million for both the three and six months ended June 30, 2006. This change in the call option market value largely offsets the change in interest credited (included within insurance benefits expense) caused by fluctuations in the value of our indexed annuity contract liabilities, discussed further below within the discussion of benefits expense. These impacts of the indexed annuity hedge program, related to both net investment income and interest credited, are excluded from our spread calculations. Net investment income on surplus increased \$9 million pre-DAC, pre-tax in the second quarter of 2007 compared to the same period in 2006 as a result of better than expected results from alternative investments. Net investment income for the three months and six months ended June 30 also included (pre-DAC and pre-tax) \$3 million and \$5 million in 2007 and \$1 million and \$3 million in 2006 related to commercial mortgage loan prepayment and bond makewhole premiums. Additionally, net investment income in the second quarter of 2006 was reduced by \$4 million (\$1 million after-DAC, after-tax) for internal default charges before the methodology was discontinued in the third quarter of 2006. See "Other Operations" below for additional information. The increase in net investment income for the six months ended June 30, 2007 is primarily due to the increase in fixed account values which were acquired in the Jefferson-Pilot merger, the impact of the changes in market value of S&P Index<sup>®</sup> call options used to hedge our indexed annuity product and higher investment income on surplus.

When analyzing the impact of net investment income, it is important to understand that a portion of the investment income earned is credited to the policyholders of our fixed annuity products. The annuity product interest rate spread represents the excess of the yield on earning assets over the average crediting rate. We exclude the impact of investment income from statutory surplus investment portfolios from our spread calculations. The yield on earning assets is calculated as net investment income on fixed product investment portfolios divided by average earning assets. The average crediting rate is calculated using interest credited on annuity products less the mark-to-market adjustment on the indexed annuity business, bonus credits and excess interest on policies with the dollar cost averaging feature, divided by the average fixed account values net of coinsured account values. For further explanation of interest credited to policyholders see Benefits and Expenses below.

The interest rate spread table above summarizes the effect of changes in the portfolio yield and the rate credited to policyholders, as well as certain significant items causing volatility in the periods presented. In addition to the significant items identified, the interest spreads for this segment have improved primarily due to an increase in earned rates on invested assets, a reduction in average crediting rates year over year driven by the lapses of higher rate multi-year products as described above, and the 5 basis point increase attributable to the opening balance sheet adjustment, discussed below.

We expect to manage the effect of spreads for near-term operating income through a combination of rate actions and portfolio management. Our expectation includes the assumption that there are no significant changes in net flows in or out of our fixed accounts or other changes that may cause interest rate spreads to differ from our expectation. For information on interest rate spreads and the interest rate risk due to falling interest rates, see Item 3 Quantitative and Qualitative Disclosures About Market Risk of this Form 10-Q.





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*Benefits and Expenses*

Insurance benefits include interest credited to policyholders of \$188 million and \$352 million for the three and six months ended June 30, 2007, and \$173 million and \$269 million for the same periods in 2006. The mark-to-market adjustment related to our indexed annuity liabilities increased interest credited for the three and six months ended June 30, 2007, by \$34 million and \$33 million and decreased interest credited by \$13 million for both the three and six months ended June 30, 2006. Fixed account values reinsured under modified coinsurance agreements are included in account values for this calculation. Statement of Financial Accounting Standards No. 133 *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) requires that we calculate the fair values of index call options we may purchase in the future to hedge policyholder index allocations applicable to future reset periods, which we refer to as the SFAS 133 forward-starting option liability. This liability represents an estimate of the cost of the options we may purchase in the future less expected charges to policyholders, discounted back to the date of the balance sheet, using current market indicators of volatility and interest rates. Changes in the fair values of this liability result in volatility in interest credited. Interest credited decreased \$10 million and \$6 million pre-DAC, pre-tax for the three and six months ended June 30, 2007 and increased by \$1 million, pre-DAC, pre-tax for the three and six months ended June 30, 2006 related to changes in the SFAS 133 forward-starting option liability. The interest rate assumption used in discounting this liability within the fair value calculation is the primary driver of the change in value. Interest credited to policyholder balances increased for the three months ended June 30, 2007 due to an increase in the indexed annuity liability mark-to-market adjustment partially offset by a favorable change in the SFAS 133 forward-starting option liability and the impact of lapsation of products with higher crediting rates. Interest credited to policyholder balances increased for the six months ended June 30, 2007, compared to the same periods in 2006 as a result of the Jefferson-Pilot merger, partially offset by lower average fixed account values and lower average crediting rates. Interest credited for the first six months of 2007 was also reduced by \$4 million (\$3 million after-tax) related to adjustments to the opening balance sheet of Jefferson-Pilot finalized in the first quarter of 2007. These adjustments increased our interest rate spread by 5 basis points in the first six months of 2007. See the table above for the interest rate credited to policyholders.

Our fixed annuity business includes products with crediting rates that are reset on an annual basis and are not subject to surrender charges. Account values for these products were \$3.6 billion at June 30, 2007 with 33% already at their minimum guaranteed rates. The average crediting rates for these products were approximately 44 basis points in excess of average minimum guaranteed rates. Our ability to retain the multi-year guarantee and annual reset annuities will be subject to current competitive conditions at the time interest rates for these products reset.

Also included in insurance benefits are the costs associated with guaranteed benefits included within variable annuities with the GMDB, GMWB or GIB riders. For the three and six months ended June 30, 2007, favorable market conditions resulted in decreased insurance benefits for the GMDB, GMWB and GIB riders, which were offset by unfavorable hedge results compared to 2006. The effect of changes in net reserve and benefit payments and results of the hedge program attributable to these guaranteed benefits was such that benefits and expenses decreased \$11 million (\$4 million after-DAC, after-tax) for the three months ended June 30, 2007 and decreased \$14 million (\$5 million after-DAC, after-tax) for the six months ended June 30, 2007, compared to the same periods in 2006.

At June 30, 2007, the segment's net amount at risk ( NAR ) related to contracts with a GMDB feature was \$0.2 billion. The related GAAP and statutory reserves were \$25 million and \$40 million, respectively. The comparable amounts at December 31, 2006, were a NAR of \$0.3 billion, GAAP reserves of \$23 million and statutory reserves of \$42 million. At any point in time, the NAR is the difference between the potential death benefit payable and the total account value, with a floor of zero (when account values exceed the potential death benefit there is no amount at risk). Accordingly, the NAR represents the maximum amount we would have to pay if all policyholders died. In evaluating the GMDB exposures that exist within our variable annuity business relative to industry peers, it is important to distinguish between the various types of GMDB features, and consider other factors such as average account values, average amounts of NAR, and the age of contractholders. The following table and discussion provides this information for our variable annuity business as of June 30, 2007:

|   | Type of GMDB Feature |                 |         |         | Total    |
|---|----------------------|-----------------|---------|---------|----------|
|   | Return of Premium    | High Water Mark | Roll-up | No GMDB |          |
| Variable Annuity Account Value (billions) | \$ 28.0              | \$ 24.8         | \$ 0.4  | \$ 5.4  | \$ 58.6  |
| % of Total Annuity Account Value          | 47.8%                | 42.3%           | 0.7%    | 9.2%    | 100.0%   |
| Average Account Value (thousands)         | \$ 116.8             | \$ 115.6        | \$ 86.5 | \$ 81.6 | \$ 111.7 |
| Average NAR (thousands)                   | 5.3                  | 7.2             | 11.8    | N/A     | 7.1      |
| NAR (billions)                            |                      | 0.2             |         |         | 0.2      |
| Average Age of Contract Holder            | 65                   | 64              | 67      | 63      | 64       |
| % of Contract Holders > 70 Years of Age   | 15.2%                | 31.3%           | 42.4%   | 32.2%   | 20.7%    |

We have variable annuity contracts containing GMDBs that have a dollar-for-dollar withdrawal feature. Under such a feature, withdrawals reduce both current account value and the GMDB amount on a dollar-for-dollar basis. For contracts containing this dollar-for-dollar feature, the account holder could withdraw a substantial portion of their account value resulting in a GMDB that is multiples of the current account value. Our exposure to this dollar-for-dollar risk is somewhat mitigated by the fact that we do not allow for partial 1035 exchanges on non-qualified contracts. To take advantage of the dollar-for-dollar feature, the contractholder must take constructive receipt of the withdrawal and pay any applicable surrender charges. We report the appropriate amount of the withdrawal that is taxable to the Internal Revenue Service, as well as indicating whether or not tax penalties apply under the premature distribution tax rules. We closely monitor the dollar-for-dollar withdrawal GMDB exposure. Beginning in 2003, the GMDB feature offered on new contract sales is a pro-rata GMDB feature whereby each dollar of withdrawal reduces the GMDB benefit in proportion to the current GMDB to account value ratio. As of June 30, 2007, there were 796 contracts for which the death benefit to account value ratio was greater than ten to one. The NAR on these contracts was \$51 million.

Underwriting, acquisition, insurance and other expenses increased \$61 million, or 28%, and \$146 million, or 38%, for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increases for both periods were driven primarily by account value growth from sales and favorable equity markets, which resulted in higher commission expenses, net of deferrals and higher DAC amortization. DAC and VOBA amortization increased \$35 million and \$66 million for the three and six months ended June 30, 2007 compared to the same periods in 2006. Broker-dealer commissions and operating expenses increased \$14 million and \$54 million in the second quarter and first six months of 2007 as a result of higher sales. Higher incentive compensation expenses due to favorable performance also contributed to the increase in expenses for the three and six month periods of 2007. The merger with Jefferson-Pilot also contributed to the increase for the six months ended June 30, 2007. Underwriting, acquisition, insurance and other expenses for six months ended June 30, 2007 were increased by \$2 million (\$1 million after-tax) related to adjustments to the opening balance sheet of Jefferson-Pilot finalized in the first quarter of 2007.

**Individual Markets Life Insurance**

| Operating Summary (in millions)                         | Three Months Ended<br>June 30, |        |        | Six Months Ended<br>June 30, |        |        |
|---|--------------------------------|--------|--------|------------------------------|--------|--------|
|   | 2007                           | 2006   | Change | 2007                         | 2006   | Change |
| <b>Operating Revenues</b>                               |                                |        |        |                              |        |        |
| Insurance premiums                                      | \$ 88                          | \$ 90  | -2%    | \$ 176                       | \$ 141 | 25%    |
| Insurance fees  | 368                            | 386    | -5%    | 787                          | 586    | 34%    |
| Net investment income                                   | 493                            | 416    | 19%    | 947                          | 655    | 45%    |
| Other revenues and fees                                 | 8                              | 9      | -11%   | 19                           | 20     | -5%    |
| Total operating revenues                                | 957                            | 901    | 6%     | 1,929                        | 1,402  | 38%    |
| <b>Operating Expenses</b>                               |                                |        |        |                              |        |        |
| Insurance benefits                                      | 517                            | 497    | 4%     | 1,015                        | 760    | 34%    |
| Underwriting, acquisition, insurance and other expenses | 171                            | 183    | -7%    | 392                          | 316    | 24%    |
| Total operating expenses                                | 688                            | 680    | 1%     | 1,407                        | 1,076  | 31%    |
| Income from operations before taxes                     | 269                            | 221    | 22%    | 522                          | 326    | 60%    |
| Federal income taxes                                    | 93                             | 74     | 26%    | 179                          | 110    | 63%    |
| Income from operations                                  | \$ 176                         | \$ 147 | 20%    | \$ 343                       | \$ 216 | 59%    |

| Interest Rate Spreads   | Three Months Ended<br>June 30, |        |                        | Six Months Ended<br>June 30, |        |                        |
|---|--------------------------------|--------|------------------------|------------------------------|--------|------------------------|
|   | 2007                           | 2006   | Basis Points<br>Change | 2007                         | 2006   | Basis Points<br>Change |
| <b>Interest-Sensitive Products</b>                                  |                                |        |                        |                              |        |                        |
| Net investment income yield on reserves, excluding below items      | 6.15%                          | 6.16%  | (1)                    | 6.14%                        | 6.19%  | (5)                    |
| Earnings from alternative investments, such as limited partnerships | 0.70%                          | 0.02%  | 68                     | 0.42%                        | 0.07%  | 35                     |
| Default charges   | 0.00%                          | -0.08% | 8                      | 0.00%                        | -0.05% | 5                      |
| Commercial mortgage loan prepayment and bond makewhole premiums     | 0.14%                          | 0.13%  | 1                      | 0.18%                        | 0.11%  | 7                      |
| Net investment income yield   | 6.99%                          | 6.23%  | 76                     | 6.74%                        | 6.32%  | 42                     |
| Interest rate credited to policyholders                             | 4.45%                          | 4.46%  | (1)                    | 4.45%                        | 4.51%  | (6)                    |
| Interest rate spread  | 2.54%                          | 1.77%  | 77                     | 2.29%                        | 1.81%  | 48                     |
| <b>Traditional Products</b>   |                                |        |                        |                              |        |                        |
| Net investment income yield on reserves, excluding below items      | 6.34%                          | 6.45%  | (11)                   | 6.37%                        | 6.50%  | (13)                   |
| Commercial mortgage loan prepayment and bond makewhole premiums     | 0.14%                          | 0.14%  |                        | 0.08%                        | 0.15%  | (7)                    |
| Net investment income yield   | 6.48%                          | 6.59%  | (11)                   | 6.45%                        | 6.65%  | (20)                   |

| (in millions)                   | Three Months Ended<br>June 30, |          |        | Six Months Ended<br>June 30, |          |        |
|---------------------------------|--------------------------------|----------|--------|------------------------------|----------|--------|
|                                 | 2007                           | 2006     | Change | 2007                         | 2006     | Change |
| <b>Sales by Product</b>         |                                |          |        |                              |          |        |
| Universal Life ("UL")           |                                |          |        |                              |          |        |
| Excluding MoneyGuard®           | \$ 145                         | \$ 98    | 48%    | \$ 311                       | \$ 139   | 124%   |
| MoneyGuard®                     | 10                             | 7        | 43%    | 17                           | 15       | 13%    |
| Total Universal Life            | 155                            | 105      | 48%    | 328                          | 154      | 113%   |
| Variable Universal Life ("VUL") | 17                             | 16       | 6%     | 38                           | 26       | 46%    |
| Whole Life                      |                                |          | NM     |                              | 1        | -100%  |
| Term                            | 8                              | 11       | -27%   | 17                           | 19       | -11%   |
| Total                           | \$ 180                         | \$ 132   | 36%    | \$ 383                       | \$ 200   | 92%    |
| <b>Net Flows</b>                |                                |          |        |                              |          |        |
| Deposits                        | \$ 1,005                       | \$ 1,024 | -2%    | \$ 2,044                     | \$ 1,511 | 35%    |
| Withdrawals and Deaths          | (419)                          | (476)    | 12%    | (760)                        | (706)    | -8%    |
| Net flows                       | \$ 586                         | \$ 548   | 7%     | \$ 1,284                     | \$ 805   | 60%    |
| Policyholder Assessments        | \$ 586                         | \$ 571   | 3%     | \$ 1,188                     | \$ 864   | 38%    |

| (in millions)                       | As of June 30, |            |        |
|-------------------------------------|----------------|------------|--------|
|                                     | 2007           | 2006       | Change |
| <b>Account Values</b>               |                |            |        |
| Universal Life                      | \$ 22,517      | \$ 21,285  | 6%     |
| Variable Universal Life             | 4,948          | 4,194      | 18%    |
| Total life insurance account values | \$ 27,465      | \$ 25,479  | 8%     |
| <b>In-Force Face Amount</b>         |                |            |        |
| Universal Life and Other            | \$ 276,040     | \$ 260,945 | 6%     |
| Term Insurance                      | 236,155        | 229,082    | 3%     |
| Total in-force                      | \$ 512,195     | \$ 490,027 | 5%     |
| <b>Net Amount at Risk</b>           |                |            |        |
| Universal Life and Other            | \$ 244,800     | \$ 231,600 | 6%     |
| Term Insurance                      | 234,900        | 228,000    | 3%     |
| Total net amount at risk            | \$ 479,700     | \$ 459,600 | 4%     |

#### Comparison of the Three and Six Months Ended June 30, 2007 to 2006

Income from operations for this segment increased \$29 million, or 20%, and \$127 million, or 59% for the three and six months ended June 30, 2007, compared to the same periods in 2006. The increase for the three months ended June 30, 2007 is primarily the result of favorable investment results, growth of business in-force and favorable retrospective net unlockings, partially offset by higher incentive compensation expenses and the impact of adjustments resulting from correcting account values for certain of our life insurance policies and modifying the accounting for certain of our life insurance policies. The increase for the six months ended June 30, 2007 is driven primarily by the merger with Jefferson-Pilot. Excluding the increased operating results from the merger, income from operations during the six months ended June 30, 2007 increased over the same period in 2006 due to favorable investment results, insurance fees and growth of business in-force.

## Revenues

Revenues for the three and six months ended June 30, 2007 increased \$56 million, or 6%, and \$527 million, or 38%, compared to the same periods in 2006. The increase for the three months ended June 30, 2007 is primarily the result of a \$77 million increase in investment income due to continued growth of business in-force, higher commercial mortgage loan prepayments, and bond makewhole premiums and investment income from alternative investments, partially offset by a \$41 million reduction in insurance fees, net of DFEL amortization, related to the adjustments noted above. Insurance fees include mortality assessments, expense assessments (net of DFEL deferrals and amortization) and surrender charges. Retrospective DFEL unlockings negatively impacted insurance fees for the three and six months ended June 30, 2007 by \$7 million pre-tax (\$5 million after-tax) and \$10 million pre-tax (\$6 million after-tax), primarily due to favorable investment results and favorable persistency. Excluding the impact of the \$41 million adjustment to insurance fees discussed above, insurance fees for the second quarter of 2007 increased \$23 million, or 6%, compared to growth in universal life insurance account values of 6%. The increase for the six months ended June 30, 2007 is primarily due to the inclusion of results from the Jefferson-Pilot companies beginning in April 2006 in addition to the same drivers mentioned above for the three months ended June 30, 2007, partially offset by lower insurance fees related to the adjustments noted above. Revenues for insurance fees for the six months ended June 30, 2007 were reduced by \$5 million (\$2 million after-DAC, after-tax) primarily related to adjustments to the opening balance sheet of Jefferson-Pilot finalized in the first quarter of 2007. In addition to the effects of the merger and excluding the adjustments noted above, growth in mortality and expense assessments for the six months ended June 30, 2007 compared to the same period in 2006 is primarily related to higher sales and increased business in-force due to new sales and favorable persistency. The improved persistency results should positively affect future revenues.

