LINCOLN NATIONAL CORP
Form 10-Q
August 09, 2010

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

# FORM 10-Q

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

For the quarterly period ended June 30, 2010
OR

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

For the transition period from to

Commission File Number 1-6028

LINCOLN NATIONAL CORPORATION
(Exact name of registrant as specified in its charter)

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

(484) 583-1400
(Registrant’s telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report.)

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

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

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

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

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

As of August 3, 2010, there were 316,735,677 shares of the registrant’s common stock outstanding.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

LINCOLN NATIONAL CORPORATION
CONSOLIDATED BALANCE SHEETS
(in millions, except share data)

| | As of June 30, 2010 (Unaudited) | As of December 31, 2009 |
|---|---|---|
| ASSETS | | |
| Investments: | | |
| Available-for-sale securities, at fair value: | | |
| Fixed maturity securities (amortized cost: 2010 - $63,321; 2009 - $60,757) | $ 66,391 | $ 60,818 |
| Variable interest entities' fixed maturity securities (amortized cost: 2010 - $568) | 581 | - |
| Equity securities (cost: 2010 - $356; 2009 - $382) | 246 | 278 |
| Trading securities | 2,608 | 2,505 |
| Mortgage loans on real estate | 6,882 | 7,178 |
| Real estate | 218 | 174 |
| Policy loans | 2,902 | 2,898 |
| Derivative investments | 1,989 | 1,010 |
| Other investments | 1,136 | 1,057 |
| Total investments | 82,953 | 75,918 |
| Cash and invested cash | 3,700 | 4,025 |
| Deferred acquisition costs and value of business acquired | 8,535 | 9,510 |
| Premiums and fees receivable | 317 | 321 |
| Accrued investment income | 945 | 889 |
| Reinsurance recoverables | 6,660 | 6,426 |
| Goodwill | 3,013 | 3,013 |
| Other assets | 3,162 | 3,831 |
| Separate account assets | 70,844 | 73,500 |
| Total assets | $ 180,129 | $ 177,433 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities | | |
| Future contract benefits | $ 17,478 | $ 15,958 |
| Other contract holder funds | 65,462 | 64,147 |
| Short-term debt | 99 | 350 |
| Long-term debt | 5,865 | 5,050 |
| Reinsurance related embedded derivatives | 92 | 31 |
| Funds withheld reinsurance liabilities | 1,196 | 1,261 |
| Deferred gain on business sold through reinsurance | 506 | 543 |
| Payables for collateral on investments | 2,376 | 1,907 |
| Variable interest entities' liabilities | 187 | - |
| Other liabilities | 3,386 | 2,986 |
| Separate account liabilities | 70,844 | 73,500 |
| Total liabilities | 167,491 | 165,733 |

| | | |
|---|---|---|
| Contingencies and Commitments (See Note 10) | | |
| | | |
| Stockholders' Equity | | |
| Preferred stock - 10,000,000 shares authorized: | | |
| Series A preferred stock - 11,365 and 11,497 shares issued and outstanding as of June 30, 2010, and December 31, 2009, respectively | - | - |
| Series B preferred stock - 950,000 shares outstanding as of December 31, 2009 | - | 806 |
| Common stock - 800,000,000 shares authorized; 316,662,480 and 302,223,281 shares issued and outstanding as of June 30, 2010, and December 31, 2009, respectively | 8,188 | 7,840 |
| Retained earnings | 3,512 | 3,316 |
| Accumulated other comprehensive income (loss) | 938 | (262) |
| Total stockholders' equity | 12,638 | 11,700 |
| Total liabilities and stockholders' equity | $ 180,129 | $ 177,433 |

See accompanying Notes to Consolidated Financial Statements

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LINCOLN NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME (LOSS)
(Unaudited, in millions, except per share data)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Revenues | | | | |
| Insurance premiums | $551 | $542 | $1,083 | $1,050 |
| Insurance fees | 793 | 691 | 1,581 | 1,392 |
| Net investment income | 1,120 | 971 | 2,226 | 1,984 |
| Realized gain (loss): | | | | |
| Total other-than-temporary impairment losses on securities | (11) | (221) | (88) | (431) |
| Portion of loss recognized in other comprehensive income | - | 103 | 24 | 192 |
| Net other-than-temporary impairment losses on securities recognized in earnings | (11) | (118) | (64) | (239) |
| Realized gain (loss), excluding other-than-temporary impairment losses on securities | 16 | (325) | 43 | (400) |
| Total realized gain (loss) | 5 | (443) | (21) | (639) |
| Amortization of deferred gain on business sold through reinsurance | 19 | 18 | 38 | 37 |
| Other revenues and fees | 117 | 104 | 225 | 191 |
| Total revenues | 2,605 | 1,883 | 5,132 | 4,015 |
| Benefits and Expenses | | | | |
| Interest credited | 613 | 607 | 1,231 | 1,234 |
| Benefits | 839 | 575 | 1,618 | 1,495 |
| Underwriting, acquisition, insurance and other expenses | 754 | 694 | 1,467 | 1,338 |
| Interest and debt expense | 69 | 61 | 137 | 61 |
| Impairment of intangibles | - | (1) | - | 603 |
| Total benefits and expenses | 2,275 | 1,936 | 4,453 | 4,731 |
| Income (loss) from continuing operations before taxes | 330 | (53) | 679 | (716) |
| Federal income tax expense (benefit) | 78 | (46) | 171 | (122) |
| Income (loss) from continuing operations | 252 | (7) | 508 | (594) |
| Income (loss) from discontinued operations, net of federal income taxes | 3 | (154) | 31 | (146) |
| Net income (loss) | 255 | (161) | 539 | (740) |
| Preferred stock dividends and accretion of discount | (149) | - | (168) | - |
| Net income (loss) available to common stockholders | $106 | $(161) | $371 | $(740) |
| | | | | |
| Earnings (Loss) Per Common Share - Basic | | | | |
| Income (loss) from continuing operations | $0.34 | $(0.03) | $1.12 | $(2.30) |
| Income (loss) from discontinued operations | 0.01 | (0.59) | 0.10 | (0.57) |
| Net income (loss) | $0.35 | $(0.62) | $1.22 | $(2.87) |
| | | | | |
| Earnings (Loss) Per Common Share - Diluted | | | | |
| Income (loss) from continuing operations | $0.32 | $(0.03) | $1.08 | $(2.30) |
| Income (loss) from discontinued operations | 0.01 | (0.59) | 0.10 | (0.57) |
| Net income (loss) | $0.33 | $(0.62) | $1.18 | $(2.87) |

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited, in millions, except per share data)

| | For the Six Months Ended June 30, | |
|---|---|---|
| | 2010 | 2009 |
| Preferred Stock | | |
| Balance as of beginning-of-year | $806 | $- |
| Redemption of Series B preferred stock | (950) | - |
| Accretion of discount on Series B preferred stock | 144 | - |
| Balance as of end-of-period | - | - |
| | | |
| Common Stock | | |
| Balance as of beginning-of-year | 7,840 | 7,035 |
| Issuance of common stock | 368 | 652 |
| Stock compensation/issued for benefit plans | 9 | (9) |
| Deferred compensation payable in stock | - | 3 |
| Effect of amendment to non-director deferred compensation plans | (29) | - |
| Balance as of end-of-period | 8,188 | 7,681 |
| | | |
| Retained Earnings | | |
| Balance as of beginning-of-year | 3,316 | 3,745 |
| Cumulative effect from adoption of new accounting standards | (169) | 102 |
| Comprehensive income | 1,558 | 458 |
| Less other comprehensive income, net of tax | 1,019 | 1,198 |
| Net income (loss) | 539 | (740) |
| Dividends declared: Common (2010 - $0.020; 2009 - $0.020) | (6) | (6) |
| Dividends on preferred stock | (24) | - |
| Accretion of discount on Series B preferred stock | (144) | - |
| Balance as of end-of-period | 3,512 | 3,101 |
| | | |
| Accumulated Other Comprehensive Income (Loss) | | |
| Balance as of beginning-of-year | (262) | (2,803) |
| Cumulative effect from adoption of new accounting standards | 181 | (102) |
| Other comprehensive income, net of tax | 1,019 | 1,198 |
| Balance as of end-of-period | 938 | (1,707) |
| Total stockholders' equity as of end-of-period | $12,638 | $9,075 |