During the three and six months ended June 30, 2007, compared to the same periods in 2006, life insurance in-force grew 5% as a result of new sales, favorable persistency and due to the merger with Jefferson-Pilot for the six month comparison. In-force growth should be considered independently with regard to term products versus permanent products, as term products have a lower profitability in relation to face amount compared to permanent products. Insurance premium revenue relates primarily to whole life and term life insurance products. For the three and six months ended June 30, 2007, insurance premiums for term insurance increased 4% and 30% compared to the same period in 2006, while insurance premiums for whole life decreased 7% and increased 17%. Excluding the impact of the Jefferson-Pilot companies, insurance premiums for term insurance increased 16% for the six months ended June 30, 2007 compared to the same period in 2006, while insurance premiums for whole life decreased 7%. For term insurance, gross premiums grew 3% for the three and six months ended June 30, 2007 from continued growth in the term insurance book of business.

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

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

Whole Life and Term 100% of first year paid premiums.

Sales are not part of revenues (other than for term products) and do not have a significant impact on current quarter income from operations, but are an indicator of future profitability. Total sales for the three and six months ended June 30, 2007 compared to the same periods in 2006, increased \$48 million and \$183 million. The increase for the three months ended June 30, 2007 is primarily the result of strong performance by our wholesaler, Lincoln Financial Distributors, and retailer, Lincoln Financial Network, as well as by third party retail channels. The increase for the six months ended June 30, 2007 is primarily a result of the merger and strong performance by our distributors. We believe that our sales of universal life products include sales with investor-owned life insurance characteristics. We have implemented procedures to identify sales believed to be associated with this type of business in order to prevent investor-owned life insurance policies from being issued. However, accurate identification of these policies can be difficult and we continue to modify our screening procedures. We cannot predict whether or not these sales will ultimately impact our profitability, however, returns on universal life business sold as part of investor-owned designs are believed to be lower than traditional estate planning universal life sales due in part to zero-expected lapses.

UL and VUL products with secondary guarantees represented approximately 28% of permanent life insurance in-force at June 30, 2007 and approximately 68% and 67% of sales for these products during the three and six months ended June 30, 2007. Actuarial Guideline 38 ( AXXX ) imposes additional reserve requirements for these products See Review of Consolidated Financial Condition Sources of Liquidity and Cash Flow Financing Activities for further information on the manner in which we reinsure our AXXX reserves.

Net investment income increased \$77 million, or 19%, and \$292 million, or 45%, in the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase for the three months ended June 30, 2007 is primarily the result of growth in investment income due to in-force growth of 5%, higher commercial mortgage loan prepayments and bond makewhole



premiums of \$1 million and investment income from alternative investments of \$38 million. Net investment income for the three months and six months ended June 30 included (pre-DAC and pre-tax) \$8 million and \$19 million in 2007 and \$7 million and \$11 million in 2006 related to commercial mortgage loan prepayment and bond makewhole premiums. Additionally, the second quarter benefited from an increase in investment income from alternative investments that was driven primarily by favorable results in limited partnership investments of \$39 million (\$19 million, after-DAC, after-tax) in 2007 compared to \$1 million (\$1 million, after-DAC, after-tax) in 2006. Also contributing to the increase in net investment income was a \$4 million reduction (\$1 million after-DAC, after-tax) attributable to internal default charges in the second quarter of 2006 before the methodology was changed. See "Other Operations" below for additional information. The increase for the six months ended June 30, 2007 is primarily driven by the merger with Jefferson-Pilot. Excluding the effects of the merger, growth in investment income for the six-month period was due to the same drivers mentioned above for the three months ended June 30, 2007. At June 30, 2007, we reduced statutory reserves related to our secondary guarantee universal life products by approximately \$200 million which will reduce the amount of future net investment income allocated to this segment by \$3 million, pre-tax, per quarter prospectively.

The interest rate spread on interest-sensitive products is the difference between the interest to be credited to policyholder accounts and the interest income we earn on the assets supporting the policyholder accounts. We exclude the impact of investment income from statutory surplus investment portfolios and the impact of earnings from affordable housing tax credit securities, which is reflected in our statement of income as a reduction to income tax expense, from our spread calculations. Traditional products use interest income to build the policy reserves. At June 30, 2007 and 2006, interest sensitive products represented approximately 82% and 81%, respectively, of total invested assets. Interest rate spreads for interest sensitive products increased 77 basis points and 48 basis points in the three and six months ended June 30, 2007 compared to the same periods in 2006. Excluding the effects of commercial mortgage loan prepayment and bond makewhole premiums and internal default charges, interest rate spreads for interest sensitive products increased 68 basis points and 36 basis points for the three and six months ended June 30, 2007, compared to the same periods in 2006, primarily driven by favorable investment income from alternative investments as discussed above. An increase in investment income in the second quarter of 2007 was also driven by 9% growth in invested assets. Higher AXXX statutory reserve liabilities on universal life policies with secondary guarantees contributed to invested asset growth. The three months and six months ended June 30, 2007 interest rate spread on interest-sensitive products was positively impacted by 1 basis point and 4 basis points due to reduced interest credited attributable to fewer calendar days than in average periods.

For the three and six months ended June 30, 2007, spreads between new money rates and general account yields have narrowed. At the end of the second quarter 2007, new money rates exceeded the portfolio rate by roughly 10 basis points. At June 30, 2007, 54% of interest sensitive account values have crediting rates at contract guaranteed levels, and 37% have crediting rates within 50 basis points of contractual guarantees. We decreased crediting rates 10 basis points effective June 1, 2007 which is expected to increase spreads 5 basis points prospectively. Going forward, we expect to be able to manage the effects of spreads on near-term income from operations through a combination of rate actions and portfolio management. This assumes no significant changes in net flows into or out of our fixed accounts or other changes that may cause interest rate spreads to differ from our expectations. For information on interest rate spreads and the interest rate risk due to falling interest rates, see Item 3 Quantitative and Qualitative Disclosures About Market Risk of this Form 10-Q.

#### *Benefits and Expenses*

Insurance benefits include interest credited to policyholders of \$254 million and \$506 million for the three and six months ended June 30, 2007 and \$241 million and \$384 million for the same periods in 2006. The 5% increase in interest credited was driven primarily by growth in universal life account values of 6% for the three months ended June 30, 2007. For the six months ended June 30, 2007, the increase is primarily attributable to the merger, higher interest credited from growth in universal life account values of 6%, partially offset by a reduction of \$14 million (\$6 million after-DAC, after-tax) related to a correction to the opening balance sheet of Jefferson-Pilot finalized in the first quarter of 2007. Refer to the table above for the interest rate credited to policyholders. On June 1, 2007, we implemented a ten basis point decrease in crediting rates on most interest-sensitive products not already at contractual guarantees. Insurance benefits also includes changes to the SOP 03-1 benefit reserve for our products with secondary guarantees. The reserve increased for the three and six months ended June 30, 2007 by \$18 million, pre-DAC, pre-tax for both periods. As a result of the adjustments in the second quarter of 2007 described above, the change in SOP 03-1 benefit reserves increased \$3 million and the ongoing impact related to this revision is expected to increase reserves by \$3 million per quarter. Insurance benefits in 2006 includes an increase to the SOP 03-1 benefit reserve that resulted from updating long-term assumptions, primarily investment interest rates. The change in assumptions was estimated to result in an increase in reserves in future quarters of approximately \$2 million (\$1 million after-tax). Death claims for the second quarter of 2007 compared to 2006 decreased \$3 million, or 2%.

Underwriting, acquisition, insurance and other expenses decreased \$12 million and increased \$76 million for the three and six months ended June 30, 2007 compared to the same periods in 2006 primarily due to changes in DAC and VOBA amortization. DAC and VOBA amortization decreased \$17 million and increased \$48 million for the three months and six month periods ended

June 30, 2007 compared to 2006. The decrease in DAC and VOBA amortization for the three months ended June 30, 2007 is due to an increase in favorable unlocking discussed in the next sentence and a \$23 million decrease in amortization resulting from the adjustments noted above. Favorable retrospective DAC and VOBA unlockings for the three and six months ended June 30, 2007 were \$21 million pre-tax (\$14 million after-tax) and \$32 million pre-tax (\$21 million after-tax) primarily due to favorable investment results and favorable persistency. The increase for the six months ended June 30, 2007 is driven primarily by the merger, partially offset by the favorable DAC and VOBA unlocking and the impact of the adjustments discussed above. DAC and VOBA amortization for the six months ended June 30, 2007 is increased by \$10 million (\$6 million after-tax) related to adjustments to the opening balance sheet of Jefferson-Pilot finalized in the first quarter of 2007. During the third quarter of 2006, we undertook our annual comprehensive review of the assumptions underlying the amortization of DAC, VOBA and DFEL. The 2006 review also resulted in a negative net prospective unlocking adjustment, primarily reflecting the impact of the increased reserves related to the sale of life insurance products sold with secondary guarantees, partially offset by improved mortality and expense assumptions. The 2006 review also resulted in an increase in the on-going amortization expense of approximately \$4 million pre-tax (\$2 million after-tax) per quarter starting in the fourth quarter of 2006. Expenses were also impacted by higher incentive compensation expense in the second quarter of 2007 due to favorable performance.

### RESULTS OF EMPLOYER MARKETS

The Employer Markets business provides its products through two segments, Retirement Products and Group Protection. The Retirement Products segment operates through two lines of business – Defined Contribution, which provides employer-sponsored variable and fixed annuities, mutual-fund based programs in the 401(k), 403(b), and 457 marketplaces; and Executive Benefits, which provides corporate-owned life insurance ( COLI ) and bank-owned life insurance ( BOLI ) and contains an Institutional Pension business. The Group Protection segment of Employer Markets offers group life, disability, and dental insurance to employers. For factors that could cause actual results to differ materially from those set forth in this section, see Part I Item 1 Risk Factors in our 2006 Form 10-K and Forward-looking Statements Cautionary Language in this report.

#### Employer Markets Retirement Products

| Operating Summary (in millions)                         | Three Months Ended<br>June 30, |       |        | Six Months Ended<br>June 30, |        |        |
|---|--------------------------------|-------|--------|------------------------------|--------|--------|
|   | 2007                           | 2006  | Change | 2007                         | 2006   | Change |
| <b>Operating Revenues</b>                               |                                |       |        |                              |        |        |
| Insurance premiums                                      | \$                             | \$    | NM     | \$ 1                         | \$ 1   |        |
| Insurance fees  | 79                             | 70    | 13%    | 156                          | 135    | 16%    |
| Net investment income                                   | 282                            | 274   | 3%     | 557                          | 508    | 10%    |
| Other revenues and fees                                 | 6                              | 6     | 0%     | 12                           | 12     |        |
| Total operating revenues                                | 367                            | 350   | 5%     | 726                          | 656    | 11%    |
| <b>Operating Expenses</b>                               |                                |       |        |                              |        |        |
| Insurance benefits                                      | 188                            | 173   | 9%     | 371                          | 316    | 17%    |
| Underwriting, acquisition, insurance and other expenses | 92                             | 77    | 19%    | 176                          | 155    | 14%    |
| Total operating expenses                                | 280                            | 250   | 12%    | 547                          | 471    | 16%    |
| Income from operations before taxes                     | 87                             | 100   | -13%   | 179                          | 185    | -3%    |
| Federal income taxes                                    | 26                             | 30    | -13%   | 54                           | 54     |        |
| Income from operations                                  | \$ 61                          | \$ 70 | -13%   | \$ 125                       | \$ 131 | -5%    |



**Retirement Products Defined Contribution**

| Operating Summary (in millions)                         | Three Months Ended<br>June 30, |              |             | Six Months Ended<br>June 30, |               |            |
|---|--------------------------------|--------------|-------------|------------------------------|---------------|------------|
|   | 2007                           | 2006         | Change      | 2007                         | 2006          | Change     |
| <b>Operating Revenues</b>                               |                                |              |             |                              |               |            |
| Insurance fees  | \$ 65                          | \$ 57        | 14%         | \$ 127                       | \$ 115        | 10%        |
| Net investment income                                   | 182                            | 187          | -3%         | 363                          | 373           | -3%        |
| Other revenues and fees                                 | 5                              | 5            | 0%          | 9                            | 10            | -10%       |
| <b>Total operating revenues</b>                         | <b>252</b>                     | <b>249</b>   | <b>1%</b>   | <b>499</b>                   | <b>498</b>    | <b>0%</b>  |
| <b>Operating Expenses</b>                               |                                |              |             |                              |               |            |
| Insurance benefits                                      | 104                            | 102          | 2%          | 209                          | 203           | 3%         |
| Underwriting, acquisition, insurance and other expenses | 81                             | 70           | 16%         | 152                          | 143           | 6%         |
| <b>Total operating expenses</b>                         | <b>185</b>                     | <b>172</b>   | <b>8%</b>   | <b>361</b>                   | <b>346</b>    | <b>4%</b>  |
| Income from operations before taxes                     | 67                             | 77           | -13%        | 138                          | 152           | -9%        |
| Federal income taxes                                    | 20                             | 23           | -13%        | 41                           | 45            | -9%        |
| <b>Income from operations</b>                           | <b>\$ 47</b>                   | <b>\$ 54</b> | <b>-13%</b> | <b>\$ 97</b>                 | <b>\$ 107</b> | <b>-9%</b> |

| (in millions)                            | As of June 30,   |                  |            |
|--|------------------|------------------|------------|
|  | 2007             | 2006             | Change     |
| <b>Account Values</b>                    |                  |                  |            |
| Variable Annuities                       | \$ 18,481        | \$ 16,144        | 14%        |
| Fixed Annuities                          | 10,940           | 11,050           | -1%        |
| <b>Total Annuities</b>                   | <b>29,421</b>    | <b>27,194</b>    | <b>8%</b>  |
| <b>Alliance Mutual Funds</b>             | <b>6,543</b>     | <b>4,330</b>     | <b>51%</b> |
| <b>Total Annuities and Alliance</b>      | <b>\$ 35,964</b> | <b>\$ 31,524</b> | <b>14%</b> |
| <b>Fixed Portion of Variable Annuity</b> | <b>\$ 6,023</b>  | <b>\$ 6,333</b>  | <b>-5%</b> |

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| Net Flows (in millions)  | Three Months Ended<br>June 30, |          |        | Six Months Ended<br>June 30, |          |        |
|--|--------------------------------|----------|--------|------------------------------|----------|--------|
|  | 2007                           | 2006     | Change | 2007                         | 2006     | Change |
| Variable Portion of Variable Annuity Deposits                    | \$ 577                         | \$ 714   | -19%   | \$ 1,232                     | \$ 1,383 | -11%   |
| Variable Portion of Variable Annuity Withdrawals                 | (747)                          | (647)    | -15%   | (1,560)                      | (1,322)  | -18%   |
| Variable Portion of Variable Annuity Net Flows                   | (170)                          | 67       | NM     | (328)                        | 61       | NM     |
| Fixed Portion of Variable Annuity Deposits                       | 87                             | 120      | -28%   | 187                          | 239      | -22%   |
| Fixed Portion of Variable Annuity Withdrawals                    | (236)                          | (231)    | -2%    | (469)                        | (452)    | -4%    |
| Fixed Portion of Variable Annuity Net Flows                      | (149)                          | (111)    | -34%   | (282)                        | (213)    | -32%   |
| Total Variable Annuity Deposits                                  | 664                            | 834      | -20%   | 1,419                        | 1,622    | -13%   |
| Total Variable Annuity Withdrawals                               | (983)                          | (878)    | -12%   | (2,029)                      | (1,774)  | -14%   |
| Total Variable Annuity Net Flows                                 | (319)                          | (44)     | NM     | (610)                        | (152)    | NM     |
| Fixed Annuity Deposits   | 146                            | 121      | 21%    | 344                          | 256      | 34%    |
| Fixed Annuity Withdrawals  | (140)                          | (113)    | -24%   | (305)                        | (221)    | -38%   |
| Fixed Annuity Net Flows  | 6                              | 8        | -25%   | 39                           | 35       | 11%    |
| Total Annuity Deposits   | 810                            | 955      | -15%   | 1,763                        | 1,878    | -6%    |
| Total Annuity Withdrawals  | (1,123)                        | (991)    | -13%   | (2,334)                      | (1,995)  | -17%   |
| Total Annuity Net Flows  | (313)                          | (36)     | NM     | (571)                        | (117)    | NM     |
| Alliance Mutual Fund Deposits                                    | 464                            | 204      | 127%   | 997                          | 522      | 91%    |
| Alliance Mutual Fund Withdrawals                                 | (77)                           | (54)     | -43%   | (131)                        | (110)    | -19%   |
| Total Alliance Mutual Fund Net Flows                             | 387                            | 150      | 158%   | 866                          | 412      | 110%   |
| Total Annuity and Alliance Deposits                              | 1,274                          | 1,159    | 10%    | 2,760                        | 2,400    | 15%    |
| Total Annuity and Alliance Withdrawals                           | (1,200)                        | (1,045)  | -15%   | (2,465)                      | (2,105)  | -17%   |
| Total Annuity and Alliance Net Flows                             | \$ 74                          | \$ 114   | -35%   | \$ 295                       | \$ 295   |        |
| Annuities Incremental Deposits                                   | \$ 854                         | \$ 935   | -9%    | \$ 1,717                     | \$ 1,843 | -7%    |
| Alliance Mutual Fund Incremental Deposits                        | 464                            | 204      | 127%   | 997                          | 522      | 91%    |
| Total Annuities and Alliance Incremental Deposits <sup>(1)</sup> | \$ 1,318                       | \$ 1,139 | 16%    | \$ 2,714                     | \$ 2,365 | 15%    |

(1) Incremental deposits represent gross deposits reduced by transfers from other segment products.

| Interest Rate Spread  | Three Months Ended<br>June 30, |       |        | Basis<br>Points<br>Change | Six Months Ended<br>June 30, |      | Basis<br>Points<br>Change |
|---|--------------------------------|-------|--------|---------------------------|------------------------------|------|---------------------------|
|   | 2007                           | 2006  | Change |                           | 2007                         | 2006 |                           |
| Net investment income yield on reserves, excluding below items  | 6.04%                          | 6.19% | (15)   | 6.11%                     | 6.19%                        | (8)  |                           |
| Commercial mortgage loan prepayment and bond makewhole premiums | 0.09%                          | 0.12% | (3)    | 0.06%                     | 0.14%                        | (8)  |                           |
| Reported net investment income yield                            | 6.13%                          | 6.31% | (18)   | 6.17%                     | 6.33%                        | (16) |                           |

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|  |                           |             |               |                         |             |               |
|--|---------------------------|-------------|---------------|-------------------------|-------------|---------------|
| Interest rate credited to policyholders            | 3.82%                     | 3.73%       | 9             | 3.81%                   | 3.70%       | 11            |
| Interest rate spread                               | 2.31%                     | 2.58%       | (27)          | 2.36%                   | 2.63%       | (27)          |
| Average fixed annuity account values (in millions) | \$ 10,958                 | \$ 11,004   |               | \$ 10,956               | \$ 11,004   |               |
|  | <b>Three Months Ended</b> |             |               | <b>Six Months Ended</b> |             |               |
|  | <b>June 30,</b>           |             |               | <b>June 30,</b>         |             |               |
| <b>(in millions)</b>                               | <b>2007</b>               | <b>2006</b> | <b>Change</b> | <b>2007</b>             | <b>2006</b> | <b>Change</b> |
| Average Daily Variable Account Values              | \$ 18,377                 | \$ 16,270   | 13%           | \$ 17,982               | \$ 16,223   | 11%           |

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**Comparison of Three and Six months ended June 30, 2007 to 2006**

Income from operations for the Defined Contribution line of business within the Retirement Products segment decreased \$7 million, or 13%, and \$10 million, or 9%, for the three and six months ended June 30, 2007 compared to the same periods in 2006, respectively. The decrease for the three and six months ended June 30, 2007 is primarily the result of the net of higher insurance fees on higher average variable account values, more than offset by a reduction in net investment income, an increase in interest credited to contractholder funds and an increase in expenses from strategic initiatives.