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in millions)

| | For the Six Months Ended June 30, | |
|---|---|---|
| | 2010 | 2009 |
| Cash Flows from Operating Activities | | |
| Net income (loss) | $539 | $(740) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Deferred acquisition costs, value of business acquired, deferred sales inducements and deferred front-end loads deferrals and interest, net of amortization | (86) | (165) |
| Trading securities purchases, sales and maturities, net | 31 | 35 |
| Change in premiums and fees receivable | 4 | 46 |
| Change in accrued investment income | (56) | (67) |
| Change in future contract benefits | 603 | (268) |
| Change in other contract holder funds | 1 | 102 |
| Change in reinsurance related assets and liabilities | (253) | 81 |
| Change in federal income tax accruals | 202 | 110 |
| Realized (gain) loss | 21 | 639 |
| Gain on early extinguishment of debt | - | (64) |
| Amortization of deferred gain on business sold through reinsurance | (38) | (37) |
| Impairment of intangibles | - | 603 |
| (Gain) loss on disposal of discontinued operations | (64) | 237 |
| Other | (31) | (65) |
| Net cash provided by operating activities | 873 | 447 |
| | | |
| Cash Flows from Investing Activities | | |
| Purchases of available-for-sale securities | (7,474) | (7,661) |
| Sales of available-for-sale securities | 2,057 | 2,078 |
| Maturities of available-for-sale securities | 1,925 | 1,619 |
| Purchases of other investments | (1,245) | (2,564) |
| Sales or maturities of other investments | 1,443 | 2,942 |
| Increase (decrease) in payables for collateral on investments | 469 | (1,994) |
| Proceeds from sale of subsidiaries/businesses, net of cash disposed | 321 | 4 |
| Other | (29) | (28) |
| Net cash used in investing activities | (2,533) | (5,604) |
| | | |
| Cash Flows from Financing Activities | | |
| Payment of long-term debt, including current maturities | (250) | (522) |
| Issuance of long-term debt, net of issuance costs | 749 | 495 |
| Decrease in commercial paper, net | (1) | (112) |
| Deposits of fixed account values, including the fixed portion of variable | 5,132 | 5,795 |
| Withdrawals of fixed account values, including the fixed portion of variable | (2,483) | (3,285) |
| Transfers to and from separate accounts, net | (1,353) | (1,028) |
| Common stock issued for benefit plans and excess tax benefits | - | (20) |
| Redemption of Series B preferred stock | (950) | - |
| Issuance of common stock | 368 | 652 |

| | | |
|---|---|---|
| Dividends paid to common and preferred stockholders | (36) | (56) |
| Net cash provided by financing activities | 1,176 | 1,919 |
| Net decrease in cash and invested cash, including discontinued operations | (484) | (3,238) |
| Cash and invested cash, including discontinued operations, as of beginning-of-year | 4,184 | 5,926 |
| Cash and invested cash, including discontinued operations, as of end-of-period | $3,700 | $2,688 |

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

## 1. Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies

### Nature of Operations

Lincoln National Corporation and its majority-owned subsidiaries ("LNC" or the "Company," which also may be referred to as "we," "our" or "us") operate multiple insurance businesses through four business segments. See Note 15 for additional details. The collective group of businesses uses "Lincoln Financial Group" as its marketing identity. Through our business segments, we sell a wide range of wealth protection, accumulation and retirement income products. These products include institutional and/or retail fixed and indexed annuities, variable annuities, universal life insurance ("UL"), variable universal life insurance ("VUL"), linked-benefit UL, term life insurance, mutual funds and group protection.

### Basis of Presentation

The accompanying unaudited consolidated financial statements are prepared in accordance with United States of America generally accepted accounting principles ("GAAP") for interim financial information and with the instructions for the Securities and Exchange Commission ("SEC") Quarterly Report on Form 10-Q, including Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Therefore, the information contained in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 ("2009 Form 10-K") should be read in connection with the reading of these interim unaudited consolidated financial statements.

In the opinion of management, these statements include all normal recurring adjustments necessary for a fair presentation of the Company's results. Operating results for the six month period ended June 30, 2010, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2010. All material intercompany accounts and transactions have been eliminated in consolidation.

Certain amounts reported in prior years' consolidated financial statements have been reclassified to conform to the presentation adopted in the current year. These reclassifications had no effect on net income or stockholders' equity of the prior years.

### Summary of Significant Accounting Policies

#### Available-For-Sale Securities – Fair Valuation Methodologies and Associated Inputs

Securities classified as available-for-sale ("AFS") consist of fixed maturity and equity securities and are stated at fair value with unrealized gains and losses included within accumulated other comprehensive income (loss) ("OCI"), net of associated deferred acquisition costs ("DAC"), value of business acquired ("VOBA"), deferred sales inducements ("DSI"), other contract holder funds and deferred income taxes. See Notes 5 and 14 for additional details.

We measure the fair value of our securities classified as AFS based on assumptions used by market participants in pricing the security. The most appropriate valuation methodology is selected based on the specific characteristics of the fixed maturity or equity security, and we consistently apply the valuation methodology to measure the security's fair value. Our fair value measurement is based on a market approach, which utilizes prices and other relevant information generated by market transactions involving identical or comparable securities. Sources of inputs to the market approach include third-party pricing services, independent broker quotations or pricing matrices. We do not adjust prices received from third parties; however, we do analyze the third-party pricing services' valuation methodologies and related inputs and perform additional evaluation to determine the appropriate level within the fair value hierarchy.

We use observable and unobservable inputs in our valuation methodologies. Observable inputs include benchmark yields, reported trades, broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. In addition, market indicators, industry and economic events are monitored and further market data is acquired if certain triggers are met. For certain security types, additional inputs may be used, or some of the inputs described above may not be applicable. For broker-quoted only securities, quotes from market makers or broker-dealers are obtained from sources recognized to be market participants. In order to validate the pricing information and broker-dealer quotes, we employ, where possible, procedures that include comparisons with similar observable positions, comparisons with subsequent sales, discussions with senior business leaders and brokers and observations of general market movements for those security classes. For those securities trading in less liquid or illiquid markets with limited or no pricing information, we use unobservable inputs in order to measure the fair value of these securities. In cases where this information is not available, such as for privately placed securities, fair value is estimated using an internal pricing matrix. This matrix relies on management's judgment concerning the discount rate used in calculating expected future cash flows, credit quality, industry sector performance and expected maturity.

The observable and unobservable inputs to our valuation methodologies are based on a set of standard inputs that we generally use to evaluate all of our AFS securities. The standard inputs used in order of priority are benchmark yields, reported trades, broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. Depending on the type of security or the daily market activity, standard inputs may be prioritized differently or may not be available for all AFS securities on any given day.

The following summarizes our fair valuation methodologies and associated inputs, which are particular to the specified security type and are in addition to the defined standard inputs to our valuation methodologies for all of our AFS securities discussed above:

- Corporate bonds and U.S. Government bonds – We also use Trade Reporting and Compliance EngineTM reported tables for our corporate bonds and vendor trading platform data for our U.S. Government bonds.
- Mortgage- and asset-backed securities – We also utilize additional inputs which include new issues data, monthly payment information and monthly collateral performance, including prepayments, severity, delinquencies, step-down features and over collateralization features for each of our mortgage-backed securities (“MBS”), which include collateralized mortgage obligations (“CMOs”), residential mortgages that back mortgage pass through securities (“MPTS”) and commercial mortgages that back commercial MBS (“CMBS”), and for our asset-backed securities (“ABS”) collateralized debt obligations (“CDOs”).
- State and municipal bonds – We also use additional inputs which include information from the Municipal Securities Rule Making Board, as well as material event notices, new issue data, issuer financial statements and Municipal Market Data benchmark yields for our state and municipal bonds.
- Hybrid and redeemable preferred and equity securities – We also utilize additional inputs of exchange prices (underlying and common stock of the same issuer) for our hybrid and redeemable preferred stocks and equity securities, including banking, insurance, other financial services and other securities.

2. New Accounting Standards

Adoption of New Accounting Standards

Consolidations Topic

In June 2009, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2009-17, “Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities” (“ASU 2009-17”), which amended the consolidation guidance for variable interest entities (“VIEs”). For a more detailed description of ASU 2009-17, see “Future Adoption of New Accounting Standards – Consolidations Topic” in Note 2 of our 2009 Form 10-K. In February 2010, the FASB issued ASU No. 2010-10, “Amendments for Certain Investment Funds” (“ASU 2010-10”), which deferred application of the guidance in ASU 2009-17 for reporting entities with interests in an entity that applies the specialized accounting guidance for investment companies.