*Revenues*

Insurance fees increased 14% and 10% for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase in insurance fees for both periods is primarily related to increases in average daily variable annuity account values which increased 13% and 11% during the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase in account values reflects positive net flows and positive net equity market returns between periods. Excluding the impact of dividends, the S&P 500 Index<sup>®</sup> at June 30, 2007 was 18.4% higher than at June 30, 2006 and the average daily S&P 500 Index<sup>®</sup> was 16.8% and 13.9% higher than the same periods in 2006.

New deposits are an important component of our effort to grow the Defined Contribution business. Although deposits do not significantly impact current period income from operations, they are an important indicator of future profitability. Deposits increased 10% and 15% for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase in new deposits for the three and six months ended June 30, 2007 is primarily due to growth in the Alliance program.

Employer Markets serves the mid-large case 401(k) and 403(b) markets with our Alliance program. Deposits for this program (including Alliance program fixed annuity deposits of \$126 million and \$304 million) were \$590 million and \$1.3 billion in the second quarter and first six months of 2007, an increase of 92% and 76% from the same periods in 2006. The Alliance program bundles our fixed annuity products with mutual funds, along with record keeping and employee education components. We earn fees for the services that we provide to mutual fund accounts and investment margins on fixed annuities of Alliance program accounts. The amounts associated with the Alliance mutual fund program are not included in the assets or liabilities reported in our Consolidated Balance Sheets.

The distribution model for the small case 401(k) market is focused on driving growth through financial intermediaries. The two primary products we sell into this market are Director and LALR. As part of the strategic redesign of this model, in October 2006, we terminated a relationship with a third-party wholesaler and committed resources to developing our own wholesale sales force. During the second quarter and first six months of 2007, 401(k) Director product sales were down 31% and 19% from the same periods in 2006 due to the termination of the third-party wholesaler. We expect that in the long-term the benefits associated with our investment in a new wholesaling force will outweigh any short-term consequences of terminating our third-party wholesaling relationship.

The other component of net flows relates to the retention of our business as demonstrated by our lapse rates. The overall lapse rate for our Defined Contribution annuity products was 15% for the three and six months ended June 30, 2007, compared to 13% for the same periods in 2006. The period over period increase in annuity product lapses is mainly driven by our older block of annuity business.

Net investment income decreased 3% for both the three and six months ended June 30, 2007, compared to the same periods in 2006. The decrease in net investment income is primarily related to a net decrease in average fixed account values. The decrease also reflects a decrease in commercial mortgage loan prepayment and bond makewhole premiums from \$3 million and \$7 million for the second quarter and first six months of 2006 to \$2 million and \$3 million for the same periods in 2007.

A portion of the net investment income in this segment is credited to our fixed annuity policyholders. The interest credited to policyholders is included in insurance benefits. Annuity product interest rate spreads represent the excess of the yield on earning assets over the average crediting rate. The yield on earning assets is calculated as net investment income on investment portfolios supporting fixed products and the fixed portion of variable products divided by average earning assets. The average crediting rate is calculated using interest credited on annuity products divided by the average fixed account values.

The interest rate spread table above summarizes the effect of changes in the portfolio yield and the rate credited to policyholders on interest rate spreads, as well as certain significant items causing volatility in the periods presented. In addition to the decrease in commercial mortgage loan prepayment and bond makewhole premiums, this segment also experienced decreases in its investment income yield and an increase in crediting rates. In response to the competitive environment, we increased crediting

rates in April 2006 by ten basis points for a series of our fixed annuity products with approximately \$6 billion of account values. Effective October 1, 2006, we increased the crediting rates for these products by an additional 10 basis points. We are currently evaluating further crediting rate actions, with the expectation of maintaining stable spreads over the near term, excluding the effects of prepayment premiums. For information on interest rate spreads and the interest rate risk due to falling interest rates, see Item 3 Quantitative and Qualitative Disclosures About Market Risk of this Form 10-Q.

#### Benefits and Expenses

Interest credited to policyholders is included in insurance benefits and increased 2% and 3% for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increases are a result of the increase in crediting rates discussed above. See the table above for the interest rate credited to policyholders.

Underwriting, acquisition, insurance and other expenses increased \$11 million, or 16%, and \$9 million, or 6%, for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase for the three and six month period was primarily the result of higher incentive compensation expense, increases in salary and related expenses as we increase our sales force due to growth in business and an increase in DAC/VOBA amortization, negative retrospective unlocking. DAC and VOBA amortization increased \$3 million and \$2 million for the three and six months ended June 30, 2007 compared to 2006. Also contributing to the increase in expenses was the impact of increased sales of our Alliance mutual fund product and decrease in sales of our annuities products. Distribution expenses of mutual fund products are not deferrable and amortized like similar costs for insurance products. As a result, the segment's non-deferrable expenses are increasing as sales of the Alliance mutual fund product increase.

A portion of the variable annuity contracts in the segment contain GMDB's in the form of a Return of Premium ( ROP ) GMDB feature, which guarantees a return of premiums adjusted for any withdrawals. At June 30, 2007, approximately \$15 billion, or 60%, of variable annuity contract account values contained an ROP death benefit feature and the net amount at risk related to these contracts was \$11 million. The remaining variable annuity contract account values, including the 401(k) Director product, contain no GMDB feature.

#### Retirement Products Executive Benefits

| Operating Summary (in millions)                         | Three Months Ended<br>June 30, |       |        | Six Months Ended<br>June 30, |       |        |
|---|--------------------------------|-------|--------|------------------------------|-------|--------|
|   | 2007                           | 2006  | Change | 2007                         | 2006  | Change |
| <b>Operating Revenues</b>                               |                                |       |        |                              |       |        |
| Insurance premiums                                      | \$                             | \$    | NM     | \$ 1                         | \$ 1  | 0%     |
| Insurance fees  | 14                             | 13    | 8%     | 29                           | 20    | 45%    |
| Net investment income                                   | 100                            | 87    | 15%    | 194                          | 135   | 44%    |
| Other revenues and fees                                 | 1                              | 1     | 0%     | 3                            | 2     | 50%    |
| Total operating revenues                                | 115                            | 101   | 14%    | 227                          | 158   | 44%    |
| <b>Operating Expenses</b>                               |                                |       |        |                              |       |        |
| Insurance benefits                                      | 84                             | 71    | 18%    | 162                          | 113   | 43%    |
| Underwriting, acquisition, insurance and other expenses | 11                             | 7     | 57%    | 24                           | 12    | 100%   |
| Total operating expenses                                | 95                             | 78    | 22%    | 186                          | 125   | 49%    |
| Income from operations before taxes                     | 20                             | 23    | -13%   | 41                           | 33    | 24%    |
| Federal income taxes                                    | 6                              | 7     | -14%   | 13                           | 9     | 44%    |
| Income from operations                                  | \$ 14                          | \$ 16 | -13%   | \$ 28                        | \$ 24 | 17%    |

| Operational Data (in millions)               | Three Months Ended |          |        | Six Months Ended |          |        |
|--|--------------------|----------|--------|------------------|----------|--------|
|  | 2007               | 2006     | Change | 2007             | 2006     | Change |
| <b>COLI/BOLI Sales</b>                       | \$ 14              | \$ 17    | -18%   | \$ 34            | \$ 35    | -3%    |
| <b>COLI/BOLI Account Value Roll Forward</b>  |                    |          |        |                  |          |        |
| Balance beginning-of-period                  | \$ 4,264           | \$ 1,387 | 207%   | \$ 4,305         | \$ 1,318 | 227%   |
| Business acquired                            |                    | 2,795    | -100%  |                  | 2,795    | -100%  |
| Deposits                                     | 79                 | 77       | 3%     | 144              | 124      | 16%    |
| Withdrawals and deaths                       | (53)               | (42)     | -26%   | (193)            | (49)     | NM     |
| Net flows                                    | 26                 | 35       | -26%   | (49)             | 75       | NM     |
| Policyholder assessments                     | (17)               | (17)     |        | (35)             | (26)     | -35%   |
| Interest credited and change in market value | 80                 | 28       | 186%   | 132              | 66       | 100%   |
| Balance end-of-period                        | \$ 4,353           | \$ 4,228 | 3%     | \$ 4,353         | \$ 4,228 | 3%     |

|   | As of June 30, |           | Change |
|---|----------------|-----------|--------|
|   | 2007           | 2006      |        |
| <b>COLI/BOLI In-Force</b>                   | \$ 14,809      | \$ 15,373 | -4%    |
| <b>Institutional Pensions Account Value</b> | \$ 2,729       | \$ 2,707  | 1%     |

#### Comparison of the Three and Six Months Ended June 30, 2007 to 2006

Income from operations for Executive Benefits business decreased \$2 million and increased \$4 million for the three and six months ended June 30, 2007 compared to the same periods in 2006. The decrease for the three months ended June 30, 2007 is primarily related to net negative retrospective unlocking discussed further below, less favorable mortality in the Institutional Pension business, and declines in COLI/BOLI in-force. For the six months ended June 30, 2007 the increase primarily reflects the April 2006 merger with Jefferson-Pilot.

#### Revenues

Insurance fees for this business increased 8% and 45% for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase in insurance fees for the three months ended June 30, 2007 is primarily related to higher variable fees resulting from a customer transferring \$55 million of fixed account value to variable account value. This had an offsetting impact on fixed investment income and interest credited as discussed below. The increase in insurance fees for the six months ended June 30, 2007 primarily reflects the addition of the Jefferson-Pilot BOLI business.

Included in the BOLI acquired with the Jefferson-Pilot companies are life insurance products sold to community banks, which accounted for \$1.8 billion in policyholder fund balances. At June 30, 2007, VOBA balances, net of unearned revenue reserves, related to these blocks were approximately \$115 million. These policies, which are generally not subject to surrender charges, are owned by several thousand policyholders. These policies were primarily originated through, and continue to be serviced by, two marketing organizations. The surrender rate for this product may increase beyond current experience due to the absence of surrender charges and rising interest rates that may result in returns available to policyholders on competitors' products being more attractive than on our policies in-force.

Consistent with the way we report UL sales, we report COLI/BOLI sales as 100% of annualized expected target premium plus 5% of paid excess premium, including an adjustment for internal replacements at approximately 50% of target. On this basis, sales for the three and six months ended June 30, 2007 decreased 18% and essentially remained flat compared to the same periods in 2006. Sales in this business tend to be of large case nature and can fluctuate significantly from quarter to quarter. The recent introduction of new products in the market place should help sales momentum continue to improve throughout the remainder of 2007.

Net investment income increased \$13 million, or 15%, and \$59 million, or 44%, for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase in net investment income for the three months ended June 30, 2007 is



primarily related to higher investment yields and an additional \$13 million of net investment income related to three secured limited recourse notes issued in December 2006 and April 2007. For additional details on the secured limited recourse notes see Consolidated Investments Credit-Linked Notes below and Note 6 to the Financial Statements. Partially offsetting this increase was the unfavorable impact of a customer transferring \$55 million of fixed account value to variable account value, which reduced the interest margin. The increase in net investment income for the six months ended June 30, 2007 was driven principally by the Jefferson-Pilot merger in addition to the current quarter increases discussed above.

#### *Benefits and Expenses*

Insurance benefits, which includes interest credited to policyholders, increased \$13 million, or 18%, in the second quarter and \$49 million, or 43%, in the first six months of 2007 compared to the same periods in 2006. The increase in insurance benefits for the three months ended June 30, 2007 is primarily related to the \$11 million increase in interest credited on the three secured limited recourse notes mentioned above, less favorable mortality in the Institutional Pension business, and the impact of the 25 basis point increase in crediting rates discussed further below. The increase for the six months ended June 30, 2007 is primarily due to interest credited to Jefferson-Pilot policyholders. On July 1, 2006, we implemented a 25 basis point increase in crediting rates on our BOLI business. Excluding the increase from Jefferson-Pilot companies, insurance benefits for the six months ended June 30, 2007 were essentially level with the same period in 2006, as increased interest credited on the secured limited recourse notes was offset by a recovery on a reinsurance agreement.

Underwriting, acquisition, insurance and other expenses increased \$4 million, or 57%, and \$12 million, or 100%, for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase for the three months ended June 30, 2007 is primarily related to \$2 million of unfavorable retrospective unlocking resulting from a customer transferring \$55 million of fixed account value to variable account value, partially offset by favorable retrospective unlocking from market conditions and lower surrenders. The increase for the six months ended June 30, 2007 was primarily the result of the merger with Jefferson-Pilot, and also reflects unfavorable retrospective unlocking in the first quarter of 2007, resulting from surrender activity, and a change in expense allocation methodology put into effect in the third quarter of 2006 as a result of the April 2006 Jefferson-Pilot merger. The change in methodology did not affect consolidated expenses. The surrender activity in the first quarter of 2007 occurred for a variety of reasons and there are no systemic issues such as service or product competitiveness. Second quarter 2007 surrender activity returned to an expected level.

#### **Employer Markets Group Protection**

The Group Protection segment offers group life, disability, and dental insurance to employers. The segment's products are marketed primarily through a national distribution system of regional group offices. These offices develop business through employee benefit brokers, third-party administrators and other employee benefit firms. The Group Protection segment was added as a result of our merger with Jefferson-Pilot. Therefore, its results are not included in our consolidated results for the first quarter of 2006.

| Operating Summary (in millions)                         | Three Months Ended<br>June 30, |              |             | Six Months Ended<br>June 30, |              |             |
|---|--------------------------------|--------------|-------------|------------------------------|--------------|-------------|
|   | 2007                           | 2006         | Change      | 2007                         | 2006         | Change      |
| <b>Operating Revenues</b>                               |                                |              |             |                              |              |             |
| Insurance premiums                                      | \$ 361                         | \$ 329       | 10%         | \$ 693                       | \$ 329       | 111%        |
| Net investment income                                   | 29                             | 25           | 16%         | 56                           | 25           | 124%        |
| Other revenues and fees                                 | 1                              | 1            |             | 2                            | 1            | 100%        |
| <b>Total operating revenues</b>                         | <b>391</b>                     | <b>355</b>   | <b>10%</b>  | <b>751</b>                   | <b>355</b>   | <b>112%</b> |
| <b>Operating Expenses</b>                               |                                |              |             |                              |              |             |
| Insurance benefits                                      | 266                            | 226          | 18%         | 512                          | 226          | 127%        |
| Underwriting, acquisition, insurance and other expenses | 80                             | 72           | 11%         | 159                          | 72           | 121%        |
| <b>Total operating expenses</b>                         | <b>346</b>                     | <b>298</b>   | <b>16%</b>  | <b>671</b>                   | <b>298</b>   | <b>125%</b> |
| Income from operations before taxes                     | 45                             | 57           | -21%        | 80                           | 57           | 40%         |
| Federal income taxes                                    | 16                             | 20           | -20%        | 28                           | 20           | 40%         |
| <b>Income from operations</b>                           | <b>\$ 29</b>                   | <b>\$ 37</b> | <b>-22%</b> | <b>\$ 52</b>                 | <b>\$ 37</b> | <b>41%</b>  |





| Product Line Data (in millions)                        | Three Months Ended June 30, 2007 |                 |             | Six Months Ended June 30, 2007 |                 |             |
|--|----------------------------------|-----------------|-------------|--------------------------------|-----------------|-------------|
|  | Income from Operations           | Earned Premiums | Loss Ratios | Income from Operations         | Earned Premiums | Loss Ratios |
| Life   | \$ 10                            | \$ 125          | 73.9%       | \$ 19                          | \$ 244          | 74.5%       |
| Disability   | 18                               | 150             | 66.4%       | 31                             | 295             | 67.9%       |
| Dental   |                                  | 34              | 79.3%       |                                | 66              | 79.2%       |
| Total non-medical                                      | 28                               | 309             | 70.8%       | 50                             | 605             | 71.8%       |
| Medical  | 1                                | 52              |             | 2                              | 88              |             |
| Total  | \$ 29                            | \$ 361          |             | \$ 52                          | 693             |             |
| Expense ratios:  |                                  |                 |             |                                |                 |             |
| General and administrative expenses to earned premiums | 10.4%                            |                 |             | 10.1%                          |                 |             |
| Total expenses to earned premiums                      | 22.3%                            |                 |             | 22.9%                          |                 |             |
| Sales annualized premium                               |                                  |                 |             |                                |                 |             |
| Life, disability and dental combined                   | \$ 62                            |                 |             | \$ 123                         |                 |             |

#### Comparison of the Three months ended June 30, 2007 to 2006

Income from operations for this segment decreased \$8 million, or 22%, and increased \$15 million, or 41% for the three and six months ended June 30, 2007 compared to the same periods in 2006. The decrease for the three month period is primarily the result of increased insurance benefits. This increase in insurance benefits was primarily due to an increase in our non-medical loss ratio from 64.7% for the second quarter of 2006 to 70.8% for the same period in 2007. Our better than expected non-medical loss ratio for 2006 was driven by favorable long-term disability claims incidence and favorable claims terminations we did not believe were sustainable.