Effective January 1, 2010, we adopted the amendments in ASU 2009-17 and ASU 2010-10, and accordingly reconsidered our involvement with all our VIEs and the primary beneficiary of the VIEs. In accordance with ASU 2009-17, we are the primary beneficiary of the VIEs associated with our investments in credit-linked notes (“CLNs”), and as such, we consolidated all of the assets and liabilities of these VIEs and recorded a cumulative effect adjustment of $169 million, after-tax, to the beginning balance of retained earnings as of January 1, 2010. In addition, we considered our investments in limited partnerships and other alternative investments, and concluded these investments are within the scope of the deferral in ASU 2010-10, and as such they are not subject to the amended consolidation guidance in ASU 2009-17. As a result, we will continue to account for our alternative investments consistent with the accounting policy in Note 1 of our 2009 Form 10-K.  See Note 4 for more detail regarding the consolidation of our VIEs.

Fair Value Measurements and Disclosures Topic

In January 2010, the FASB issued ASU No. 2010-06, "Improving Disclosures about Fair Value Measurements" ("ASU 2010-06"), which requires us to disclose additional information related to the three-level fair value hierarchy.  For a more detailed description of ASU 2010-06, see "Future Adoption of New Accounting Standards – Fair Value Measurements and Disclosures Topic" in Note 2 of our 2009 Form 10-K.  We adopted the amendments in ASU 2010-06 effective January 1, 2010, and have prospectively included the required disclosures in Note 14.  The disclosures related to purchases, sales, issuances and settlements for Level 3 fair value measurements are effective for reporting periods beginning after December 15, 2010, and as such, these disclosures will be included in the Notes to Consolidated Financial Statements effective January 1, 2011.

Transfers and Servicing Topic

In June 2009, the FASB issued ASU No. 2009-16, "Accounting for Transfers of Financial Assets" ("ASU 2009-16"), which eliminates the concept of a qualifying special-purpose entity ("SPE") and removes the scope exception for a qualifying SPE from the Consolidations Topic of the FASB Accounting Standards CodificationTM ("ASC"). For a more detailed description of ASU 2009-16, see "Future Adoption of New Accounting Standards – Transfers and Servicing Topic" in Note 2 of our 2009 Form 10-K. We adopted ASU 2009-16 effective January 1, 2010. The adoption did not have a material impact on our consolidated financial condition and results of operations.

Future Adoption of New Accounting Standards

Derivatives and Hedging Topic

In March 2010, the FASB issued ASU No. 2010-11, "Scope Exception Related to Embedded Credit Derivatives" ("ASU 2010-11"), to clarify the scope exception when evaluating an embedded credit derivative which may potentially require separate accounting. Specifically, ASU 2010-11 states that only an embedded credit derivative feature related to the transfer of credit risk that is solely in the form of subordination of one financial instrument to another is not subject to further analysis as a potential embedded derivative under the Derivatives and Hedging Topic of the FASB ASC. The amendments specify that embedded credit derivatives not qualifying for the scope exception, such as an embedded derivative related to a credit default swap on a referenced credit, would be subject to a bifurcation analysis even if their effects are allocated to interests in subordinated tranches of the securitized financial instrument. ASU 2010-11 will be effective at the beginning of the first fiscal quarter beginning after June 15, 2010. The fair value option may be elected for investments within the scope of ASU 2010-11 on an instrument-by-instrument basis. If the fair value option is not elected, preexisting contracts acquired, issued or subject to a remeasurement event on or after January 1, 2007, must be evaluated under the guidance in ASU 2010-11. We will adopt the amendments in ASU 2010-11 effective with the interim reporting period ending September 30, 2010. We do not expect the adoption will have a material impact on our consolidated financial condition and results of operations.

Financial Services – Insurance Industry Topic

In April 2010, the FASB issued ASU No. 2010-15, "How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments" ("ASU 2010-15"), to clarify a consolidation issue for insurance entities that hold a controlling interest in an investment fund either partially or completely through separate accounts. ASU 2010-15 concludes that an insurance entity would not be required to consider interests held in separate accounts when determining whether or not to consolidate an investment fund, unless the separate account interest is held for the benefit of a related party. If an investment fund is consolidated, the portion of the assets representing interests held in separate accounts would be recorded as a separate account asset with a corresponding separate account liability. The remaining investment fund assets would be consolidated in the insurance entity's general account. ASU 2010-15 will be applied retrospectively for fiscal years and interim periods within those fiscal years beginning after December 15, 2010, with early application permitted. We are currently evaluating the impact of the adoption on our consolidated financial condition and results of operations.

Receivables Topic

In July 2010, the FASB issued ASU No. 2010-20, "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses" ("ASU 2010-20"), which will enhance and expand the financial statement disclosures related to this topic. These amendments are focused on providing financial statement users with more information regarding the nature of the risk associated with financing receivables and how the assessment of the risk is used to estimate the allowance for credit losses. In addition, expanded disclosures are required to provide financial statement users with more information regarding changes recognized during the reporting period to the allowance for credit losses. The new disclosure requirements in ASU 2010-20 will primarily be effective for interim and annual reporting periods ending on or after December 15, 2010. Disclosures that provide information about the activity during a reporting period, primarily in the allowance for credit losses and modifications of financing receivables, are effective for interim and annual reporting periods beginning on or after December 15, 2010. Comparative disclosures are not required for earlier reporting periods ending prior to the initial adoption date. We are currently evaluating the disclosure requirements of ASU 2010-20, and will include the required disclosures in the Notes to Consolidated Financial Statements beginning with the reporting period ending December 31, 2010. The required disclosures in ASU 2010-20 related to activity that occurs during a reporting period will be included in the Notes to Consolidated Financial Statements beginning with the reporting period ending March 31, 2011.

## 3. Dispositions

### Discontinued Investment Management Operations

On August 18, 2009, we entered into a purchase and sale agreement with Macquarie Bank Limited (“MBL”), pursuant to which we agreed to sell to MBL all of the outstanding capital stock of Delaware Management Holdings, Inc. (“Delaware”), our subsidiary, which provided investment products and services to individuals and institutions. This transaction closed on January 4, 2010, with after-tax proceeds of approximately $405 million.

In addition, certain of our subsidiaries, including The Lincoln National Life Insurance Company (“LNL”), our primary insurance subsidiary, entered into investment advisory agreements with Delaware, pursuant to which Delaware will continue to manage the majority of the general account insurance assets of the subsidiaries. The investment advisory agreements will have 10-year terms, and we may terminate them without cause, subject to a purchase price adjustment of up to $80 million, the amount of which is dependent on the timing of any termination and which agreements are terminated. The amount of the potential adjustment will decline on a pro rata basis over the 10-year term of the advisory agreements.

Accordingly, in the periods prior to closing, the assets and liabilities of this business were classified as held-for-sale and reported within other assets and other liabilities on our Consolidated Balance Sheets. The major classes of assets and liabilities held-for-sale (in millions) were as follows:

| | As of December 31, 2009 |
|---|---|
| Assets | |
| Cash and invested cash | $ 159 |
| Premiums and fees receivable | 39 |
| Goodwill | 248 |
| Other assets | 61 |
| Total assets held-for-sale | $ 507 |
| | |
| Liabilities | |
| Other liabilities | $ 116 |
| Total liabilities held-for-sale | $ 116 |

We have reclassified the results of operations of Delaware into income from discontinued operations for all periods presented on our Consolidated Statements of Income (Loss), and selected amounts (in millions) were as follows:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Discontinued Operations Before Disposal | | | | |
| Revenues: | | | | |
| Investment advisory fees - external | $- | $48 | $- | $92 |
| Investment advisory fees - internal | - | 20 | - | 40 |
| Other revenues and fees | - | 24 | - | 42 |
| Gain on sale of business | 4 | 2 | 4 | 4 |
| Total revenues | $4 | $94 | $4 | $178 |
| Income (loss) from discontinued operations before disposal, before federal income tax expense (benefit) | $4 | $12 | $(13) | $17 |
| Federal income tax expense (benefit) | 1 | 6 | (2) | 8 |
| Income (loss) from discontinued operations before disposal | 3 | 6 | (11) | 9 |
| Disposal | | | | |
| Gain on disposal, before federal income tax expense | - | - | 37 | - |
| Federal income tax expense | - | - | 13 | - |
| Gain on disposal | - | - | 24 | - |
| Income from discontinued operations | $3 | $6 | $13 | $9 |

The income (loss) from discontinued operations before disposal for the three and six months ended June 30, 2010, includes final cash received toward the purchase price for certain institutional taxable fixed income business sold during the fourth quarter 2007. The loss from discontinued operations before disposal for the six months ended June 30, 2010, also reflects stock compensation expense attributable to the acceleration of vesting of equity awards for certain Delaware employees upon the sale of Delaware.