Income from operations for this segment benefited from favorable claim experience on all products. Because group underwriting risks may change over time, management focuses on trends in loss ratios to compare actual experience with pricing expectations. The level of expenses is also 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. Reported sales relate to long-duration contracts sold to new policyholders and new programs sold to existing policyholders. The trend in sales is an important indicator of development of business in-force over time.

The adoption of SOP 05-1 resulted in a cumulative effect reduction of \$38 million in the segment's DAC and VOBA balances. The adoption of SOP 05-1 also increased DAC and VOBA net amortization after-tax, by \$2 million and \$3 million for the three and six months ended June 30, 2007. The total expected after-tax impact to DAC and VOBA net amortization for 2007 is \$7 million.

For additional information about the impact of SOP 05-1, refer to Note 2 of our consolidated financial statements.

#### Revenues

Insurance premiums for the three months ended June 30, 2007 increased 10% compared to the same period in 2006 and the six month period increased 7% compared to the same period in 2006 including the activity reported by Jefferson-Pilot prior to the merger. The increase for the three month period is primarily related to normal organic growth in our non-medical business.

The increase in net investment income is primarily the result of second quarter of 2006 being reduced by \$1 million pre-DAC, pre-tax, for internal default charges before the methodology was changed. See "Other Operations" below for additional information.

Sales increased for the three and six months ended June 30, 2007 compared to the comparable periods including the activity reported by Jefferson-Pilot prior to the merger. Sales showed continued growth in the core under 200 lives segment, which were up 12% over the first six months of the prior year. Sales in the voluntary lines, an area of focus due to favorable pricing characteristics, were up 84% and 34% over the second quarter and first six month periods of 2007 compared to 2006. Partially offsetting this growth is the decrease in the sales of large cases, which are down 21% and reflect of a very competitive market.

#### *Benefits and Expenses*

Policy benefits reflect a total non-medical loss ratio of 70.8% and 71.8% for the second quarter and first six months of 2007, reflecting loss ratios in the low end of our expected range of 71% to 74%. The discount rate used to calculate reserves for newly incurred long-term disability and life waiver claims is 5.27%. Underwriting, acquisition, insurance and other expenses for the three months ended June 30, 2007 increased compared to the same period in 2006 primarily due to higher incentive compensation expense, commissions and administrative fees, partially offset by lower Voba amortization as a result of implementation of SOP 05-1. In addition to the factors mentioned for the quarter, the six-month period was also affected by purchase accounting relative to DAC amortization recorded by Jefferson-Pilot for the first quarter in 2006.

### RESULTS OF INVESTMENT MANAGEMENT

The Investment Management segment, through Delaware Investments, provides a broad range of managed account portfolios, mutual funds, subadvised funds, and other investment products to individual investors and to institutional investors such as private and public pension funds, foundations, and endowment funds. Delaware Investments is the marketing name for Delaware Management Holdings, Inc. and its subsidiaries. For factors that could cause actual results to differ materially from those set forth in this section, see Part I Item 1 Risk Factors in our 2006 Form 10-K and Forward-looking Statements Cautionary Language in this report.

| Operating Summary (in millions)            | Three Months Ended<br>June 30, |              |            | Six Months Ended<br>June 30, |              |            |
|--|--------------------------------|--------------|------------|------------------------------|--------------|------------|
|  | 2007                           | 2006         | Change     | 2007                         | 2006         | Change     |
| <b>Operating Revenues</b>                  |                                |              |            |                              |              |            |
| Investment advisory fees                   | \$ 92                          | \$ 81        | 14%        | \$ 182                       | \$ 159       | 14%        |
| Investment advisory fees insurance-related | 20                             | 24           | -17%       | 45                           | 48           | -6%        |
| Other revenues and fees                    | 39                             | 30           | 30%        | 74                           | 67           | 10%        |
| <b>Total operating revenues</b>            | <b>151</b>                     | <b>135</b>   | <b>12%</b> | <b>301</b>                   | <b>274</b>   | <b>10%</b> |
| <b>Operating Expenses</b>                  |                                |              |            |                              |              |            |
| Operating and administrative expenses      | 133                            | 117          | 14%        | 258                          | 232          | 11%        |
| <b>Total operating expenses</b>            | <b>133</b>                     | <b>117</b>   | <b>14%</b> | <b>258</b>                   | <b>232</b>   | <b>11%</b> |
| Income from operations before taxes        | 18                             | 18           | 0%         | 43                           | 42           | 2%         |
| Federal income taxes                       | 7                              | 6            | 17%        | 15                           | 15           | 0%         |
| <b>Income from operations</b>              | <b>\$ 11</b>                   | <b>\$ 12</b> | <b>-8%</b> | <b>\$ 28</b>                 | <b>\$ 27</b> | <b>4%</b>  |
| <b>Margin Data</b>                         |                                |              |            |                              |              |            |
| Pre-tax operating margin                   | 11.8%                          | 13.6%        |            | 14.4%                        | 15.2%        |            |

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| <b>Assets Under Management at June 30, (in millions)</b>   | <b>2007</b>       | <b>2006</b>       | <b>Change</b> |
|--|-------------------|-------------------|---------------|
| Retail-equity  | \$ 38,586         | \$ 36,036         | 7%            |
| Retail-fixed   | 12,303            | 10,007            | 23%           |
| <b>Total retail</b>  | <b>50,889</b>     | <b>46,043</b>     | <b>11%</b>    |
| Institutional-equity                                       | 23,228            | 21,729            | 7%            |
| Institutional-fixed  | 23,608            | 18,154            | 30%           |
| <b>Total institutional</b>                                 | <b>46,836</b>     | <b>39,883</b>     | <b>17%</b>    |
| Insurance-related assets                                   | 66,423            | 65,637            | 1%            |
| <b>Total assets under management</b>                       | <b>\$ 164,148</b> | <b>\$ 151,563</b> | <b>8%</b>     |
| <b>Total Sub-Advised Assets, Included in Above Amounts</b> |                   |                   |               |
| Retail   | \$ 16,329         | \$ 16,899         | -3%           |
| Institutional  | 4,593             | 4,592             | 0%            |
| <b>Total sub-advised assets at the end of the period</b>   | <b>\$ 20,922</b>  | <b>\$ 21,491</b>  | <b>-3%</b>    |

| <b>Net flows (in millions)</b> | <b>Three Months Ended<br/>June 30,</b> |              |               | <b>Six Months Ended<br/>June 30,</b> |              |               |
|--------------------------------|--|--------------|---------------|--------------------------------------|--------------|---------------|
|                                | <b>2007</b>                            | <b>2006</b>  | <b>Change</b> | <b>2007</b>                          | <b>2006</b>  | <b>Change</b> |
| <b>Retail</b>                  |  |              |               |                                      |              |               |
| <b>Equity</b>                  |  |              |               |                                      |              |               |
| Sales                          | \$ 1,778                               | \$ 2,249     | -21%          | \$ 4,016                             | \$ 5,318     | -24%          |
| Redemptions and transfers      | (2,482)                                | (2,167)      | -15%          | (4,958)                              | (4,020)      | -23%          |
| <b>Net flows-equity</b>        | <b>(704)</b>                           | <b>82</b>    | <b>NM</b>     | <b>(942)</b>                         | <b>1,298</b> | <b>NM</b>     |
| <b>Fixed income</b>            |  |              |               |                                      |              |               |
| Sales                          | 1,494                                  | 1,034        | 44%           | 2,860                                | 1,985        | 44%           |
| Redemptions and transfers      | (1,067)                                | (794)        | -34%          | (1,962)                              | (1,656)      | -18%          |
| <b>Net flows-fixed income</b>  | <b>427</b>                             | <b>240</b>   | <b>78%</b>    | <b>898</b>                           | <b>329</b>   | <b>173%</b>   |
| <b>Total retail</b>            |  |              |               |                                      |              |               |
| Sales                          | 3,272                                  | 3,283        | 0%            | 6,876                                | 7,303        | -6%           |
| Redemptions and transfers      | (3,549)                                | (2,961)      | -20%          | (6,920)                              | (5,676)      | -22%          |
| <b>Net flows-total retail</b>  | <b>(277)</b>                           | <b>322</b>   | <b>NM</b>     | <b>(44)</b>                          | <b>1,627</b> | <b>NM</b>     |
| <b>Institutional</b>           |  |              |               |                                      |              |               |
| <b>Equity</b>                  |  |              |               |                                      |              |               |
| Inflows                        | 1,320                                  | 1,130        | 17%           | 2,190                                | 3,094        | -29%          |
| Withdrawals and transfers      | (1,754)                                | (1,335)      | -31%          | (4,026)                              | (2,343)      | -72%          |
| <b>Net flows-equity</b>        | <b>(434)</b>                           | <b>(205)</b> | <b>NM</b>     | <b>(1,836)</b>                       | <b>751</b>   | <b>NM</b>     |
| <b>Fixed income</b>            |  |              |               |                                      |              |               |
| Inflows                        | 1,557                                  | 1,634        | -5%           | 3,118                                | 4,714        | -34%          |
| Withdrawals and transfers      | (1,271)                                | (742)        | -71%          | (1,751)                              | (1,186)      | -48%          |
| <b>Net flows-fixed income</b>  | <b>286</b>                             | <b>892</b>   | <b>-68%</b>   | <b>1,367</b>                         | <b>3,528</b> | <b>-61%</b>   |

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|   |          |          |      |          |          |      |
|---|----------|----------|------|----------|----------|------|
| <b>Total institutional</b>                  |          |          |      |          |          |      |
| Inflows                                     | 2,877    | 2,764    | 4%   | 5,308    | 7,808    | -32% |
| Withdrawals and transfers                   | (3,025)  | (2,077)  | -46% | (5,777)  | (3,529)  | -64% |
| Net flows-total institutional               | (148)    | 687      | NM   | (469)    | 4,279    | NM   |
| <b>Combined Retail and Institutional</b>    |          |          |      |          |          |      |
| Sales/inflows                               | 6,149    | 6,047    | 2%   | 12,184   | 15,111   | -19% |
| Redemptions, withdrawals and transfers      | (6,574)  | (5,038)  | -30% | (12,697) | (9,205)  | -38% |
| Net flows-combined retail and institutional | \$ (425) | \$ 1,009 | NM   | \$ (513) | \$ 5,906 | NM   |

Note: Sales/inflows include transfer in kind purchases, contributions and dividend reinvestment. The table above excludes the transfer of \$780 million in assets to other operations for the six months ended June 30, 2007. As well as the transfer of \$153 million of 529 Plan Assets to an unaffiliated 529 Plan provider and the transfer of \$3 billion in assets to another internal advisor, both for the three and six months ended June 30, 2007.

#### **Comparison of the Three and Six Months Ended June 30, 2007 to 2006**

Income from operations for the three and six months ended June 30, 2007 was \$11 million and \$28 million compared to \$12 million and \$27 million for the same periods in 2006. The decrease in income from operations for the three months ended June 30, 2007 is primarily due to several non-recurring items incurred in the second quarter of 2007, which are detailed below, as well as increases in variable expenses that vary with levels of assets and revenues. The growth in earnings for the six months ended June 30, 2007 was primarily driven by an increase in third-party assets under management, including higher general account assets acquired through the merger with Jefferson-Pilot, offset by the negative impact of the recurring items detailed below. The segment's pre-tax operating margin for the three and six months ended June 30, 2007 was 12% and 14% compared to approximately 14% and 15% for the same periods in 2006. Pre-tax operating margin is determined by dividing pre-tax income from operations by operating revenue.

Effective May 1, 2007, the investment advisory role for the Lincoln Variable Insurance Trust, a product within our Employer Markets business, transitioned from Delaware to another internal advisor. In the role of investment advisor, Delaware provided investment performance and compliance oversight on third-party investment managers in exchange for a fee. Delaware will continue to manage certain of the assets as a sub-advisor. As a result of this change, the Investment Management assets under management decreased by \$3 billion, with a corresponding reduction in Investment advisory fees insurance-related and associated expenses. The quarterly impact to the segment's income from operations was not significant. There is no impact to our consolidated assets under management or net income.

On July 9, 2007, we announced an agreement with an unaffiliated investment management company involving certain members of our fixed income team and related institutional separate account business. We believe that the announcement of this transaction has contributed to some of the softness in our fixed income institutional separate account net flows. The transaction is expected to close during the fourth quarter of 2007. The maximum institutional separate accounts involved in the transaction is approximately \$14 billion. However, the amount of assets included in the final transaction is dependent on individual clients' decisions to transfer their relationship to the unaffiliated company. This transaction does not impact the fixed income team that manages our fixed income mutual funds or general account assets. This transaction will not be material to LNC's results of operations, liquidity or capital resources.

#### *Revenues, Deposits and Net Flows*

Investment advisory fees increased 14% for the three and six months ended June 30, 2007 compared to the same period in 2006, as a result of higher average level of third-party assets under management, changes in product mix and positive equity market returns which were a factor in both time periods under consideration. The average level of the equity markets was higher for the three and six months ended June 30, 2007 compared to the same periods in 2006, resulting in higher fee income. Excluding the impact of dividends, the S&P 500 Index® at June 30, 2007 was 18% higher than at June 30, 2006 and the average daily S&P 500 Index® for the three and six months ended June 30, 2007 was 17% and 14% higher than the same periods of 2006.

Investment advisory fees include amounts that are ultimately paid to sub-advisors for managing the sub-advised assets. The amounts paid to sub-advisors are generally included in the segment's expenses. In addition, included in the investment advisory fees external are fees earned from managing funds included within our variable annuity and life insurance products.

Investment advisory fees insurance-related consists of fees for asset management services this segment provides for our general account assets supporting our fixed products and surplus, including those of the Individual and Employer Markets businesses. These fees decreased 17% and 6% for the three and six months ended June 30, 2007 compared to the same period in 2006. The decreases are attributable to a combination of lower fees earned on management of the general account assets, coupled with the transfer of management of certain short-term assets to an internal manager and the May 1, 2007 transition of \$3 billion from Delaware to another internal advisor.

Total assets as of June 30, 2007 were \$164.1 billion, a decrease of \$0.6 billion when compared to December 31, 2006 ending assets. The year to date change was largely the result of: a \$4 billion reduction due to transfer of assets to other internal managers; a \$1 billion reduction in general account assets; \$0.5 billion of negative net flows; a \$0.2 billion reduction due to the transition of Pennsylvania 529 Plan assets; offset by \$5.1 billion of market value gains.

Year to date net flows were negative \$0.5 billion, which is \$6.4 billion lower when compared to the prior year period. The closing of several products and the variability of institutional sales accounted for this variance, along with the announcement of the fixed income transaction. The level of net flows may vary considerably from period to period, and therefore results in one period are not indicative of net flows in subsequent periods. While we expect investment performance to remain solid and look for positive net flows in 2007, capacity constraints in certain investment strategies and the previously discussed fixed income transaction may limit sales growth for the remainder of 2007 and into 2008.

#### Expenses

Operating and administrative expenses increased 14% and 11% for the three and six months ended June 30, 2007 compared to the same periods in 2006. These increases primarily reflect several non-recurring items taken in the second quarter and increases in expenses that vary with levels of assets and revenues. Expenses included \$6 million pre-tax in the second quarter 2007 due to higher accruals for legal expenses. In addition, on June 29, 2007, Delaware Investments issued Delaware Enhanced Global Dividend and Income Fund, a new closed-end fund that combines domestic and international stocks, real estate investment trusts, and debt securities seeking diversification and high current income. Costs associated with the launch of this fund increased expenses \$5 million pre-tax in the second quarter of 2007.

### RESULTS OF LINCOLN UK

Lincoln UK is headquartered in Barnwood, Gloucester, England, and is licensed to do business throughout the United Kingdom. Lincoln UK primarily focuses on protecting and enhancing the value of its existing customer base. The segment accepts new deposits from existing relationships and markets a limited range of new products. Beginning in 2006 and continuing into 2007, Lincoln UK began participating in our overall RISV initiative and we have now introduced retirement income product solutions into the U.K. marketplace. Lincoln UK's product portfolio principally consists of unit-linked life and pension products, which are similar to U.S. produced variable life and annuity products, where the risk associated with the underlying investments is borne by the policyholders. For factors that could cause actual results to differ materially from those set forth in this section, see Part I Item 1 Risk Factors in our 2006 Form 10-K and Forward-looking Statements Cautionary Language in this report.

| Operating Summary (in millions)                         | Three Months Ended |                  |               | Six Months Ended |                  |            |
|---|--------------------|------------------|---------------|------------------|------------------|------------|
|   | June 30,<br>2007   | June 30,<br>2006 | Change        | June 30,<br>2007 | June 30,<br>2006 | Change     |
| <b>Operating Revenues</b>                               |                    |                  |               |                  |                  |            |
| Insurance premiums                                      | \$ 24              | \$ 20            | 20%           | \$ 48            | \$ 37            | 30%        |
| Insurance fees  | 50                 | 43               | 16%           | 96               | 79               | 22%        |
| Net investment income                                   | 19                 | 18               | 6%            | 39               | 35               | 11%        |
| <b>Total operating revenues</b>                         | <b>93</b>          | <b>81</b>        | <b>15%</b>    | <b>183</b>       | <b>151</b>       | <b>21%</b> |
| <b>Operating Expenses</b>                               |                    |                  |               |                  |                  |            |
| Insurance benefits                                      | 34                 | 27               | 26%           | 70               | 53               | 32%        |
| Underwriting, acquisition, insurance and other expenses | 41                 | 39               | 5%            | 78               | 66               | 18%        |
| <b>Total operating expenses</b>                         | <b>75</b>          | <b>66</b>        | <b>14%</b>    | <b>148</b>       | <b>119</b>       | <b>24%</b> |
| Income from operations before taxes                     | 18                 | 15               | 20%           | 35               | 32               | 9%         |
| Federal income taxes                                    | 6                  | 5                | 20%           | 12               | 11               | 9%         |
| <b>Income from operations</b>                           | <b>\$ 12</b>       | <b>\$ 10</b>     | <b>20%</b>    | <b>\$ 23</b>     | <b>\$ 21</b>     | <b>10%</b> |
| <b>June 30, (in millions, except exchange rate)</b>     | <b>2007</b>        | <b>2006</b>      | <b>Change</b> |                  |                  |            |
| Unit-linked assets                                      | \$ 9,168           | \$ 7,857         | 17%           |                  |                  |            |
| Individual life insurance in-force                      | 19,605             | 18,289           | 7%            |                  |                  |            |
| Exchange rate ratio-U.S. dollars to pounds sterling:    |                    |                  |               |                  |                  |            |
| Average for the year-to-date period                     | 1.977              | 1.791            | 10%           |                  |                  |            |

|   |       |       |    |
|---|-------|-------|----|
| End of period   | 2.008 | 1.849 | 9% |
| <b>Comparison of the Three and Six Months Ended June 30, 2007 to 2006</b> |       |       |    |

Income from operation for this segment increased \$2 million, or 20%, and \$2 million, or 10%, for the three and six months ended June 30, 2007, compared to the same periods in 2006. For the three and six months ended June 30, 2007, the average exchange rate for the U.S. dollar relative to the British pound sterling increased 9% and 10% compared to the same periods in 2006. This increase in the exchange rate and the growth in insurance fees were the primary drivers of the increase in income from operations.



*Revenues*

Excluding the effect of the exchange rate, insurance premiums increased 10% and 18% for the three and six months ended June 30, 2007 compared to same periods of 2006, reflecting an increase in the annuitization of vesting pension policies. The receipt of these premiums results in a corresponding increase in benefits. Our annualized policy lapse rate for the six months ended June 30, 2007 was 6.7% compared to 6.8% for the same period in 2006, as measured by the number of policies in-force. Excluding the effects of exchange rates, insurance fees increased 7% and 10% for the three and six months ended June 30, 2007 compared to the same periods in 2006. The growth in insurance fees was primarily due to higher average equity-linked account values resulting from favorable U.K. equity markets, partially offset by lower tax related fees. The average values of the FTSE 100 index were 12% and 10% higher in the three and six months ended June 30, 2007 compared to the same periods in 2006.

The segment is sensitive to changes in the foreign currency exchange rate between the U.S. dollar and the British pound sterling. A significant increase in the value of the U.S. dollar relative to the British pound has a significant adverse effect on the segment's operating results. Although the use of the enhanced reversion to the mean process has lessened the impact of short-term volatility of the equity markets, the segment also remains subject to volatility in the equity markets on fee income.

*Expenses*

Operating expenses were 14% and 24% higher for the three and six months ended June 30, 2007 compared to the same periods in 2006. Excluding the effect of the exchange rate, operating expenses were 4% and 13% higher for the three and six months ended June 30, 2007 compared to the same periods in 2006. Increased expenses in both periods under consideration were impacted by investment in developing our Retirement Income strategy as well as the increase in reserves due to higher levels of vesting annuity premiums received. The six months ended June 30, 2007 also had an additional provision of \$2 million pre-tax to cover costs associated with the UK selling practice matters discussed below.

Lincoln UK maintains reserves established in 1997 and 1999 for mis-selling activities. On an ongoing basis, Lincoln UK evaluates various assumptions underlying these estimated liabilities, including the expected levels of future complaints and the potential implications with respect to the adequacy of the aggregate liability associated with UK selling practice matters. We increased our provision by \$2 million in the first quarter of 2007 due to remedial work that we carried out following the Financial Services Authority (FSA) review of our complaints handling process late in 2006. Future changes in complaint levels could effect Lincoln UK's ultimate exposure to mis-selling issues, although we believe that any future change would not materially effect our consolidated financial position.

### RESULTS OF LINCOLN FINANCIAL MEDIA

The Lincoln Financial Media segment consists of 18 radio and 3 television broadcasting stations located in selected markets in the Southeastern and Western United States and also produces and distributes syndicated collegiate basketball and football sports programming. Operations of this segment were acquired in the April 2006 merger with Jefferson-Pilot. Therefore, its results are not included in our consolidated results for the first quarter of 2006. For factors that could cause actual results to differ materially from those set forth in this section, see Part I Item 1 Risk Factors in our 2006 Form 10-K and Forward-looking Statements Cautionary Language in this report.

| Operating Summary (in millions)              | Three Months Ended<br>June 30, |       |        | Six Months Ended<br>June 30, |       |        |
|--|--------------------------------|-------|--------|------------------------------|-------|--------|
|  | 2007                           | 2006  | Change | 2007                         | 2006  | Change |
| <b>Operating Revenue</b>                     |                                |       |        |                              |       |        |
| Communications revenues (net) <sup>(1)</sup> | \$ 57                          | \$ 58 | -2%    | \$ 125                       | \$ 58 | 116%   |
| <b>Operating Expenses</b>                    |                                |       |        |                              |       |        |
| Operating expenses                           | 36                             | 38    | -5%    | 85                           | 38    | 124%   |
| Income from operations before taxes          | 21                             | 20    | 5%     | 40                           | 20    | 100%   |
| Federal income taxes                         | 7                              | 8     | -13%   | 14                           | 8     | 75%    |
| Income from operations                       | \$ 14                          | \$ 12 | 17%    | \$ 26                        | \$ 12 | 117%   |

<sup>(1)</sup> Communications revenues are net of commissions of \$9 million paid to agencies for the three months ended June 30, 2007 and 2006, and \$17 million and \$9 million for the six months ended June 30, 2007 and 2006, respectively.

#### Comparison of Three and Six Months Ended June 30, 2007 to 2006

Communications revenues for the six months ended June 30, 2007 increased 116% compared to the same period in 2006. Income from operations was \$14 million and \$26 million for the three and six months ended June 30, 2007 compared to \$12 million for the same periods in 2006. The slight increase in operating income for the three months ended June 30, 2007 was primarily the result of a decrease in intangible amortization due to acquired advertising contracts being fully amortized in the second quarter of 2006 following the merger with Jefferson-Pilot. Amortization can vary from quarter to quarter in this segment depending on the sports rights fees from quarter to quarter. The increase in operating income for the six month period was a result of the merger with Jefferson-Pilot as discussed above. Profitability for Lincoln Financial Media is seasonal and is principally influenced by such factors as retail events, special and sporting events and political advertising.

On June 7, 2007 we announced plans to explore strategic options for Lincoln Financial Media. We are evaluating a range of options including, but not limited to, divestiture strategies. For additional details, see Note 1 of our consolidated financial statements.

### RESULTS OF OTHER OPERATIONS

Other Operations includes investments related to the excess capital in our insurance subsidiaries, other corporate investments, benefit plan net assets, and the unamortized deferred gain on the indemnity reinsurance portion of the sales transaction for our former reinsurance segment, which was sold to Swiss Re Life & Health America Inc. ( Swiss Re ) in 2001. Income (loss) from operations for Other Operations includes earnings on invested excess capital and other investments, amortization of the deferred gain on the indemnity reinsurance portion of the transaction with Swiss Re, interest expense on corporate debt, interest credited on corporate reinsurance and expenses that are corporate in nature such as merger-related expenses, restructuring costs, branding, charitable contributions, certain litigation reserves and other expenses not allocated to our business segments. Other Operations also includes the eliminations of intercompany transactions and the inter-segment elimination of the investment advisory fees for asset management services the Investment Management segment provides to Individual Markets and Employer Markets.

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For factors that could cause actual results to differ materially from those set forth in this section, see Part I Item 1 Risk Factors in our 2006 Form 10-K and Forward-looking Statements Cautionary Language in this report.

| Operating Summary (in millions)                        | Three Months Ended<br>June 30, |                |             | Six Months Ended<br>June 30, |                |             |
|--|--------------------------------|----------------|-------------|------------------------------|----------------|-------------|
|  | 2007                           | 2006           | Change      | 2007                         | 2006           | Change      |
| <b>Operating Revenues</b>                              |                                |                |             |                              |                |             |
| Premiums   | \$                             | \$             | NM          | \$ 1                         | \$ 1           | 0%          |
| Net investment income                                  | 45                             | 72             | -38%        | 91                           | 112            | -19%        |
| Amortization of deferred gain on indemnity reinsurance | 18                             | 20             | -10%        | 37                           | 37             | 0%          |
| Other revenue and fees                                 | 3                              |                | NM          |                              | (1)            | 100%        |
| Inter-segment elimination of investment advisory fees  | (20)                           | (23)           | 13%         | (44)                         | (49)           | 10%         |
| <b>Total operating revenues</b>                        | <b>46</b>                      | <b>69</b>      | <b>-33%</b> | <b>85</b>                    | <b>100</b>     | <b>-15%</b> |
| <b>Operating Expenses</b>                              |                                |                |             |                              |                |             |
| Insurance benefits                                     | 8                              | 5              | 60%         | 13                           | 7              | 86%         |
| Interest credited to contractholder funds              | 33                             | 37             | -11%        | 70                           | 70             | 0%          |
| Insurance and other expenses                           | 35                             | 29             | 21%         | 53                           | 31             | 71%         |
| Interest and debt expense                              | 72                             | 64             | 13%         | 133                          | 86             | 55%         |
| Inter-segment elimination of investment advisory fees  | (20)                           | (23)           | 13%         | (44)                         | (49)           | 10%         |
| <b>Total operating expenses</b>                        | <b>128</b>                     | <b>112</b>     | <b>14%</b>  | <b>225</b>                   | <b>145</b>     | <b>55%</b>  |
| Loss from operations before taxes                      | (82)                           | (43)           | -91%        | (140)                        | (45)           | NM          |
| Federal income taxes                                   | (36)                           | (17)           | NM          | (57)                         | (19)           | NM          |
| <b>Loss from operations</b>                            | <b>\$ (46)</b>                 | <b>\$ (26)</b> | <b>-77%</b> | <b>\$ (83)</b>               | <b>\$ (26)</b> | <b>NM</b>   |

**Comparison of the Three and Six Months Ended June 30, 2007 to 2006**

*Revenues*

Net investment income decreased 38% and 19% for the three and six months ended June 30, 2007 compared to the same periods in 2006. The decrease in net income for the three and six months ended June 30, 2007 is primarily due to a decrease in invested assets driven by share repurchases, debt repayment and dividends paid to shareholders exceeding our insurance segments distributable earnings and our non-insurance segments dividends received. Also contributing to the decline is \$12 million (\$8 million after-tax) for internal default charges recorded in the second quarter of 2006. In the third quarter of 2006, we harmonized our policy for accounting and reporting for investment defaults by discontinuing the historical practice followed by Jefferson-Pilot of business segments reimbursing Other Operations for actual default experience through intra-segment charge referred to as the internal default charge. This change did not have an effect on consolidated income from operations. Finally, the elimination of interest expense on the inter-segment cash management account, which also decreased net investment income, totaled \$6 million (\$4 million after-tax) and \$14 million (\$9 million after-tax) for the three and six months ended June 30, 2007 and none for the same periods in 2006. 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. Other Operations is impacted by merger-related expenses, use of capital by our other segments and use of capital for other activities, such as dividends to shareholders, share repurchases and business acquisitions. Furthermore, if regulations require increases in our insurance segments statutory reserves and surplus the Other Operations segment investment income will be negatively impacted.

*Operating Expenses*

Operating expenses increased 14% and 55% for the three and six months ended June 30, 2007 compared to the same periods in 2006 primarily due to higher merger-related expenses, interest expense, expenses related to strategic initiatives such as Retirement Income Security Ventures and an accrual for litigation expenses, partially offset by a pension curtailment gain. Operating expenses for the three and six months ended June 30, 2007 include \$30 million (\$20 million after-tax) and \$44 million (\$29 million after-tax) in merger-related integration costs, including restructuring charges, compared to \$17 million (\$11 million after-tax) for the same periods in 2006. The increase was due to an increase in system integration work. See Note 12 to the consolidated financial statements for additional information. During the third quarter of 2007, we

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expect to record a projected separation benefit of approximately \$8 million (\$5 million after-tax) related to the retirement of certain key executives.

Interest and debt expense increased 13% and 55% for the three and six months ended June 30, 2007 compared to the same periods in 2006. The increase for the three months ended June 30, 2007 compared to the same period in 2006 is primarily due to the increase in the average balance of outstanding debt. The increase in the six months ended June 30, 2007 compared to the same

period in 2006 is primarily due to the increase of \$3.4 billion in corporate borrowings, including approximately \$2.1 billion used to finance the \$1.8 billion cash portion of the Jefferson-Pilot merger consideration. The increase also includes \$0.9 billion for the fair value of Jefferson-Pilot corporate debt. The timing and/or discretionary nature of uses of cash for the repurchase of stock, incentive compensation and the availability of funds from our cash management account may result in changes in external financing and volatility in interest expense. For additional information on our financing activities, see Review of Consolidated Financial Condition Liquidity and Cash Flow Sources of Liquidity and Cash Flow Financing Activities.

Insurance and other expenses increased 21% and 71% for the three and six months ended June 30, 2007 compared to the same periods in 2006 with the second quarter increase attributable to a \$3 million (\$2 million after-tax) increase in our Retirement Income Security Ventures strategic initiative, higher incentive compensation expenses and a \$3 million (\$2 million after-tax) increase in accruals for legal expenses. The increase for the six months ended June 30, 2007 is primarily related to the merger with Jefferson-Pilot.

On May 1, 2007, we announced plans to change the employee retirement plan, which includes replacing traditional pension retirement benefits with an enhanced match in our 401(k) defined contribution plan beginning January 1, 2008. This change resulted in a one-time curtailment gain of \$9 million, pre-tax, which was reported within insurance and other expenses, for the second quarter of 2007. For additional details, see Note 7 of our consolidated financial statements.

The interest credited to contractholder funds decreased for the three months ended June 30, 2007 and was flat for the six months ended June 30, 2007 compared to the same period in 2006 primarily due to a reclassification to insurance benefits during the second quarter of 2007. The majority of the interest credited to policyholders relates to our reinsurance operations sold to Swiss Re in 2001. A substantial amount of the business was sold through indemnity reinsurance transactions resulting in some of the business still flowing through our financial statements. The interest credited corresponds to investment income earnings on the assets we continue to hold for this business. There is no impact to the income or loss in Other Operations or to our consolidated income.

### CONSOLIDATED INVESTMENTS

The following table presents consolidated invested assets, net investment income and investment yield.

| (in millions)  | June 30,<br>2007               | December 31,<br>2006 | June 30,<br>2006             |          |         |      |
|--|--------------------------------|----------------------|------------------------------|----------|---------|------|
| Total consolidated investments (at carrying amount)                          | \$ 70,868                      | \$ 71,488            | \$ 69,714                    |          |         |      |
| Average invested assets at amortized cost <sup>(1)</sup>                     | 69,984                         | 64,099               | 57,648                       |          |         |      |
|  | Three Months Ended<br>June 30, |                      | Six Months Ended<br>June 30, |          | Change  |      |
| (in millions)  | 2007                           | 2006                 | 2007                         | 2006     | Quarter | Year |
| Net investment income  | \$ 1,170                       | \$ 1,068             | \$ 2,259                     | \$ 1,747 | 10%     | 29%  |
| Investment yield (ratio of net investment income to average invested assets) | 6.69%                          | 6.03%                | 6.46%                        | 6.07%    |         |      |
| <b>Items included in net investment income:</b>                              |                                |                      |                              |          |         |      |
| Limited partnership investment income  | \$ 66                          | \$ 15                | \$ 85                        | \$ 27    | NM      | 215% |
| Prepayment and makewhole premiums  | 22                             | 15                   | 37                           | 26       | 47%     | 42%  |
| Consent fees   | 1                              | 1                    | 8                            | 2        | 0%      | 300% |
| Standby real estate equity commitments                                       | 1                              | 3                    | 5                            | 7        | -67%    | -29% |

(1) Based on the average of invested asset balances at the beginning and ending of each quarter within the year. The increase is primarily attributable to the \$27.9 billion in Jefferson-Pilot investments acquired on April 3, 2006.

The total investment portfolio decreased \$620 million during the first six months of 2007. The decrease was related to negative net flows and transfers from fixed to variable accounts in the individual fixed annuity product and a decrease in the market value of the portfolio related to the increase in interest rates during the latter half of the second quarter.

The quality of our available-for-sale fixed maturity securities portfolio, as measured at fair value and by the percentage of fixed maturity securities invested in various ratings categories, relative to the entire available-for-sale fixed maturity security portfolio, as of June 30 2007, was as follows:



(in millions)

| NAIC Designation | Rating Agency Equivalent Designation | Amortized Cost | Estimated Fair Value | % of Total |
|------------------|--------------------------------------|----------------|----------------------|------------|
| 1                | AAA / AA / A                         | \$ 34,576      | \$ 34,458            | 62.1%      |
| 2                | BBB                                  | 17,777         | 17,746               | 32.0%      |
| 3                | BB                                   | 2,115          | 2,124                | 3.9%       |
| 4                | B                                    | 944            | 964                  | 1.7%       |
| 5                | CCC and lower                        | 132            | 140                  | 0.3%       |
| 6                | In or near default                   | 11             | 15                   | 0.0%       |
|                  |                                      | \$ 55,555      | \$ 55,447            | 100.0%     |

The National Association of Insurance Commissioners ( NAIC ) assigns securities quality ratings and uniform valuations called NAIC Designations which are used by insurers when preparing their annual statements. The NAIC assigns designations to publicly traded as well as privately placed securities. The designations assigned by the NAIC range from class 1 to class 6, with designations in classes 1 and 2 generally considered investment grade.

Fixed maturity securities available-for-sale invested in below investment grade securities (NAIC designations 3 through 6) were \$3.2 billion, or 5.9% and \$3.7 billion, or 6.6%, of all fixed maturity securities available-for-sale, as of June 30, 2007 and December 31, 2006, respectively. This represents 4.6% of the total investment portfolio at June 30, 2007 compared to 5.2% at December 31, 2006. On an amortized cost basis, below investment grade securities represented 5.9% of available-for-sale fixed maturity securities at June 30, 2007 compared to 6.5% at December 31, 2006.

**Fixed Maturity and Equity Securities Portfolios:** Fixed maturity securities and equity securities consist of portfolios classified as available-for-sale and trading. Mortgage-backed and private securities are included in both available-for-sale and trading portfolios.

*Available-for-Sale:* Securities that are classified as available-for-sale are carried at fair value in our Consolidated Balance Sheets and make up 95% of our fixed maturity and equity securities portfolio. The fair value for all private securities was \$7.5 billion at June 30, 2007 compared to \$7.1 billion at December 31, 2006, representing approximately 11% and 10% of total invested assets as of June 30, 2007 and December 31, 2006, respectively.

*Trading Securities:* Trading securities, which support certain funds withheld and modified coinsurance arrangements ( Modco ), are carried at fair value and changes in fair value are recorded in net income as they occur. Investment results for these portfolios, including gains and losses from sales, are passed directly to the reinsurers through the contractual terms of the reinsurance arrangements. Offsetting these amounts are corresponding changes in the fair value of the embedded derivative liability associated with the underlying reinsurance arrangement.