Discontinued U.K. Operations

On June 15, 2009, we entered into a share purchase agreement with SLF of Canada UK Limited ("SLF") and Sun Life Assurance Company of Canada, as the guarantor, pursuant to which we agreed to sell to SLF all of the outstanding capital stock of Lincoln National (UK) plc ("Lincoln UK"), our subsidiary, which focused primarily on providing life and retirement income products in the United Kingdom. This transaction closed on October 1, 2009, and we retained Lincoln UK's pension plan assets and liabilities.

We have reclassified the results of operations of Lincoln UK into income from discontinued operations for all periods presented on our Consolidated Statements of Income (Loss), and selected amounts (in millions) were as follows:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Discontinued Operations Before Disposal | | | | |
| Revenues: | | | | |
| Insurance premiums | $- | $14 | $- | $25 |
| Insurance fees | - | 33 | - | 57 |
| Net investment income | - | 15 | - | 28 |
| Realized gain (loss) | - | - | - | (3) |
| Other revenues and fees | - | 1 | - | - |
| Total revenues | $- | $63 | $- | $107 |
| Income from discontinued operations before disposal, before federal income tax expense | $- | $15 | $- | $23 |
| Federal income tax expense | - | 5 | - | 8 |
| Income from discontinued operations before disposal | - | 10 | - | 15 |
| Disposal | | | | |
| Gain (loss) on disposal, before federal income tax expense (benefit) | - | (237) | 27 | (237) |
| Federal income tax expense (benefit) | - | (67) | 9 | (67) |
| Gain (loss) on disposal | - | (170) | 18 | (170) |
| Income (loss) from discontinued operations | $- | $(160) | $18 | $(155) |

The gain on disposal for the six months ended June 30, 2010, related to additional consideration received attributable to a post-closing adjustment of the purchase price based upon a final actuarial appraisal of the value of the business as set forth in the share purchase agreement.

## 4. Variable Interest Entities

Our involvement with VIEs is primarily to obtain financing and to invest in assets that allow us to gain exposure to a broadly diversified portfolio of asset classes. The factors used to determine whether or not we are the primary beneficiary and must consolidate a VIE in which we hold a variable interest changed effective January 1, 2010, upon the adoption of new accounting guidance. See “Consolidations Topic” in Note 2 for details. Beginning January 1, 2010, we continuously analyze the primary beneficiary of our VIEs, to determine whether we are the primary beneficiary, by applying a qualitative approach to identify the variable interest that has the power to direct activities that most significantly impact the performance of the VIE and absorb losses or receive returns that could potentially be significant to the VIE.

### Consolidated VIEs

We invested in the Class 1 Notes of two CLN structures, which represent special purpose trusts that combine asset-backed securities with credit default swaps to produce multi-class structured securities. The Class 2 Notes are held by third parties, and, together with the Class 1 Notes, represent 100% of the outstanding notes of the CLN structures. The entities that issued the CLNs are financed by the note holders, and, as such, the note holders participate in the expected losses and residual returns of the entities. Because the note holders do not have voting rights or similar rights, we determined the entities issuing the CLNs are VIEs, and as a note holder, our interest represented a variable interest. As of December 31, 2009, these VIEs were not consolidated because under the previous accounting guidance, we were not the primary beneficiary of the VIEs because the subordinated class of notes (Class 2) absorbed the majority of the expected losses under the CLN structures. The carrying value of the CLNs as of December 31, 2009, was recognized as a fixed maturity security within AFS on our Consolidated Balance Sheets.

Effective January 1, 2010, we adopted the new accounting guidance noted above and evaluated the primary beneficiary of the CLN structures using qualitative factors. Based on our evaluation, we concluded that the ability to actively manage the reference portfolio underlying the credit default swaps is the most significant activity impacting the performance of the CLN structures, because the subordination and participation in credit losses may change. We concluded that we have the power to direct this activity. In addition, we receive returns from the CLN structures and may absorb losses that could potentially be significant to the

CLN structures. As such, we concluded that we are the primary beneficiary of the VIEs associated with our CLNs. We consolidated all of the assets and liabilities of the CLN structures through a cumulative effect adjustment to the beginning balance of retained earnings as of January 1, 2010, and recognized the results of operations of these VIEs on our consolidated financial statements beginning in the first quarter of 2010.

The following summarizes the increases or (decreases) recorded effective January 1, 2010, to the categories (in millions) on our Consolidated Balance Sheets for this cumulative effect adjustment:

| | |
|---|---|
| Assets | |
| AFS securities, at fair value: | |
| Fixed maturity securities - ABS CLNs | $(322) |
| VIEs' fixed maturity securities | 565 |
| Total assets | $243 |
| Liabilities | |
| VIEs' liabilities: | |
| Derivative instruments | $225 |
| Federal income tax | (91) |
| Total VIEs' liabilities | 134 |
| Other liabilities - deferred income taxes | 97 |
| Total liabilities | 231 |
| Stockholders' Equity | |
| Retained earnings | (169) |
| Accumulated OCI - unrealized gain (loss) on AFS securities | 181 |
| Total stockholders' equity | 12 |
| Total liabilities and stockholders' equity | $243 |

Asset and liability information (dollars in millions) for these consolidated VIEs included on our Consolidated Balance Sheets as of June 30, 2010, was as follows:

| | Number of Instruments | Notional Amounts | Carrying Value |
|---|---|---|---|
| Assets | | | |
| Fixed maturity corporate asset-backed credit card loan securities (1) | N/A | $- | $581 |
| Liabilities | | | |
| Derivative instruments not designated and not qualifying as hedging instruments: | | | |
| Credit default swaps (2) | 2 | $600 | $309 |
| Contingent forwards (2) | 2 | - | (12) |
| Total derivative instruments not designated and not qualifying as hedging instruments | 4 | 600 | 297 |
| Federal income tax (2) | N/A | - | (110) |
| Total liabilities | 4 | $600 | $187 |

(1) Reported in VIEs' fixed maturity securities on our Consolidated Balance Sheets.
(2) Reported in VIEs' liabilities on our Consolidated Balance Sheets.

For details related to the fixed maturity AFS securities for these VIEs, see Note 5.

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The credit default swaps create variability in the CLN structures and expose the note holders to the credit risk of the referenced portfolio.

The contingent forwards transfer a portion of the loss in the underlying fixed maturity corporate asset-backed credit card loan securities back to the counterparty after credit losses reach our attachment point.

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

| | For the Three Months Ended June 30, 2010 | For the Six Months Ended June 30, 2010 |
|---|---|---|
| Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments | | |
| Credit default swaps (1) | $(70) | $(69) |
| Contingent forwards (1) | 2 | (3) |
| Total derivative instruments not designated and not qualifying as hedging instruments | $(68) | $(72) |

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

LNL invested the proceeds of $600 million received for issuing two funding agreements in 2006 and 2007 into the Class 1 Notes of the two CLN structures we are consolidating, and this balance was reported in other contract holder funds on our Consolidated Balance Sheets as of June 30, 2010, and December 31, 2009. As of December 31, 2009, the CLNs are included in fixed maturity AFS securities on our Consolidated Balance Sheets.

The following summarizes information regarding the CLN structures (dollars in millions) as of June 30, 2010:

| | Amount and Date of Issuance | |
|---|---|---|
| | $400 | $200 |
| | December 2006 | April 2007 |
| Original attachment point (subordination) | 5.50 % | 2.05 % |
| Current attachment point (subordination) | 4.17 % | 1.48 % |
| Maturity | 12/20/2016 | 3/20/2017 |
| Current rating of tranche | B- | Ba3 |
| Current rating of underlying collateral pool | Aa1-B3 | Aaa-B1 |
| Number of defaults in underlying collateral pool | 2 | 2 |
| Number of entities | 123 | 99 |
| Number of countries | 19 | 23 |

There has been no event of default on the CLNs themselves. Based upon our analysis, the remaining subordination as represented by the attachment point should be sufficient to absorb future credit losses, subject to changing market conditions. Similar to other debt market instruments, our maximum principal loss is limited to our original investment as of June 30, 2010.

As described more fully in Note 1 of our 2009 10-K, we regularly review our investment holdings for other-than-temporary impairments ("OTTIs"). Based upon this review, we believe that the fixed maturity corporate asset-backed credit card loan securities were not other-than-temporarily impaired as of June 30, 2010.

The following summarizes the exposure of the CLN structures' underlying collateral by industry and rating as of June 30, 2010:

| Industry | AAA | AA | A | BBB | BB | B | Total |
|---|---|---|---|---|---|---|---|
| Financial intermediaries | 0.3% | 3.0% | 7.2% | 0.6% | 0.0% | 0.0% | 11.1% |
| Telecommunications | 0.0% | 0.0% | 6.4% | 3.7% | 1.1% | 0.0% | 11.2% |
| Oil and gas | 0.0% | 0.7% | 1.5% | 4.1% | 0.0% | 0.0% | 6.3% |
| Utilities | 0.0% | 0.0% | 2.1% | 2.4% | 0.0% | 0.0% | 4.5% |
| Chemicals and plastics | 0.0% | 0.0% | 2.3% | 1.6% | 0.0% | 0.0% | 3.9% |
| Drugs | 0.3% | 2.5% | 0.9% | 0.0% | 0.0% | 0.0% | 3.7% |
| Retailers (except food and drug) | 0.0% | 0.0% | 0.6% | 1.8% | 1.1% | 0.0% | 3.5% |
| Industrial equipment | 0.0% | 0.0% | 3.0% | 0.3% | 0.0% | 0.0% | 3.3% |
| Sovereign | 0.0% | 0.3% | 1.6% | 1.3% | 0.0% | 0.0% | 3.2% |
| Food products | 0.0% | 0.3% | 1.8% | 1.1% | 0.0% | 0.0% | 3.2% |
| Conglomerates | 0.0% | 2.7% | 0.5% | 0.0% | 0.0% | 0.0% | 3.2% |
| Forest products | 0.0% | 0.0% | 0.0% | 1.6% | 1.4% | 0.0% | 3.0% |
| Other industry < 3% (28 industries) | 0.0% | 1.6% | 16.0% | 17.7% | 3.4% | 1.2% | 39.9% |
| Total by industry | 0.6% | 11.1% | 43.9% | 36.2% | 7.0% | 1.2% | 100.0% |

Unconsolidated VIEs

Through our investment activities, we make passive investments in structured securities issued by VIEs for which we are not the manager. These structured securities include our MBS, which include CMOs, MPTS and CMBS and our ABS CDOs. We have not provided financial or other support with respect to these structured securities other than our original investment. We have determined that we are not the primary beneficiary of these structured securities due to the relative size of our investment in comparison to the principal amount of the structured securities issued by the VIEs and the level of credit subordination which reduces our obligation to absorb losses or right to receive benefits. Our maximum exposure to loss on these structured securities, both VIEs and non-VIEs, is limited to the amortized cost for these investments. We recognize our variable interest in these VIEs at fair value on our consolidated financial statements. For information about these structured securities, see Note 5.

5. Investments

AFS Securities

Pursuant to the Fair Value Measurements and Disclosures Topic of the FASB ASC, we have categorized AFS securities into a three-level hierarchy, based on the priority of the inputs to the respective valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3), as described in Note 1 in our 2009 Form 10-K, which also includes additional disclosures regarding our fair value measurements.

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

| | As of June 30, 2010 | | | | |
|---|---|---|---|---|---|
| | Amortized | | Gross Unrealized | | Fair |
| | Cost | Gains | Losses | OTTI | Value |
| Fixed Maturity Securities | | | | | |
| Corporate bonds | $47,145 | $3,848 | $692 | $57 | $50,244 |
| U.S. Government bonds | 186 | 24 | 1 | - | 209 |
| Foreign government bonds | 441 | 37 | 4 | - | 474 |
| MBS: | | | | | |
| CMOs | 5,914 | 387 | 202 | 151 | 5,948 |
| MPTS | 3,377 | 153 | 5 | - | 3,525 |
| CMBS | 2,314 | 93 | 274 | - | 2,133 |
| ABS CDOs | 178 | 14 | 26 | 9 | 157 |
| State and municipal bonds | 2,431 | 121 | 12 | - | 2,540 |
| Hybrid and redeemable preferred securities | 1,335 | 23 | 197 | - | 1,161 |
| VIEs' fixed maturity securities | 568 | 13 | - | - | 581 |
| Total fixed maturity securities | 63,889 | 4,713 | 1,413 | 217 | 66,972 |
| | | | | | |
| Equity Securities | | | | | |
| Banking securities | 243 | - | 124 | - | 119 |
| Insurance securities | 31 | 1 | 3 | - | 29 |
| Other financial services securities | 19 | 10 | - | - | 29 |
| Other securities | 63 | 6 | - | - | 69 |
| Total equity securities | 356 | 17 | 127 | - | 246 |
| Total AFS securities | $64,245 | $4,730 | $1,540 | $217 | $67,218 |

| | As of December 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Amortized | | Gross Unrealized | | Fair |
| | Cost | Gains | Losses | OTTI | Value |
| Fixed Maturity Securities | | | | | |
| Corporate bonds | $44,307 | $2,260 | $1,117 | $71 | $45,379 |
| U.S. Government bonds | 186 | 13 | 4 | - | 195 |
| Foreign government bonds | 488 | 26 | 9 | - | 505 |
| MBS: | | | | | |
| CMOs | 6,112 | 258 | 307 | 157 | 5,906 |
| MPTS | 3,028 | 64 | 26 | - | 3,066 |
| CMBS | 2,436 | 49 | 354 | - | 2,131 |
| ABS: | | | | | |
| CDOs | 189 | 11 | 33 | 9 | 158 |
| CLNs | 600 | - | 278 | - | 322 |
| State and municipal bonds | 2,009 | 14 | 55 | - | 1,968 |
| Hybrid and redeemable preferred securities | 1,402 | 36 | 250 | - | 1,188 |
| Total fixed maturity securities | 60,757 | 2,731 | 2,433 | 237 | 60,818 |
| | | | | | |
| Equity Securities | | | | | |
| Banking securities | 266 | - | 119 | - | 147 |
| Insurance securities | 44 | 2 | - | - | 46 |
| Other financial services securities | 22 | 12 | 6 | - | 28 |
| Other securities | 50 | 7 | - | - | 57 |
| Total equity securities | 382 | 21 | 125 | - | 278 |
| Total AFS securities | $61,139 | $2,752 | $2,558 | $237 | $61,096 |
| | | | | | c |

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

| | As of June 30, 2010 | |
|---|---|---|
| | Amortized Cost | Fair Value |
| Due in one year or less | $2,512 | $2,565 |
| Due after one year through five years | 12,378 | 13,186 |
| Due after five years through ten years | 18,546 | 20,010 |
| Due after ten years | 18,670 | 19,448 |
| Subtotal | 52,106 | 55,209 |
| MBS | 11,605 | 11,606 |
| CDOs | 178 | 157 |
| Total fixed maturity AFS securities | $63,889 | $66,972 |

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

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

| | As of June 30, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than or Equal to Twelve Months | | Greater Than Twelve Months | | Total | |
| | Fair Value | Gross Unrealized Losses and OTTI | Fair Value | Gross Unrealized Losses and OTTI | Fair Value | Gross Unrealized Losses and OTTI |
| Fixed Maturity Securities | | | | | | |
| Corporate bonds | $1,814 | $162 | $3,287 | $587 | $5,101 | $749 |
| U.S. Government bonds | 2 | - | 15 | 1 | 17 | 1 |
| Foreign government bonds | 25 | - | 8 | 4 | 33 | 4 |
| MBS: | | | | | | |
| CMOs | 264 | 136 | 905 | 217 | 1,169 | 353 |
| MPTS | 6 | - | 60 | 5 | 66 | 5 |
| CMBS | 48 | 1 | 420 | 273 | 468 | 274 |
| ABS CDOs | 12 | 4 | 126 | 31 | 138 | 35 |
| State and municipal bonds | 118 | 4 | 35 | 8 | 153 | 12 |
| Hybrid and redeemable preferred securities | 126 | 14 | 725 | 183 | 851 | 197 |
| Total fixed maturity securities | 2,415 | 321 | 5,581 | 1,309 | 7,996 | 1,630 |
| | | | | | | |
| Equity Securities | | | | | | |
| Banking securities | 2 | 1 | 117 | 123 | 119 | 124 |
| Insurance securities | 22 | 3 | - | - | 22 | 3 |
| Total equity securities | 24 | 4 | 117 | 123 | 141 | 127 |
| Total AFS securities | $2,439 | $325 | $5,698 | $1,432 | $8,137 | $1,757 |
| | | | | | | |
| Total number of AFS securities in an unrealized loss position | | | | | | 1,113 |