*Mortgage-Backed Securities:* Our fixed maturity securities include mortgage-backed securities. These securities are subject to risks associated with variable prepayments. This may result in differences between the actual cash flow and maturity of these securities than that expected at the time of purchase. We limit the extent of our risk on mortgage-backed securities by prudently limiting exposure to the asset class, by generally avoiding the purchase of securities with a cost that significantly exceeds par, by purchasing securities backed by stable collateral, and by concentrating on securities with enhanced priority in their trust structure. Such securities with reduced risk typically have a lower yield (but higher liquidity) than higher-risk mortgage-backed securities. At selected times, higher-risk securities may be purchased if they do not compromise the safety of the general portfolio. At June 30, 2007, we did not have a significant amount of higher-risk mortgage-backed securities.

**Mortgage Loans on Real Estate:** The following summarizes key information on mortgage loans:

| (in millions)   | June 30,<br>2007 | December 31,<br>2006 |
|---|------------------|----------------------|
| Total portfolio (net of reserves)                               | \$ 7,311         | \$ 7,384             |
| Percentage of total investment portfolio                        | 10.3%            | 10.3%                |
| Percentage of investment by property type:                      |                  |                      |
| Commercial office buildings                                     | 34.5%            | 33.6%                |
| Retail stores   | 23.5%            | 24.7%                |
| Industrial buildings  | 24.3%            | 22.0%                |
| Apartments  | 10.6%            | 11.1%                |
| Hotels/motels   | 5.1%             | 6.4%                 |
| Other   | 2.0%             | 2.2%                 |
| Impaired mortgage loans   | \$ 7             | \$ 29                |
| Impaired mortgage loans as a percentage of total mortgage loans | 0.1%             | 0.4%                 |
| Restructured loans in good standing                             | \$ 58            | \$ 59                |
| Reserve for mortgage loans                                      | 1                | 2                    |

In addition to the dispersion by property type, the mortgage loan portfolio is geographically diversified throughout the United States.

All mortgage loans that are impaired have an established allowance for credit loss. Changing economic conditions impact our valuation of mortgage loans. Changing vacancies and rents are incorporated into the discounted cash flow analysis that we perform for monitored loans and may contribute to the establishment of (or an increase or decrease in) an allowance for credit losses. In addition, we continue to monitor the entire commercial mortgage loan portfolio to identify risk. Areas of current emphasis are the hotel, retail, office and industrial properties that have deteriorating credits or have experienced debt coverage reduction. Where warranted, we have established or increased loss reserves based upon this analysis. Impaired mortgage loans were 0.1% and 0.4% of total mortgage loans as of June 30, 2007 and December 31, 2006, respectively. For both June 30, 2007 and December 31, 2006, we had two commercial mortgage loans that were two or more payments delinquent. The total principal and interest due on these loans as of June 30, 2007 and December 31, 2006 was less than \$1 million.

Our exposure to subprime mortgage lending is limited to investments in banks and other financial institutions that may be impacted by subprime lending and direct investments in asset-backed securities collateralized debt obligations ( ABS CDOs ), residential mortgage asset-backed securities ( ABS ) and residential mortgage-backed securities ( RMBS ). RMBS are backed by residential mortgages and mortgage-related ABS are backed by home equity loans. These securities are backed by loans that are characterized by borrowers of differing levels of creditworthiness: Prime, Alt-A and Subprime. Alt-A lending is the origination of residential mortgage loans to customers who have Prime credit profiles but lack documentation to substantiate income. Subprime lending is the origination of loans to customers with weak or impaired credit profiles.

The slowing U.S. housing market, increased interest rates and relaxed underwriting standards for some originators of residential mortgage loans and home equity loans have recently led to higher delinquency rates, especially for loans originated in 2006. We expect delinquency rates and loss rates on residential mortgages and home equity loans to increase in the future; however, we expect to continue to receive payments in accordance with contractual terms of our securities, largely due to the seniority of the claim on the collateral. The tranches of the securities will experience losses according to their seniority level with the least senior (or most junior), typically the unrated residual tranche, taking the initial loss. The credit ratings of the securities reflect the seniority of the securities that we own. Our residential mortgage-backed securities had an amortized cost on June 30, 2007 of \$8.7 billion and an unrealized loss of \$135 million, or 1.5%, which is primarily due to the impact of changes in interest rates.

The tables below summarize the nature of our investments in securities, including both available-for-sale and trading securities, backed by pools of residential mortgages or home equity loans, the credit quality of the underlying loans backing the securities and the year in which the loans backing our securities were originated. The amortized cost of investments backed by subprime loans was \$861 million and represented 1.2% of our total investment portfolio as of June 30, 2007. The market value of the subprime investments was \$832 million. Investments rated A or above represented 93% of the subprime investments and \$431 million amortized cost of our subprime investments was backed by loans originating in 2005 and forward. Available-for-sale securities represent most of the subprime exposure with trading securities being only \$22 million or 2.6%.



The following table shows Collateral Creditworthiness of Residential Mortgage-backed Securities, at amortized cost.

| Type (in millions) | Total    | Prime    | Alt-A    | Subprime |
|--------------------|----------|----------|----------|----------|
| RMBS               | \$ 7,391 | \$ 6,465 | \$ 926   | \$       |
| ABS                | 1,294    |          | 444      | 850      |
| CDO                | 11       |          |          | 11       |
| Total              | \$ 8,696 | \$ 6,465 | \$ 1,370 | \$ 861   |

The following tables show the credit quality of Residential Mortgage-backed Securities, at amortized cost (in millions).

| Rating      | Alt-A    | Subprime |
|-------------|----------|----------|
| AAA         | \$ 1,031 | \$ 676   |
| AA          | 266      | 67       |
| A           | 42       | 55       |
| BBB         | 24       | 52       |
| B and below | 7        | 11       |
| Total       | \$ 1,370 | \$ 861   |

| Origination Year | Alt-A    | Subprime |
|------------------|----------|----------|
| Pre-2005         | \$ 365   | \$ 430   |
| 2005             | 130      | 262      |
| 2006             | 345      | 169      |
| 2007             | 530      |          |
| Total            | \$ 1,370 | \$ 861   |

None of these investments include any direct investments in subprime lenders or mortgages. We have exposure related to investments made by the hedge funds and limited partnerships that we own, but we are not aware of material exposure to subprime in those asset-classes.

**Limited Partnership Investments:** As of June 30, 2007 and December 31, 2006, our consolidated investments included investments in limited partnerships of \$741 million and \$590 million, respectively. As of June 30, 2007 and December 31, 2006, these include investments in approximately 94 and 84 different partnerships, respectively that allow us to gain exposure to a broadly diversified portfolio of asset classes such as venture capital, hedge funds, and oil and gas and real estate. The partnerships do not represent off-balance sheet financing and generally involve several third-party partners. Select 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 pose no threat to our liquidity. Limited partnership investments are accounted for using the equity method of accounting and are included in other investments in our Consolidated Balance Sheets.

**Net Investment Income:** Net investment income increased 10% and 29% for the three and six months ended June 30, 2007, compared to the same periods in 2006. The increase in net investment income for the three month period primarily reflects favorable performance from limited partnership investments, increased prepayment and makewhole premiums and higher portfolio yields. Excluding commercial mortgage loan prepayment, bond makewhole premiums and fees received from the standby real estate equity commitments financing program, the increase in net investment income for the six month period primarily reflects higher portfolio yields and higher invested assets due to the April 2006 Jefferson-Pilot merger, which added \$27.9 billion in invested assets.

As of June 30, 2007 and December 31, 2006, the carrying amount of fixed maturity securities, mortgage loans on real estate and real estate that were non-income producing was \$29 million and \$40 million, respectively.

The following discussion addresses our invested assets excluding trading account securities. As discussed above, investment results attributable to the trading securities are passed to the reinsurers under the terms of the reinsurance arrangements.



**Realized Gains and Losses on Investments and Derivative Instruments:** We had net pre-tax realized gains (losses) on investments and derivatives of \$(9) million and \$(7) million for the three months ended June 30, 2007 and 2006, respectively, and \$18 million and \$(14) million for the six months ended June 30, 2007 and 2006, respectively. Prior to the amortization of DAC, provision for policyholder commitments and investment expenses, pre-tax realized gains (losses) were \$(7) million and \$13 million for the three months ended June 30, 2007 and 2006, respectively and \$39 million and \$22 million for the six months ended June 30, 2007 and 2006, respectively.

The gross realized gains on fixed maturity and equity securities were \$30 million and \$34 million for the three months ended June 30, 2007 and 2006, respectively and \$87 million and \$58 million for the six months ended June 30, 2007 and 2006, respectively. Gross realized losses on fixed maturity and equity securities were \$47 million and \$26 million for the three months ended June 30, 2007 and 2006, respectively and \$57 million and \$46 million for the six months ended June 30, 2007 and 2006, respectively. Included in losses for fixed maturities and equity securities are write-downs for impairments of \$32 million and \$36 million for the three and six months ended June 30, 2007, respectively compared to \$2 million and \$3 million for the same periods in 2006. The write-down for impairments includes both credit-related and interest-rate related impairments.

For additional information regarding our process for determining whether declines in fair value of securities available-for-sale are other-than-temporary, see Critical Accounting Policies Write-Downs for Other-Than-Temporary Impairments and Allowance for Losses in our 2006 Form 10-K.

**Unrealized Gains and Losses Available-for-Sale Securities:** When considering unrealized gain and loss information, it is important to realize that the information relates to the status of securities is 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, since 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 impact of unrealized loss securities on our future earnings. At June 30, 2007 and December 31, 2006, gross unrealized gains on securities available-for-sale were \$799 million and \$1.3 billion, respectively, and gross unrealized losses on securities available-for-sale were \$890 million and \$373 million, respectively. At June 30, 2007, gross unrealized gains and losses on fixed maturity securities available-for-sale were \$776 million and \$884 million, and gross unrealized gains and losses on equity securities available-for-sale were \$23 million and \$6 million. At December 31, 2006, gross unrealized gains and losses on fixed maturity securities available-for-sale were \$1.3 billion and \$371 million, and gross unrealized gains and losses on equity securities available-for-sale were \$22 million and \$2 million. Changes in unrealized gains and losses can be attributed to changes in interest rates and credit spreads, which have created temporary price fluctuations.

For total publicly traded and private securities that we held at June 30, 2007 that were in an unrealized loss position, the fair value, amortized cost, unrealized loss and total time period that the security has been in an unrealized loss position are presented in the table below:

| (in millions)             | Fair Value | % Fair Value | Amortized Cost | % Amortized Cost | Unrealized Loss | % Unrealized Loss |
|---------------------------|------------|--------------|----------------|------------------|-----------------|-------------------|
| <= 90 days                | \$ 21,029  | 60.1%        | \$ 21,333      | 59.6%            | \$ (304)        | 34.2%             |
| > 90 days but < 180 days  | 3,591      | 10.3%        | 3,733          | 10.4%            | (142)           | 16.0%             |
| > 180 days but < 270 days | 1,360      | 3.9%         | 1,409          | 3.9%             | (49)            | 5.5%              |
| > 270 days but < 1 year   | 282        | 0.8%         | 300            | 0.8%             | (18)            | 2.0%              |
| > 1 year                  | 8,695      | 24.9%        | 9,072          | 25.3%            | (377)           | 42.3%             |
| Total                     | \$ 34,957  | 100.0%       | \$ 35,847      | 100.0%           | \$ (890)        | 100.0%            |

The composition by industry categories of all securities in unrealized loss status, which we held at June 30, 2007, is presented in the table below:

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| (in millions)                               | Fair Value | % Fair Value | Amortized Cost | % Amortized Cost | Unrealized Loss | % Unrealized Loss |
|---|------------|--------------|----------------|------------------|-----------------|-------------------|
| Collateralized mortgage obligations ("CMO") | \$ 4,492   | 12.9%        | \$ 4,597       | 12.8%            | \$ (105)        | 11.9%             |
| Banking                                     | 3,492      | 10.0%        | 3,571          | 10.0%            | (79)            | 8.9%              |
| ABS   | 2,225      | 6.4%         | 2,301          | 6.4%             | (76)            | 8.5%              |
| Electric                                    | 2,973      | 8.5%         | 3,035          | 8.5%             | (62)            | 7.1%              |
| CMBS  | 1,797      | 5.1%         | 1,843          | 5.1%             | (46)            | 5.2%              |
| Food and Beverage                           | 1,387      | 4.0%         | 1,421          | 4.0%             | (34)            | 3.8%              |
| Distributors                                | 939        | 2.7%         | 963            | 2.7%             | (24)            | 2.7%              |
| Sovereigns                                  | 543        | 1.6%         | 567            | 1.6%             | (24)            | 2.7%              |
| Pipelines                                   | 1,075      | 3.1%         | 1,098          | 3.1%             | (23)            | 2.6%              |
| Media Non-cable                             | 631        | 1.8%         | 652            | 1.8%             | (21)            | 2.4%              |
| Property & Casualty insurers ("P&C")        | 857        | 2.5%         | 878            | 2.4%             | (21)            | 2.4%              |
| Retailers                                   | 498        | 1.4%         | 516            | 1.4%             | (18)            | 2.0%              |
| Automotive                                  | 282        | 0.8%         | 297            | 0.8%             | (15)            | 1.7%              |
| Metals and Mining                           | 429        | 1.2%         | 444            | 1.2%             | (15)            | 1.7%              |
| Paper                                       | 328        | 0.9%         | 342            | 1.0%             | (14)            | 1.6%              |
| Financial Other                             | 350        | 1.0%         | 364            | 1.0%             | (14)            | 1.6%              |
| Non Captive Consumer                        | 391        | 1.1%         | 405            | 1.1%             | (14)            | 1.6%              |
| Real Estate Investment Trusts ("REITS")     | 674        | 1.9%         | 687            | 1.9%             | (13)            | 1.5%              |
| Oil Field Services                          | 587        | 1.7%         | 599            | 1.7%             | (12)            | 1.3%              |
| Gaming                                      | 169        | 0.5%         | 180            | 0.5%             | (11)            | 1.2%              |
| Government Sponsored                        | 538        | 1.5%         | 549            | 1.5%             | (11)            | 1.2%              |
| Entertainment                               | 374        | 1.1%         | 385            | 1.1%             | (11)            | 1.2%              |
| Conventional 30yr                           | 435        | 1.2%         | 446            | 1.2%             | (11)            | 1.2%              |
| Owned No Guarantee                          | 308        | 0.9%         | 319            | 0.9%             | (11)            | 1.2%              |
| Chemicals                                   | 499        | 1.4%         | 509            | 1.4%             | (10)            | 1.1%              |
| Home Construction                           | 289        | 0.8%         | 299            | 0.8%             | (10)            | 1.1%              |
| Brokerage                                   | 596        | 1.7%         | 606            | 1.7%             | (10)            | 1.1%              |
| Technology                                  | 371        | 1.1%         | 380            | 1.1%             | (9)             | 1.0%              |
| Railroads                                   | 283        | 0.8%         | 292            | 0.8%             | (9)             | 1.0%              |
| Wirelines                                   | 322        | 0.9%         | 331            | 0.9%             | (9)             | 1.0%              |
| Consumer Products                           | 279        | 0.8%         | 288            | 0.8%             | (9)             | 1.0%              |
| Independent                                 | 341        | 1.0%         | 350            | 1.0%             | (9)             | 1.0%              |
| Diversified Manufacturing                   | 535        | 1.5%         | 544            | 1.5%             | (9)             | 1.0%              |
| Integrated                                  | 404        | 1.2%         | 413            | 1.2%             | (9)             | 1.1%              |
| Healthcare                                  | 397        | 1.1%         | 406            | 1.1%             | (9)             | 1.0%              |
| Transportation Services                     | 392        | 1.1%         | 400            | 1.1%             | (8)             | 0.9%              |
| Wireless                                    | 160        | 0.5%         | 168            | 0.5%             | (8)             | 0.9%              |
| Building Materials                          | 398        | 1.1%         | 406            | 1.1%             | (8)             | 0.9%              |
| Non Captive Diversified                     | 351        | 1.0%         | 359            | 1.0%             | (8)             | 0.9%              |
| Life  | 512        | 1.5%         | 520            | 1.5%             | (8)             | 0.9%              |
| Industrial Other                            | 374        | 1.1%         | 381            | 1.1%             | (7)             | 0.8%              |
| Pharmaceuticals                             | 254        | 0.7%         | 260            | 0.7%             | (6)             | 0.7%              |
| Industries with U/R Losses < \$1MM          | 351        | 1.1%         | 357            | 1.0%             | (6)             | 0.8%              |
| Packaging                                   | 168        | 0.5%         | 173            | 0.5%             | (5)             | 0.6%              |
| Municipal                                   | 182        | 0.5%         | 187            | 0.5%             | (5)             | 0.6%              |
| Health Insurance                            | 199        | 0.6%         | 203            | 0.6%             | (4)             | 0.4%              |
| Local Authorities                           | 144        | 0.4%         | 148            | 0.4%             | (4)             | 0.4%              |
| Non Agency                                  | 136        | 0.4%         | 140            | 0.4%             | (4)             | 0.4%              |
| Lodging                                     | 119        | 0.3%         | 122            | 0.3%             | (3)             | 0.3%              |
| Refining                                    | 149        | 0.4%         | 152            | 0.4%             | (3)             | 0.3%              |
| Utility-Other                               | 90         | 0.3%         | 93             | 0.3%             | (3)             | 0.3%              |
| Consumer Cyclical Services                  | 37         | 0.1%         | 39             | 0.2%             | (2)             | 0.2%              |
| Supranational                               | 150        | 0.4%         | 152            | 0.4%             | (2)             | 0.2%              |
| Construction_Machinery                      | 186        | 0.5%         | 188            | 0.5%             | (2)             | 0.2%              |
| Media_Cable                                 | 111        | 0.3%         | 113            | 0.3%             | (2)             | 0.2%              |
| Supermarkets                                | 174        | 0.5%         | 176            | 0.5%             | (2)             | 0.2%              |
| Textile                                     | 56         | 0.2%         | 57             | 0.2%             | (1)             | 0.1%              |
| Aerospace/Defense                           | 157        | 0.4%         | 158            | 0.4%             | (1)             | 0.1%              |
| Unassigned                                  | 17         | 0.0%         | 18             | 0.1%             | (1)             | 0.1%              |

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|       |           |        |           |        |          |        |
|-------|-----------|--------|-----------|--------|----------|--------|
| Total | \$ 34,957 | 100.0% | \$ 35,847 | 100.0% | \$ (890) | 100.0% |
|-------|-----------|--------|-----------|--------|----------|--------|

**Unrealized Loss on All Below-Investment-Grade Available-for-Sale Fixed Maturity Securities:** Gross unrealized losses on all available-for-sale below-investment-grade securities were \$60 million at June 30, 2007, representing 7% of total gross unrealized losses on all available-for-sale securities. Generally, below-investment-grade fixed maturity securities are more likely than investment-grade securities to develop credit concerns. The remaining \$830 million, or 93%, of the gross unrealized losses relate to investment grade available-for-sale securities. The ratios of fair value to amortized cost reflected in the table below are not necessarily indicative of the market value to amortized cost relationships for the securities throughout the entire time that the securities have been in an unrealized loss position nor are they necessarily indicative of these ratios subsequent to June 30, 2007.