| | As of December 31, 2009 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than or Equal to Twelve Months | | Greater Than Twelve Months | | Total | |
| | Fair Value | Gross Unrealized Losses and OTTI | Fair Value | Gross Unrealized Losses and OTTI | Fair Value | Gross Unrealized Losses and OTTI |
| Fixed Maturity Securities | | | | | | |
| Corporate bonds | $4,375 | $236 | $5,795 | $952 | $10,170 | $1,188 |
| U.S. Government bonds | 44 | 4 | 3 | - | 47 | 4 |
| Foreign government bonds | 34 | - | 46 | 9 | 80 | 9 |
| MBS: | | | | | | |
| CMOs | 404 | 159 | 929 | 305 | 1,333 | 464 |
| MPTS | 1,293 | 14 | 81 | 12 | 1,374 | 26 |
| CMBS | 153 | 13 | 656 | 341 | 809 | 354 |
| ABS: | | | | | | |
| CDOs | 9 | 7 | 128 | 35 | 137 | 42 |
| CLNs | - | - | 322 | 278 | 322 | 278 |
| State and municipal bonds | 1,203 | 46 | 54 | 9 | 1,257 | 55 |
| Hybrid and redeemable preferred securities | 105 | 5 | 819 | 245 | 924 | 250 |
| Total fixed maturity securities | 7,620 | 484 | 8,833 | 2,186 | 16,453 | 2,670 |
| | | | | | | |
| Equity Securities | | | | | | |
| Banking securities | 124 | 119 | - | - | 124 | 119 |
| Other financial services securities | 4 | 6 | - | - | 4 | 6 |
| Total equity securities | 128 | 125 | - | - | 128 | 125 |
| Total AFS securities | $7,748 | $609 | $8,833 | $2,186 | $16,581 | $2,795 |
| | | | | | | |
| Total number of AFS securities in an unrealized loss position | | | | | | 1,735 |

For information regarding our investments in VIEs, see Note 4.

We perform detailed analysis on the AFS securities backed by pools that are most at risk of impairment based on factors discussed in Note 1 in our 2009 Form 10-K. Selected information for these securities in a gross unrealized loss position (in millions) was as follows:

| | As of June 30, 2010 | | |
|---|---|---|---|
| | Amortized Cost | Fair Value | Unrealized Loss |
| Total | | | |
| AFS securities backed by pools of residential mortgages | $2,609 | $1,919 | $690 |
| AFS securities backed by pools of commercial mortgages | 792 | 498 | 294 |
| Total | $3,401 | $2,417 | $984 |
| | | | |
| Subject to Detailed Analysis | | | |
| AFS securities backed by pools of residential mortgages | $2,572 | $1,882 | $690 |
| AFS securities backed by pools of commercial mortgages | 203 | 70 | 133 |
| Total | $2,775 | $1,952 | $823 |

| | As of December 31, 2009 | | |
|---|---|---|---|
| | Amortized Cost | Fair Value | Unrealized Loss |
| Total | | | |
| AFS securities backed by pools of residential mortgages | $4,316 | $3,388 | $928 |
| AFS securities backed by pools of commercial mortgages | 1,220 | 841 | 379 |
| Total | $5,536 | $4,229 | $1,307 |
| | | | |
| Subject to Detailed Analysis | | | |
| AFS securities backed by pools of residential mortgages | $2,858 | $1,948 | $910 |
| AFS securities backed by pools of commercial mortgages | 311 | 164 | 147 |
| Total | $3,169 | $2,112 | $1,057 |

For the six months ended June 30, 2010 we recorded OTTI for AFS securities backed by pools of residential and commercial mortgages of $49 million, pre-tax, and before associated amortization expense for DAC, VOBA, DSI and deferred front-end loads ("DFEL"), of which $13 million was recognized in OCI and $62 million was recognized in net income (loss).

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

| | As of June 30, 2010 | | | |
|---|---|---|---|---|
| | Fair | Gross Unrealized | | Number of Securities |
| | Value | Losses | OTTI | (1) |
| Less than six months | $374 | $117 | $9 | 74 |
| Six months or greater, but less than nine months | 10 | 4 | 3 | 8 |
| Nine months or greater, but less than twelve months | 33 | 15 | - | 15 |
| Twelve months or greater | 1,394 | 947 | 196 | 277 |
| Total | $1,811 | $1,083 | $208 | 374 |

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| | As of December 31, 2009 | | | |
|---|---|---|---|---|
| | Fair | Gross Unrealized | | Number of Securities |
| | Value | Losses | OTTI | (1) |
| Less than six months | $434 | $130 | $4 | 81 |
| Six months or greater, but less than nine months | 118 | 61 | - | 25 |
| Nine months or greater, but less than twelve months | 427 | 165 | 100 | 96 |
| Twelve months or greater | 1,800 | 1,426 | 124 | 310 |
| Total | $2,779 | $1,782 | $228 | 512 |

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

We regularly review our investment holdings for OTTI. Based upon this review, the cause of the $1.0 billion decrease in our gross AFS securities unrealized losses for the six months ended June 30, 2010, which was attributable to a decline in overall market yields, which was driven, in part, by improved credit fundamentals (i.e., market improvement and narrowing credit spreads). As discussed further below, we believe the unrealized loss position as of June 30, 2010, does not represent OTTI as we did not intend to sell these fixed maturity AFS securities, it is not more likely than not that we will be required to sell the fixed maturity AFS securities before recovery of their amortized cost basis, the estimated future cash flows were equal to or greater than the amortized cost basis of the debt securities, or we had the ability and intent to hold the equity AFS securities for a period of time sufficient for recovery.

Based upon this evaluation as of June 30, 2010, management believed we had the ability to generate adequate amounts of cash from our normal operations (e.g., insurance premiums and fees and investment income) to meet cash requirements with a prudent margin of safety without requiring the sale of our temporarily-impaired securities.

As of June 30, 2010, the unrealized losses associated with our corporate bond securities were attributable primarily to securities that were backed by commercial loans and individual issuer companies. For our corporate bond securities with commercial loans as the underlying collateral, we evaluated the projected credit losses in the underlying collateral and concluded that we had sufficient subordination or other credit enhancement when compared with our estimate of credit losses for the individual security and we expected to recover the entire amortized cost for each security. For individual issuers, we performed detailed analysis of the financial performance of the issuer and determined that we expected to recover the entire amortized cost for each security.

As of June 30, 2010, the unrealized losses associated with our MBS and ABS CDOs were attributable primarily to collateral losses and credit spreads. We assessed for credit impairment using a cash flow model as discussed above. The key assumptions included default rates, severities and prepayment rates. We estimated losses for a security by forecasting the underlying loans in each transaction. The forecasted loan performance was used to project cash flows to the various tranches in the structure, as applicable. Our forecasted cash flows also considered, as applicable, independent industry analyst reports and forecasts, sector credit ratings and other independent market data. Based upon our assessment of the expected credit losses of the security given the performance of the underlying collateral compared to our subordination or other credit enhancement, we expected to recover the entire amortized cost basis of each security.

As of June 30, 2010, the unrealized losses associated with our hybrid and redeemable preferred securities were attributable primarily to wider credit spreads caused by illiquidity in the market and subordination within the capital structure, as well as credit risk of specific issuers. For our hybrid and redeemable preferred securities, we evaluated the financial performance of the issuer based upon credit performance and investment ratings and determined we expected to recover the entire amortized cost of each security.

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Balance as of beginning-of-period | $293 | $103 | $268 | $31 |
| Increases attributable to: | | | | |
| Credit losses on securities for which an OTTI was not previously recognized | 11 | 23 | 13 | 95 |
| Credit losses on securities for which an OTTI was previously recognized | - | 36 | 27 | 36 |
| Decreases attributable to: | | | | |
| Securities sold | (11) | - | (15) | - |
| Amounts recognized in net income (loss) | - | (30) | - | (30) |
| Balance as of end-of-period | $293 | $132 | $293 | $132 |

During the three and six months ended June 30, 2010, we recorded credit losses on securities for which an OTTI was not previously recognized as we determined the cash flows expected to be collected would not be sufficient to recover the entire amortized cost basis of the security. The credit losses we recorded on securities for which an OTTI was not previously recognized were attributable primarily to one or a combination of the following reasons:

- Failure of the issuer of the security to make scheduled payments;
- Deterioration of creditworthiness of the issuer;
- Deterioration of conditions specifically related to the security;
- Deterioration of fundamentals of the industry in which the issuer operates;
- Deterioration of fundamentals in the economy including, but not limited to, higher unemployment and lower housing prices; and
- Deterioration of the rating of the security by a rating agency.

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

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

| | As of June 30, 2010 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized OTTI | Fair Value | OTTI in Credit Losses |
| Corporate bonds | $147 | $57 | $90 | $52 |
| MBS CMOs | 399 | 131 | 268 | 241 |
| Total | $546 | $188 | $358 | $293 |

Mortgage Loans on Real Estate

Mortgage loans on real estate principally involve commercial real estate. The commercial loans are geographically diversified throughout the U.S. with the largest concentrations in California and Texas, which accounted for approximately 30% and 29% of mortgage loans as of June 30, 2010, and December 31, 2009, respectively. The number of impaired mortgage loans and the carrying value of impaired mortgage loans (dollars in millions) were as follows:

| | As of June 30, 2010 | As of December 31, 2009 |
|---|---|---|
| Number of impaired mortgage loans | 10 | 9 |
| | | |
| Impaired mortgage loans | $ 94 | $ 56 |
| Valuation allowance associated with impaired mortgage loans | (23) | (22) |
| Carrying value of impaired mortgage loans | $ 71 | $ 34 |

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Average carrying value for impaired loans | $59 | $26 | $49 | $13 |

For the three and six months ended June 30, 2010, we have recognized and collected less than $1 million of interest income on impaired mortgage loans. For the three and six months ended June 30, 2009, we did not recognize or collect interest income on impaired mortgage loans.

Alternative Investments

As of June 30, 2010, and December 31, 2009, alternative investments included investments in approximately 96 and 99 different partnerships, respectively, and the portfolio represented less than 1% of our overall invested assets.

Realized Gain (Loss) Related to Certain Investments

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Fixed maturity AFS securities: | | | | |
| Gross gains | $35 | $33 | $84 | $86 |
| Gross losses | (29) | (172) | (113) | (413) |

| | | | | |
|---|---|---|---|---|
| Equity AFS securities: | | | | |
| Gross gains | 5 | 1 | 6 | 4 |
| Gross losses | - | (6 ) | (4 ) | (9 ) |
| Gain (loss) on other investments | (8 ) | (58 ) | (29 ) | (60 ) |
| Associated amortization income (expense) of DAC, VOBA, DSI and DFEL and changes in other contract holder funds | (8 ) | 48 | (4 ) | 104 |
| Total realized gain (loss) related to certain investments | $(5 ) | $(154 ) | $(60 ) | $(288 ) |

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| OTTI Recognized in Net Income (Loss) | | | | |
| Fixed maturity securities: | | | | |
| Corporate bonds | $(5) | $(75) | $(46) | $(157) |
| MBS: | | | | |
| CMOs | (12) | (61) | (36) | (142) |
| ABS CDOs | - | (30) | (1) | (30) |
| Hybrid and redeemable preferred securities | - | - | (5) | (1) |
| Total fixed maturity securities | (17) | (166) | (88) | (330) |
| | | | | |
| Equity Securities | | | | |
| Other financial services securities | - | - | (3) | (3) |
| Other securities | - | (6) | - | (6) |
| Total equity securities | - | (6) | (3) | (9) |
| Gross OTTI recognized in net income (loss) | (17) | (172) | (91) | (339) |
| Associated amortization expense of DAC, VOBA, DSI and DFEL | 6 | 54 | 27 | 100 |
| Net OTTI recognized in net income (loss), pre-tax | $(11) | $(118) | $(64) | $(239) |
| | | | | |
| Portion of OTTI Recognized in OCI | | | | |
| Gross OTTI recognized in OCI | $- | $130 | $22 | $242 |
| Change in DAC, VOBA, DSI and DFEL | - | (27) | 2 | (50) |
| Net portion of OTTI recognized in OCI, pre-tax | $- | $103 | $24 | $192 |

Determination of Credit Losses on Corporate Bonds and ABS CDOs

As of June 30, 2010, we reviewed our corporate bond and ABS CDO portfolios for potential shortfall in contractual principal and interest based on numerous subjective and objective inputs.  The factors used to determine the amount of credit loss for each individual security, include, but are not limited to, near term risk, substantial discrepancy between book and market value, sector or company-specific volatility, negative operating trends and trading levels wider than peers.

Credit ratings express opinions about the credit quality of a security.  Securities rated investment grade, that is those rated BBB- or higher by Standard & Poor's ("S&P") Rating Services or Baa3 or higher by Moody's Investors Service, are generally considered by the rating agencies and market participants to be low credit risk.  As of June 30, 2010, 95% of the fair value of our corporate bond portfolio was rated investment grade.  As of June 30, 2010, the portion of our corporate bond portfolio rated below investment grade had an amortized cost of $2.7 billion and a fair value of $2.4 billion.  As of June 30, 2010, 78% of the fair value of our ABS CDO portfolio was rated investment grade.  As of June 30, 2010, the portion of our ABS CDO portfolio rated below investment grade had an amortized cost of $43 million and fair value $34 million.  Based upon the analysis discussed above, we believed as of June 30, 2010, that we would recover the amortized cost of each corporate bond and ABS CDO security.

For securities where we recorded an OTTI recognized in net income (loss) for the six months ended June 30, 2010, the recovery as a percentage of amortized cost was 80% for corporate bonds and 0% for ABS CDOs.

Determination of Credit Losses on MBS

As of June 30, 2010, default rates were projected by considering underlying MBS loan performance and collateral type. Projected default rates on existing delinquencies vary between 25% to 100% depending on loan type and severity of delinquency status. In addition, we estimate the potential contributions of currently performing loans that may become delinquent in the future based on the change in delinquencies and loan liquidations experienced in the recent history. Finally, we develop a default rate timing curve by aggregating the defaults for all loans (delinquent loans, foreclosure and real estate owned and new delinquencies from currently performing loans) in the pool to project the future expected cash flows.

We use certain available loan characteristics such as lien status, loan sizes and occupancy to estimate the loss severity of loans. Second lien loans are assigned 100% severity, if defaulted. For first lien loans, we assume a minimum of 30% loan severity with higher severity assumed for investor properties and further housing price depreciation.

Payables for Collateral on Investments

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

| | As of June 30, 2010 | | As of December 31, 2009 | |
|---|---|---|---|---|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Collateral payable held for derivative investments (1) | $1,421 | $1,421 | $617 | $617 |
| Securities pledged under securities lending agreements (2) | 188 | 180 | 501 | 479 |
| Securities pledged under reverse repurchase agreements (3) | 335 | 352 | 344 | 359 |
| Securities pledged for Term Asset-Backed Securities Loan Facility ("TALF") (4) | 332 | 377 | 345 | 386 |
| Securities pledged for Federal Home Loan Bank of Indianapolis Securities ("FHLBI") (5) | 100 | 112 | 100 | 111 |
| Total payables for collateral on investments | $2,376 | $2,442 | $1,907 | $1,952 |

(1) We obtain collateral based upon contractual provisions with our counterparties. These agreements take into consideration the counterparties' credit rating as compared to ours, the fair value of the derivative investments and specified thresholds that once exceeded result in the receipt of cash that is typically invested in cash and invested cash. See Note 6 for details about maximum collateral potentially required to post on our credit default swaps.
(2) Our pledged securities under securities lending agreements are included in fixed maturity AFS securities on our Consolidated Balance Sheets. We generally obtain collateral in an amount equal to 102% and 105% of the fair value of the domestic and foreign securities, respectively. We value collateral daily and obtain additional collateral when deemed appropriate. The cash received in our securities lending program is typically invested in cash and invested cash or fixed maturity AFS securities.
(3) Our pledged securities under reverse repurchase agreements are included in fixed maturity AFS securities on our Consolidated Balance Sheets. We obtain collateral in an amount equal to 95% of the fair value of the securities, and our agreements with third parities contain contractual provisions to allow for additional collateral to be obtained when necessary. The cash received in our reverse repurchase program is typically invested in fixed maturity AFS securities.
(4) Our pledged securities for TALF are included in fixed maturity AFS securities on our Consolidated Balance Sheets. We obtain collateral in an amount that has typically averaged 90% of the fair value of the TALF securities. The cash received in these transactions is invested in fixed maturity AFS securities.
(5)

Our pledged securities for FHLBI are included in fixed maturity AFS securities on our Consolidated Balance Sheets. We generally obtain collateral in an amount equal to 85% to 95% of the fair value of the FHLBI securities. The cash received in these transactions is typically invested in cash and invested cash or fixed maturity AFS securities.