For fixed maturity securities that we held at June 30, 2007, that are below investment grade and in an unrealized loss position, the fair value, amortized cost, unrealized loss and the ratios of market value to amortized cost are presented in the table below.

| Aging Category (in millions)   | Ratio of Amortized Cost to Fair Value | Fair Value | Amortized Cost | Unrealized Loss |
|--------------------------------|---------------------------------------|------------|----------------|-----------------|
| <=90 days                      | 70% to 100%                           | \$ 651     | \$ 660         | \$ (9)          |
|                                | 40% to 70%                            | 2          | 4              | (2)             |
|                                | Below 40%                             |            |                |                 |
| <=90 days total                |                                       | 653        | 664            | (11)            |
| >90 days but <=180 days        | 70% to 100%                           | 131        | 135            | (4)             |
|                                | 40% to 70%                            |            |                |                 |
|                                | Below 40%                             |            |                |                 |
| >90 days but <=180 days total  |                                       | 131        | 135            | (4)             |
| >180 days but <=270 days       | 70% to 100%                           | 73         | 79             | (6)             |
|                                | 40% to 70%                            | 1          | 1              |                 |
|                                | Below 40%                             |            |                |                 |
| >180 days but <=270 days total |                                       | 74         | 80             | (6)             |
| >270 days but <=1 year         | 70% to 100%                           | 47         | 53             | (6)             |
|                                | 40% to 70%                            |            |                |                 |
|                                | Below 40%                             |            |                |                 |
| >270 days but <=1 year total   |                                       | 47         | 53             | (6)             |
| >1 year                        | 70% to 100%                           | 355        | 387            | (32)            |
|                                | 40% to 70%                            | 2          | 3              | (1)             |
|                                | Below 40%                             |            |                |                 |
| >1 year total                  |                                       | 357        | 390            | (33)            |
| Total below-investment-grade   |                                       | \$ 1,262   | \$ 1,322       | \$ (60)         |

At June 30, 2007 and December 31, 2006 there were \$13 million and \$16 million, respectively, of the publicly traded and private securities held that were subject to enhanced analysis and monitoring for potential changes in unrealized loss status. At December 31, 2006, 7.4% of these were rated as investment grade. There were none at June 30, 2007. At June 30, 2007, the range of maturity dates for these securities varies, with 97.3% maturing between 1 and 5 years and 2.7% maturing in one year or less. At December 31, 2006, the range of maturity dates for these securities varied, with 7.4% of these securities maturing in greater than 10 years and 92.6% maturing in one year or less. At June 30, 2007 and December 31, 2006, 96.3% and 95.7% of total publicly traded and private securities in unrealized loss status were rated as investment grade.

As of June 30, 2007, gross unrealized losses totaled \$890 million compared to \$373 million at December 31, 2006. The change in unrealized losses is primarily related to an increase in interest rates during the period. We expect an ultimate recovery of full principal and interest of our securities with unrealized losses.



**Unrealized Loss on Fixed Maturity Securities Available-for-Sale in Excess of \$10 million:** At June 30, 2007, fixed maturity securities available-for-sale with gross unrealized losses greater than \$10 million are presented in the table below.

| (in millions)                     | Fair Value    | Amortized Cost | Unrealized Loss | Length of Time in Loss    |
|-----------------------------------|---------------|----------------|-----------------|---------------------------|
|                                   |               |                |                 | Position                  |
| <b>Investment Grade</b>           |               |                |                 |                           |
| Structured Note                   | \$ 380        | \$ 400         | \$ (20)         | > 90 days but <= 180 days |
| <b>Total Investment-Grade</b>     | <b>\$ 380</b> | <b>\$ 400</b>  | <b>\$ (20)</b>  |                           |
| <b>Non-Investment Grade</b>       |               |                |                 |                           |
| Domestic Media Company            | \$ 54         | \$ 64          | \$ (10)         | > 1 year                  |
| <b>Total Non-Investment-Grade</b> | <b>\$ 54</b>  | <b>\$ 64</b>   | <b>\$ (10)</b>  |                           |

The information presented above is subject to rapidly changing conditions. As such, we expect that the level of securities with overall unrealized losses will fluctuate, as will the level of unrealized loss securities that are subject to enhanced analysis and monitoring. The volatility of financial market conditions results in increased recognition of both investment gains and losses, as portfolio risks are adjusted through sales and purchases. As discussed below, this is consistent with our classification of our investment portfolios as available-for-sale.

**Credit-Linked Notes:** As of June 30, 2007 and December 31, 2006, we had \$1.2 billion and \$700 million outstanding in funding agreements, which is classified in investment contract and policyholder funds on our Consolidated Balance Sheets. We invested proceeds of \$850 million from three funding agreements issued in 2006 and 2007 into three separate credit-linked notes originated by third-party companies. We earn a spread between the coupon received on the credit-linked notes and the interest credited on the funding agreements. Our credit-linked notes were created using a trust that combined a high quality asset with a credit default swap to produce multi-class structured securities. Consistent with other debt market instruments, we are exposed to credit losses within the structure of the credit-linked notes, which could result in principal losses to our investments. However, we have insulated our investments from credit losses due to the multi-tiered class structure of the credit-linked note, which requires the subordinated classes of the investment pool to absorb all of the initial credit losses. Our affiliate, Delaware Investments, manages the investments in the underlying portfolio. We will not incur credit losses until after the subordinated classes are retired and additional credit losses are incurred in the underlying credit-linked note structure. Similar to other debt market instruments, our maximum principal loss is limited to our original investment of \$850 million as of June 30, 2007.

The statutory surplus of our insurance subsidiaries is impacted by changes in the market value of these investments. See *Review of Consolidated Financial Condition* Liquidity and Capital Resources, Uses of Capital, *Return of Capital to Shareholders*, for additional information.

The table below summarizes information regarding our investments in these securities:

| (dollars in millions)      | Amount and Date of Issuance    |                             |                             |
|----------------------------|--------------------------------|-----------------------------|-----------------------------|
|                            | \$400 million<br>December 2006 | \$200 million<br>April 2007 | \$250 million<br>April 2007 |
| Amount of subordination*   | \$ 2,220                       | \$ 410                      | \$ 1,167                    |
| Total amount of pool       | \$ 40,000                      | \$ 20,000                   | \$ 25,000                   |
| Maturity                   | 12/20/16                       | 3/20/17                     | 6/20/17                     |
| Current rating of tranche* | AA                             | Aa2                         | AA                          |
| Number of entities*        | 125                            | 100                         | 102                         |
| Number of countries*       | 19                             | 21                          | 15                          |
| Number of industries*      | 36                             | 27                          | 30                          |

\* As of August 2, 2007

We are not aware of any significant realized credit losses in the above investments as of June 30, 2007. We have determined that we are not the primary beneficiary, as we do not hold the majority of the risk of loss.





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**REINSURANCE**

Our insurance companies cede insurance to other companies. The portion of risks exceeding each of our insurance company's retention limit is reinsured with other insurers. We seek reinsurance coverage within the businesses that sell life insurance to limit our exposure to mortality losses and enhance our capital management.

Portions of our deferred annuity business have been reinsured on a modified coinsurance basis with other companies to limit our exposure to interest rate risks. At June 30, 2007, the reserves associated with these reinsurance arrangements totaled \$1.5 billion. To cover products other than life insurance, we acquire other insurance coverage with retentions and limits that management believes are appropriate for the circumstances. The accompanying financial statements reflect premiums, benefits and DAC, net of insurance ceded. Our insurance companies remain liable if their reinsurers are unable to meet contractual obligations under applicable reinsurance agreements.

Our amounts recoverable from reinsurers represent receivables from and reserves ceded to reinsurers. At June 30, 2007 the amounts recoverable from reinsurers was \$8.2 billion, compared to \$7.9 billion at December 31, 2006. We obtain reinsurance from a diverse group of reinsurers and we monitor concentration, as well as financial strength ratings of our principal reinsurers. Swiss Re represents our largest exposure. In 2001, we sold our reinsurance business to Swiss Re primarily through indemnity reinsurance arrangements. Because we are not relieved of our liability to the ceding companies for this business, the liabilities and obligations associated with the reinsured contracts remain on our Consolidated Balance Sheets with a corresponding reinsurance receivable from the business sold to Swiss Re, which totaled \$4.2 billion and \$4.1 billion at June 30, 2007 and December 31, 2006, respectively. Swiss Re has funded a trust with a balance of \$1.8 billion at June 30, 2007 to support this business. In addition to various remedies that we would have in the event of a default by Swiss Re, we continue to hold assets in support of certain of the transferred reserves. These assets consist of those reported as trading securities and certain mortgage loans. Our liabilities for funds withheld and embedded derivatives included \$2.2 billion and \$0.1 billion, respectively, at June 30, 2007 related to the business sold to Swiss Re.

Included in the business sold to Swiss Re through indemnity reinsurance in 2001 was disability income business. Swiss Re is disputing its obligation to pay approximately \$80 million of reinsurance recoverables on certain of this income disability business. We have instituted suit to, among other things, collect such amount, and Swiss Re has initiated arbitration seeking, among other things, to be released from its reinsurance obligations on certain of the disability income business. Although the outcome of these proceedings is uncertain, we currently believe that it is probable that we will ultimately collect the full amount of the reinsurance recoverable from Swiss Re and that Swiss Re will ultimately remain at risk on all of its obligations on the disability income business that it acquired from us in 2001.

In the second quarter of 2007, we recognized increased reserves on the personal accident business that was sold to Swiss Re through the indemnity reinsurance transaction in 2001, at which time we recognized a deferred gain that is being amortized into income at the rate that earnings are expected to emerge within a 15 year period. This adjustment resulted in a non-cash charge of \$13 million, after-tax, to increase reserves which was partially offset by a cumulative catch-up adjustment to the deferred gain amortization of \$5 million, after-tax, for a total decrease to net income of \$8 million. The impact of the accounting for reserve adjustments related to this reinsurance treaty is excluded from our definition of income from operations. Because Swiss Re is responsible for paying the underlying claims to the ceding companies corresponding to the reserve increase we record an increase in the reinsurance recoverable in the period of the change. The amount of the additional increase to the deferred gain above the cumulative amortization catch-up adjustment will be amortized into income in future periods over the remaining period of expected run-off of the underlying business.

During the third quarter of 2006 one of our reinsurers, Scottish Re Group Ltd ( Scottish Re ), received rating downgrades from various rating agencies. Of the \$1.0 billion of fixed annuity business that we reinsure with Scottish Re, approximately 73% is reinsured through the use of modified coinsurance treaties, in which we possess the investments that support the reserves ceded to Scottish Re. For our annuity business ceded on a coinsurance basis, Scottish Re had previously established an irrevocable investment trust supporting the reserves for the benefit of LNC. In addition to fixed annuities, we have approximately \$93 million of policy liabilities on the life insurance business we have reinsured with Scottish Re. Scottish Re continues to perform under its contractual responsibilities to us. We continue to evaluate the impact of these ratings downgrades with respect to our existing exposures to Scottish Re. Based on current information, we do not believe that Scottish Re's ratings downgrades will have a material adverse effect on our results of operations, liquidity or financial condition.

At June 30, 2007, we had reinsurance recoverables of \$742 million and policy loans of \$51 million which are related to the businesses of Jefferson-Pilot that are coinsured with Household International (HI) affiliates. HI has provided payment, performance and capital maintenance guarantees with respect to the balances receivable. We regularly evaluate the financial condition of our reinsurers and monitor concentrations of credit risk related to reinsurance activities.

For factors that could cause actual results to differ materially from those set forth in this section, see Part I Item 1 Risk Factors in our 2006 Form 10-K and Forward-looking Statements Cautionary Language in this report.

## 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, investment advisory fees and investment income, while sources of cash flows from investing activities result from maturities and sales of invested assets. Our operating activities provided cash of \$1.4 billion and \$922 million for the first six months of 2007 and 2006, respectively. 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, a commercial paper program, 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, and acquisitions.

The following table summarizes the primary sources of holding company cash flow. The table 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 intercompany cash management account (discussed below). Taxes have been eliminated from the analysis due to a tax sharing agreement among our primary subsidiaries resulting in a modest impact 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.

| (in millions)                                    | Three Months Ended |                  | Six Months Ended |                  | Year Ended           |
|--|--------------------|------------------|------------------|------------------|----------------------|
|  | June 30,<br>2007   | June 30,<br>2006 | June 30,<br>2007 | June 30,<br>2006 | December 31,<br>2006 |
| <b>Dividends from subsidiaries:</b>              |                    |                  |                  |                  |                      |
| LNL  | \$ 225             | \$ 52            | \$ 300           | \$ 152           | \$ 352               |
| Jefferson Pilot Financial Insurance Company      | 73                 | 73               | 144              | 73               | 217                  |
| Lincoln Financial Media                          | 5                  | 13               | 22               | 13               | 39                   |
| Delaware Investments                             | 15                 | 12               | 30               | 24               | 48                   |
| Other non-regulated companies <sup>(1)</sup>     |                    | 235              |                  | 235              | 235                  |
| Lincoln UK                                       | 16                 | 20               | 32               | 40               | 85                   |
| Other  |                    |                  |                  |                  | 11                   |
| <b>Subsidiary loan repayments and interest:</b>  |                    |                  |                  |                  |                      |
| LNL interest on surplus notes                    | 20                 | 20               | 39               | 39               | 78                   |
| Jefferson Pilot Financial Insurance Company      |                    | 1                | 2                | 1                | 4                    |
|  | \$ 354             | \$ 426           | \$ 569           | \$ 577           | \$ 1,069             |
| <b>Other cash flow and liquidity items:</b>      |                    |                  |                  |                  |                      |
| Return of seed capital                           | \$                 | \$ 4             | \$               | \$ 4             | \$ 21                |
| Net capital received from stock option exercises | 29                 | 23               | 76               | 63               | 191                  |
|  | \$ 29              | \$ 27            | \$ 76            | \$ 67            | \$ 212               |

<sup>(1)</sup> Represents dividend of proceeds from sale of equity securities used to repay borrowings under the bridge facility.

*Subsidiaries*

Our domestic insurance subsidiaries paid cash dividends of \$298 million and \$444 million for the three and six months ended June 30, 2007 compared to \$125 million and \$225 million for the same periods in 2006. Based upon anticipated ongoing positive statutory earnings and favorable credit markets, our domestic insurance subsidiaries could pay additional dividends in 2007, which would require the pre-approval of the Indiana Insurance Commissioner. The actual amount of surplus that our insurance subsidiaries could pay as dividends is constrained by the amount of surplus we hold to maintain our ratings, to provide an additional layer of margin for risk protection, and for future investment in our businesses. Our non-regulated subsidiaries have dividend capacity of over \$500 million in 2007.

*Financing Activities*

Although our subsidiaries generate adequate cash flow to meet the needs of our normal operations, periodically we may issue debt or equity securities 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, and trust preferred securities of our affiliated trusts. Our Board of Directors authorized us to issue up to \$4 billion of such securities, and we have issued \$2.8 billion pursuant to that authorization.

The following summarizes debt and financing activity during the six months ended June 30, 2007.

In March 2007, LNC issued \$500 million of 6.05% Capital Securities (callable in year 10 at par) due April 20, 2067 and \$250 million 3-year floating rate senior notes at LIBOR plus 8 basis points due April 20, 2010 for aggregate gross proceeds of \$750 million.

On June 15, 2007, LNC repaid \$244 million (\$6 million was owed to a non-regulated subsidiary and eliminated in consolidation) of 5.25% senior notes that matured.

We have also redeemed the following securities originally issued by Jefferson-Pilot during the first six months of 2007:

On January 11, 2007, we redeemed all of the outstanding 8.14% Junior Subordinated Deferrable Interest Debentures, Series A due 2046, which were held by Jefferson-Pilot Capital Trust A. The redemption price for the Capital Securities, Series A was \$1,040.70 per security, for a total principal amount of \$206 million, plus \$16 million for accrued interest through the redemption date.

On March 1, 2007, we redeemed all of the outstanding 8.285% Junior Subordinated Deferrable Interest Debentures, Series B due 2046, which were held by Jefferson-Pilot Capital Trust B. The redemption price for the Capital Securities, Series B was \$1,041.43 per security, for a total principal amount of \$103 million, plus \$8 million for accrued interest through the redemption date.

At June 30, 2007, we maintained three credit facilities with a group of domestic and foreign banks:

a \$1.6 billion five-year credit facility entered into in March 2006 and maturing in March 2011, allowing for borrowing or issuances of letters of credit ( LOC );

a \$1 billion five-year credit facility entered into in February 2006 and maturing in February 2011, allowing for borrowing or issuances of LOCs; and

a 10 million pounds sterling (\$20 million at March 31, 2007) one-year U.K. credit facility for use by our U.K. subsidiary renewed in November 2006 and maturing in December 2007.

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At June 30, 2007, there were approximately \$1.2 billion in outstanding LOCs under the various credit agreements. These LOCs support intercompany reinsurance transactions and specific treaties associated with our former Reinsurance segment. LOCs are primarily used to satisfy the U.S. regulatory requirements of domestic clients of the former Reinsurance segment who have contracted with the reinsurance subsidiaries not domiciled in the United States and, as discussed below, for the reserve credit provided by our affiliated offshore reinsurance company to our domestic insurance companies for ceded business.

Under the credit agreements, we must maintain a minimum consolidated net worth level. In addition, the agreements contain covenants restricting our ability to incur liens, merge or consolidate with another entity where we are not the surviving entity and dispose of all or substantially all of our assets. At June 30, 2007, we were in compliance with all such covenants. All of our credit agreements are unsecured.

If current debt ratings and claims paying ratings were downgraded in the future, certain covenants of various contractual obligations may be triggered which could negatively impact overall liquidity. In addition, contractual selling agreements with intermediaries could be negatively impacted which could have an adverse impact on overall sales of annuities, life insurance and investment products. At June 30, 2007, we maintained adequate current financial strength and senior debt ratings and do not anticipate any ratings-based impact to future liquidity.

Included in the amounts outstanding at June 30, 2007, discussed above, was approximately \$975 million of outstanding LOCs supporting the reinsurance obligations of our non-U.S. domiciled subsidiary to LNL on universal life business with secondary guarantees. Recognizing that LOCs are generally one to five years in duration, it is likely that our insurance companies will apply a mix of LOCs, reinsurance and capital market strategies in addressing long-term AXXX and XXX needs. LOCs and related capital market alternatives lower the RBC impact of the universal life business with secondary guarantee products. An inability to obtain the necessary LOC capacity or other capital market alternatives could impact our returns on universal life business with secondary guarantee products. We are currently pursuing capital management strategies related to our AXXX reserves involving reinsurance and securitizations. We are targeting a transaction in the fourth quarter and another transaction during 2008 that will reduce the amount of statutory reserves related to our insurance products with secondary guarantees. In addition, a portion of our term life insurance business is reinsured with a domestic reinsurance captive as part of our overall strategy of managing the statutory capital of our insurance subsidiaries. There are no outstanding LOCs related to this business.

A new statutory reserving standard (commonly called VACARVM) is being developed by the NAIC replacing current statutory reserve practices for variable annuities with guaranteed benefits such as GMWBs. The timing for adoption of VACARVM is not certain. Because the NAIC has not determined the final version of VACARVM, we cannot estimate the ultimate impact that VACARVM will have on our liquidity and capital resources. However, in its current draft form, VACARVM has the potential to require statutory reserves well in excess of current levels for certain variable annuity riders sold by Lincoln. We plan to utilize existing captive reinsurance structures to lessen any negative impact on statutory capital and dividend capacity in our life insurance subsidiaries. However, additional statutory reserves could lead to lower risk-based capital ratios and potentially reduce future dividend capacity from our insurance subsidiaries.

#### *Alternative Sources of Liquidity*

In order to maximize the use of available cash, the holding company maintains an intercompany cash management account where subsidiaries can borrow from the holding company to meet their short-term needs and can invest their short-term funds with the holding company. The holding company finances this program from its primary sources of cash flow discussed above. Depending on the overall cash availability or need, the holding company invests excess cash in short-term investments or borrows funds in the financial markets.

The holding company used \$450 million of funds from the cash management account on average during the six months ended June 30, 2007 to fund loans to its subsidiaries and for general corporate purposes. The holding company had a maximum amount of \$728 million of financing that it used from the cash management account during this period and a minimum of \$7 million.

Our insurance subsidiaries, by virtue of their general account fixed income investment holdings, can access liquidity through securities lending programs and repurchase agreements. At June 30, 2007, our insurance subsidiaries had securities with a carrying value of \$869 million out on loan under the securities lending program, and \$504 million carrying value subject to reverse-repurchase agreements.

LNC has a \$1 billion commercial paper program that is rated A-1, P-2, F-1. The commercial paper program is backed by a bank line of credit. During the six months ended June 30, 2007, LNC had an average of \$151 million in commercial paper outstanding with a maximum amount of \$375 million outstanding at any time. LNC had \$30 million of commercial paper outstanding at June 30, 2007.

**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 shareholders and to repurchase our stock and debt securities.

**Return of Capital to Shareholders**

One of the holding company's principal uses of cash is to provide a return to our shareholders. Through dividends and stock repurchases, we have an established record of providing significant cash returns to our shareholders. We have increased our dividend in each of the last 24 years. In determining our dividend payout, we balance the desire to increase the dividend against capital needs, rating agency considerations and requirements for financial flexibility. The following table summarizes this activity for 2007 and 2006.

| (in millions, except per share data)       | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |               | Year Ended<br>December 31, |
|--|--------------------------------|---------------|------------------------------|---------------|----------------------------|
|  | 2007                           | 2006          | 2007                         | 2006          | 2006                       |
| Dividends to shareholders                  | \$ 108                         | \$ 147        | \$ 214                       | \$ 215        | \$ 429                     |
| Repurchase of common stock                 |                                | 503           | 512                          | 503           | 1,006                      |
| <b>Total cash returned to shareholders</b> | <b>\$ 108</b>                  | <b>\$ 650</b> | <b>\$ 726</b>                | <b>\$ 718</b> | <b>\$ 1,435</b>            |
| Number of shares repurchased               |                                | 8.060         | 7.215                        | 8.060         | 16.887                     |
| Average price per share                    | \$                             | \$ 56.98      | \$ 70.92                     | \$ 56.98      | \$ 59.40                   |

On February 22, 2007, our Board of Directors approved an additional \$2 billion in security repurchase authority. LNC also repurchased \$512 million of its common stock in the first six months of 2007, \$162 million through open market repurchases and \$350 million through an accelerated share repurchase transaction. Under the accelerated share repurchase program, LNC received approximately 4.8 million shares of its common stock in exchange for \$350 million.

On July 10, 2007, we received our final delivery of approximately 180,000 shares under our previously disclosed accelerated stock buyback program, bringing the total aggregate shares retired under the plan to approximately 5.0 million shares.

Subsequent to June 30, 2007, we completed \$100 million of open-market stock repurchases pursuant to Rule 10b-18 under the Securities Exchange Act of 1934, as amended.

Our insurance subsidiaries have invested into three separate credit-linked notes originated by third-party companies. See Consolidated Investments Credit-Linked Notes for additional information. The statutory surplus of our insurance subsidiaries is impacted by changes in the market value of these investments. The market values of these investments are sensitive to credit spreads. Sustained declines in the market value of these investments, such as widening credit spreads, would reduce the surplus and may negatively impact the dividend capacity of our insurance subsidiaries.

The following table summarizes the primary uses of holding company cash flow. The 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 intercompany cash management account. Taxes have been eliminated from the analysis due to a tax sharing agreement among our primary subsidiaries resulting in a modest impact on net cash flows at the holding company.

| (in millions)                | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |               | Year Ended<br>December 31, |
|------------------------------|--------------------------------|---------------|------------------------------|---------------|----------------------------|
|                              | 2007                           | 2006          | 2007                         | 2006          | 2006                       |
| Debt service (interest paid) | \$ 79                          | \$ 40         | \$ 133                       | \$ 62         | \$ 195                     |
| Common dividends             | 107                            | 107           | 216                          | 174           | 393                        |
| Common stock repurchase      |                                | 505           | 512                          | 505           | 1,006                      |
| <b>Total</b>                 | <b>\$ 186</b>                  | <b>\$ 652</b> | <b>\$ 861</b>                | <b>\$ 741</b> | <b>\$ 1,594</b>            |

*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 and surplus note interest payments of its insurance company subsidiaries. The insurance company subsidiaries dividend capacity is impacted by



factors influencing their risk-based capital and statutory earnings performance. In recent periods, Delaware Investments and our U.K. operations have contributed significant free cash flow. Improved financial performance at Delaware, our decision to run-off significant blocks of business in the U.K. and cash flow from Lincoln Financial Media are responsible for the improved cash flow and the return of capital to LNC in recent periods. Currently, we expect to have sufficient liquidity and capital resources to meet our obligations in 2007. For factors that could effect our expectations for liquidity and capital, see Part I Item 1 Business Risk Factors in the 2006 Form 10-K.

### **Shareholders Equity**

Total shareholders equity decreased \$365 million during the six months ended June 30, 2007, primarily due to share repurchase activity and to a lesser extent dividends declared and unrealized losses on available-for-sale securities included in other comprehensive income from increased interest rates, partially offset by net income.

## **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, to make permanent recent reductions in individual tax rates, to permanently repeal the estate tax and to increase regulation of our annuity and investment management businesses. 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 1 Risk Factors in our 2006 Form 10-K and Forward-looking Statements Cautionary Language in this report.

### **Recent Accounting Pronouncements**

See Note 2 to our consolidated financial statements 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.

## **ACQUISITIONS AND DIVESTITURES**

### *Merger with Jefferson-Pilot Corporation*

See Introduction Recent Developments and Liquidity and Capital Resources of the 2006 Form 10-K for discussion regarding the merger with Jefferson-Pilot.

## **RESTRUCTURING ACTIVITIES**

See Note 12 to the unaudited consolidated financial statements for the detail of our restructuring activities.

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

We provided a discussion of our market risk in Item 7A of our 2006 Form 10-K. During the first six months of 2007, there was no substantive change in our market risk except for the items noted below:

**Interest Rate Risk**

**Interest Rate Risk Falling Rates.** As discussed in the Quantitative and Qualitative Disclosures About Market Risk section of our 2006 Form 10-K, spreads on our fixed annuity and interest-sensitive whole life, universal life and fixed portion of variable universal life insurance policies, are at risk if interest rates decline and remain low for a period of time.

See Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations by Segment for the effects of interest rate environments on interest rate margins.

**Derivatives.** As indicated in Note 10 of our 2006 Form 10-K, we have entered into derivative transactions to reduce our exposure to rapid rises in interest rates, the risk of changes in liabilities indexed to equity markets, credit risk, foreign exchange risk and to increase our exposure to certain investments in exchange for a premium. In addition, we are subject to risks associated with changes in the value of our derivatives; however, such changes in value are generally offset by changes in the value of the items being hedged by such contracts. Modifications to our derivative strategy are initiated periodically upon review of our overall risk assessment. During the second quarter of 2007, the more significant changes in our derivative positions are as follows:

A total of \$52 million notional of interest rate swap agreements matured or was terminated, resulting in a remaining notional of \$1.1 billion. These interest rate swap agreements convert floating rate bond coupon payments into a fixed rate of return.

Entered into \$250 million notional of forward-starting interest rate swap agreements. These swaps partially hedged the future cash flows of a forecasted debt issuance. The entire \$250 million notional was terminated resulting in a \$2 million loss recorded in Other Comprehensive Income. The loss will be recognized into income over the life of the debt.

Terminated 0.3 million call options on LNC stock, resulting in a total of 0.6 million call options remaining on an equal number of shares of LNC stock. These call options are hedging the increase in liabilities arising from stock appreciation rights granted on LNC stock.

We had financial futures net purchase/termination activity in the amount of \$(2.5) billion notional resulting in a remaining notional of \$626 million. These futures are hedging a portion of the liability exposure on certain options in variable annuity products. No gain or loss was recognized as a result of the expirations or terminations.

Entered into \$425 million notional of put option agreements, resulting in a total notional of \$2.6 billion. These put options are hedging a portion of the liability exposure on certain options in variable annuity products. We will receive a payment from the counterparty if the strike rate in the agreement is higher than the specified index rate at maturity. No gain or loss was recognized as a result of the terminations.

Entered into \$36 million and terminated \$32 million notional of foreign exchange forward contracts, resulting in a total remaining notional of \$4 million. These contracts are hedging dividends received from our Lincoln UK subsidiary.

Entered into \$194 million notional of foreign currency swaps, resulting in a total notional of \$280 million. These foreign currency swap agreements are part of a hedging strategy. We own various foreign issue securities. Interest payments from these securities are received in a foreign currency and then swapped into U.S. dollars.

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Entered into \$1.0 billion notional of S&P 500 call options. A total of \$751 million notional expired, resulting in a remaining notional of \$2.6 billion. These call options are hedging the impact of the equity-index interest credited to our equity indexed annuity products.

The remaining \$100 million notional of interest rate swap agreements hedging fixed rate debt matured. These interest rate swap agreements effectively convert fixed rate debt payments into floating rate debt payments.

Entered into \$150 million notional and terminated \$115 million notional of forward-starting interest rate swap agreements, resulting in a remaining notional of \$35 million. These swaps are used to hedge interest rate risk associated with purchasing assets that support our annuity liabilities.

Entered into \$16 million notional of total return swap agreements resulting in a total of \$126 million notional. These swap agreements are hedging a portion of the liability related to our deferred compensation plans. We receive the total return on a portfolio of indexes and pay a floating rate of interest.

A total of \$225 million notional of interest rate cap agreements matured, resulting in a remaining notional of \$5.7 billion. These interest rate cap agreements are used to hedge our annuity business against the negative impact of a significant and sustained rise in interest rates.

We are exposed to credit loss in the event of non-performance by counterparties on various derivative contracts. However, we do not anticipate non-performance by any of the counterparties. The credit risk associated with such agreements is minimized by purchasing such agreements from financial institutions with long-standing superior performance records.

**Item 4. Controls and Procedures**

**(a) 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 our 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 covered 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.

**(b) Changes in Internal Control Over Financial Reporting**

There was no change in our internal control over financial reporting (as that term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended June 30, 2007 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 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 June 30, 2007:

| <b>Period</b>    | <b>(a) Total<br/>Number of<br/>Shares (or<br/>Units)<br/>Purchased <sup>(1)</sup></b> | <b>(b) Average<br/>Price Paid<br/>per Share<br/>(or Unit)</b> | <b>(c) Total Number<br/>of Shares (or Units)<br/>Purchased as Part of<br/>Publicly Announced<br/>Plans or Programs <sup>(2)</sup></b> | <b>(d) Approximate Dollar<br/>Value of Shares<br/>that<br/>May Yet Be<br/>Purchased<br/>Under the Plans or<br/>Programs (in millions) <sup>(3)</sup></b> |
|------------------|---|---|---|--|
| 4/1/07 - 4/30/07 | 64,453  | \$ 70.87  |   | \$ 2,137.9   |
| 5/1/07 - 5/31/07 | 98,728  | 73.86   |   | 2,137.9  |
| 6/1/07 - 6/30/07 | 22,222  | 71.01   |   | 2,137.9  |

<sup>(1)</sup> Of the total number of shares purchased, 185,403 shares were received in connection with the exercise of stock options and related taxes. No shares were withheld for taxes on the vesting of restricted stock. For the quarter ended June 30, 2007, no shares were purchased as part of publicly announced plans or programs.

<sup>(2)</sup> On February 23, 2007, we announced that our Board approved a \$2 billion increase in our securities repurchase authorization, bringing the total authorization to \$2.6 billion. At June 30, 2007, there was approximately \$2.1 billion of security buyback authorization remaining. The 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.

<sup>(3)</sup> As of the last day of the applicable month.

**Item 4. Submission of Matters to a Vote of Security Holders**

(a) Our 2007 annual meeting of shareholders was held on May 10, 2007.

(b) Proxies were solicited pursuant to Regulation 14A under the Securities Exchange Act of 1934 and there was no solicitation in opposition to the management nominees. Four nominees were elected to serve as directors for a three-year term expiring at the 2010 Annual Meeting or until their successors are duly elected and qualified. As stated in our Form 8-K, filed with the SEC on April 30, 2007, Jill S. Ruckelshaus, a nominee for director named in the proxy statement, dated April 5, 2007, informed us that she would be unable to stand for election at the 2007 annual meeting due to health reasons. Accordingly, four of the five directors named in the proxy statement stood for election. Finally, as disclosed in our Form 8-K, filed with the SEC on July 11, 2007, the Board of Directors has amended our Bylaws to decrease the size of the Board to 12 members.

(c) The matters voted upon at the meeting and the votes cast with respect to such matters are as follows:

**Item 1 Election of Directors**

| <b>Nominee</b>        | <b>Votes Cast For</b> | <b>Votes Withheld</b> |
|-----------------------|-----------------------|-----------------------|
| William J. Avery      | 240,905,490           | 3,656,301             |
| William H. Cunningham | 218,137,561           | 26,424,230            |
| William Porter Payne  | 240,168,604           | 4,393,187             |
| Patrick S. Pittard    | 237,954,435           | 6,607,356             |

**Item 2** To ratify the appointment of Ernst & Young LLP, as our independent registered public accounting firm for 2007.

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| <b>For</b>  | <b>Against</b> | <b>Abstain</b> | <b>Broker Non-Votes</b> |
|-------------|----------------|----------------|-------------------------|
| 240,406,739 | 2,412,024      | 1,743,029      |                         |

Item 3 Approve an amendment and restatement of the Lincoln National Corporation Amended and Restated Incentive Compensation Plan.

| For         | Against    | Abstain   | Broker Non-Votes |
|-------------|------------|-----------|------------------|
| 178,230,138 | 32,634,856 | 2,968,588 | 30,728,209       |

Item 4 Approve the Lincoln National Corporation Stock Option Plan for Non-Employee Directors.

| For         | Against    | Abstain   | Broker Non-Votes |
|-------------|------------|-----------|------------------|
| 186,204,776 | 24,682,901 | 2,945,905 | 30,728,209       |

**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.

**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/ FREDERICK J. CRAWFORD**  
**Frederick J. Crawford**

**Senior Vice President and Chief Financial Officer**

By: **/s/ DOUGLAS N. MILLER**  
**Douglas N. Miller**

**Vice President and Chief Accounting Officer**

Date: August 9, 2007



**LINCOLN NATIONAL CORPORATION**

**Exhibit Index for the Report on Form 10-Q**

**For the Quarter Ended June 30, 2007**

- 3.1 Lincoln National Corporation Restated Articles of Incorporation is incorporated by reference to Exhibit 3.1 of LNC's Form 8-K (File No. 1-6028) filed with the SEC on May 10, 2007.
- 3.2 Amended and Restated Bylaws of Lincoln National Corporation (effective July 6, 2007) is incorporated by reference to Exhibit 3.1 of LNC's Form 8-K (File No. 1-6028) filed with the SEC on July 11, 2007.
- 10.1 Lincoln National Corporation Amended and Restated Incentive Compensation Plan (as amended and restated on May 10, 2007) is incorporated by reference to Exhibit 4 to LNC's Proxy Statement (File No. 1-6028) filed with the SEC on April 4, 2007.
- 10.2 Lincoln National Corporation Stock Option Plan for Non-Employee Directors is incorporated by reference to Exhibit 5 to LNC's Proxy Statement (File No. 1-6028) filed with the SEC on April 4, 2007.
- 10.3 Non-Qualified Stock Option Agreement for the Lincoln National Corporation Stock Option Plan for Non-Employee Directors is incorporated by reference to Exhibit 10.3 of LNC's Form 8-K (File No. 1-6028) filed with the SEC on May 10, 2007.
- 10.4 Amendment No. 2 to Employment Agreement of Dennis R. Glass, dated April 2, 2007, is 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.