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

| | For the Six Months Ended June 30, | |
|---|---|---|
| | 2010 | 2009 |
| Collateral payable held for derivative investments | $ 804 | $ (2,119 ) |
| Securities pledged under securities lending agreements | (313 ) | 10 |
| Securities pledged under reverse repurchase agreements | (9 ) | (124 ) |
| Securities pledged for TALF | (13 ) | 139 |
| Securities pledged for FHLBI | - | 100 |
| Total increase (decrease) in payables for collateral on investments | $ 469 | $ (1,994) |

Investment Commitments

As of June 30, 2010, our investment commitments for fixed maturity AFS securities (primarily private placements), limited partnerships, real estate and mortgage loans on real estate were $810 million, which included $343 million of limited partnerships, $86 million of standby commitments to purchase real estate upon completion and leasing, $305 million of private placements and $76 million of mortgage loans.

Concentrations of Financial Instruments

As of June 30, 2010, and December 31, 2009, our most significant investments in one issuer were our investments in securities issued by the Federal Home Loan Mortgage Corporation with a fair value of $5.5 billion and $4.8 billion, or 7% and 6% of our invested assets portfolio, respectively, and our investments in securities issued by Fannie Mae with a fair value of $2.9 billion and $3.0 billion, or 4% of our invested assets portfolio, respectively.  These investments are included in corporate bonds in the tables above.

As of June 30, 2010, and December 31, 2009, our most significant investment in one industry was our investment securities in the CMO industry with a fair value of $6.9 billion, or 9% of the invested assets portfolios.  We utilized the industry classifications to obtain the concentration of financial instruments amount, as such, this amount will not agree to the AFS securities table above.

6.  Derivative Instruments

Types of Derivative Instruments and Derivative Strategies

We maintain an overall risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate risk, foreign currency exchange risk, equity market risk, default risk, basis risk and credit risk.  We assess these risks by continually identifying and monitoring changes in interest rate exposure, foreign currency exposure, equity market exposure and credit exposure that may adversely impact expected future cash flows and by evaluating hedging opportunities. Derivative instruments that are used as part of our interest rate risk management strategy include interest rate swap agreements, interest rate futures, interest rate cap agreements, forward-starting interest rate swaps, consumer price index swaps, interest rate cap corridors and treasury locks.  Derivative instruments that are used as part of our foreign currency risk management strategy include foreign currency swaps, currency futures and foreign currency forwards.  Call options based on our stock, call options based on the S&P 500 Index® (“S&P 500”), total return swaps, variance swaps, equity collars, put options and equity futures are used as part of our equity market risk management strategy.  We also use credit default swaps as part of our credit risk management strategy.

We evaluate and recognize our derivative instruments in accordance with the Derivatives and Hedging Topic of the FASB ASC. As of June 30, 2010, we had derivative instruments that were designated and qualifying as cash flow hedges and fair value hedges. We also had embedded derivatives that did not qualify as hedging instruments and derivative instruments that were economic hedges, but were not designed to meet the requirements to be accounted for as a hedge. See Note 1 in our 2009 Form 10-K for a detailed discussion of the accounting treatment for derivative instruments.

Our derivative instruments are monitored by our Asset Liability Management Committee and our Equity Risk Management Committee as part of those committees' oversight of our derivative activities. Our committees are responsible for implementing various hedging strategies that are developed through their analysis of financial simulation models and other internal and industry sources. The resulting hedging strategies are incorporated into our overall risk management strategies.

We use a hedging strategy designed to mitigate the risk and income statement volatility caused by changes in the equity markets, interest rates and volatility associated with living benefit guarantees offered in our variable annuity products, including the Lincoln SmartSecurity® Advantage guaranteed withdrawal benefit ("GWB") feature, the 4LATER® Advantage guaranteed income benefit ("GIB") feature and the i4LIFE® Advantage GIB feature. See "Guaranteed Living Benefit Embedded Derivative Reserves" below for further details.

See Note 14 for additional disclosures related to the fair value of our financial instruments and see Note 4 for derivative instruments related to our consolidated VIEs.

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

| | As of June 30, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Number of Instruments | Notional Amounts | Asset Carrying or Fair Value Gain | Asset Carrying or Fair Value Loss | (Liability) Carrying or Fair Value Gain | (Liability) Carrying or Fair Value Loss |
| Derivative Instruments Designated and Qualifying as Hedging Instruments | | | | | | |
| Cash flow hedges: | | | | | | |
| Interest rate swap agreements (1) | 144 | $879 | $25 | $(95) | $- | $- |
| Foreign currency swaps (1) | 13 | 340 | 59 | (7) | - | - |
| Total cash flow hedges | 157 | 1,219 | 84 | (102) | - | - |
| Fair value hedges: | | | | | | |
| Interest rate swap agreements (2) | 4 | 1,175 | 118 | - | - | (118) |
| Equity collars (1) | 1 | 49 | 138 | - | - | - |
| Total fair value hedges | 5 | 1,224 | 256 | - | - | (118) |
| Total derivative instruments designated and qualifying as hedging instruments | 162 | 2,443 | 340 | (102) | - | (118) |
| Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments | | | | | | |
| Interest rate cap agreements (1) | 15 | 750 | - | - | - | - |
| Interest rate futures (1) | 22,425 | 3,476 | - | - | - | - |
| Equity futures (1) | 31,638 | 1,721 | - | - | - | - |
| Interest rate swap agreements (1) | 93 | 7,843 | 271 | (378) | - | - |
| Credit default swaps (3) | 10 | 160 | - | - | - | (30) |
| Total return swaps (1) | 8 | 750 | 55 | - | - | - |
| Put options (1) | 124 | 4,790 | 1,467 | - | - | - |
| Call options (based on S&P 500) (1) | 545 | 3,672 | 164 | - | - | - |
| Variance swaps (1) | 30 | 22 | 138 | (1) | - | - |
| Currency futures (1) | 2,891 | 371 | - | - | - | - |
| Consumer price index swaps (1) | 50 | 44 | - | (2) | - | - |
| Interest rate cap corridors (1) | 39 | 5,400 | 24 | - | - | - |
| Embedded derivatives: | | | | | | |
| Deferred compensation plans (3) | 6 | - | - | - | - | (319) |
| Indexed annuity contracts (4) | 118,663 | - | - | - | - | (383) |
| GLB embedded derivative reserves (4) | 283,949 | - | - | - | 334 | (2,003) |
| Reinsurance related embedded derivatives (5) | - | - | - | - | - | (92) |
| | 1 | - | 13 | - | - | - |

| | | | | | | |
|---|---|---|---|---|---|---|
| AFS securities embedded derivatives (1) | | | | | | |
| Total derivative instruments not designated and not qualifying as hedging instruments | 460,487 | 28,999 | 2,132 | (381) | 334 | (2,827) |
| Total derivative instruments | 460,649 | $31,442 | $2,472 | $(483) | $334 | $(2,945) |

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| | Number of Instruments | Notional Amounts | As of December 31, 2009 Asset Carrying or Fair Value Gain | Asset Carrying or Fair Value Loss | (Liability) Carrying or Fair Value Gain | (Liability) Carrying or Fair Value Loss |
|---|---|---|---|---|---|---|
| Derivative Instruments Designated and Qualifying as Hedging Instruments | | | | | | |
| Cash flow hedges: | | | | | | |
| Interest rate swap agreements (1) | 85 | $ 620 | $ 24 | $ (45 ) | $ - | $ - |
| Foreign currency swaps (1) | 13 | 340 | 33 | (19 ) | - | - |
| Total cash flow hedges | 98 | 960 | 57 | (64 ) | - | - |
| Fair value hedges: | | | | | | |
| Interest rate swap agreements (2) | 1 | 375 | 54 | - | - | (54 ) |
| Equity collars (1) | 1 | 49 | 135 | - | - | - |
| Total fair value hedges | 2 | 424 | 189 | - | - | (54 ) |
| Total derivative instruments designated and qualifying as hedging instruments | 100 | 1,384 | 246 | (64 ) | - | (54 ) |
| Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments | | | | | | |
| Interest rate cap agreements (1) | 20 | 1,000 | - | - | - | - |
| Interest rate futures (1) | 19,073 | 2,333 | - | - | - | - |
| Equity futures (1) | 21,149 | 1,147 | - | - | - | - |
| Interest rate swap agreements (1) | 81 | 6,232 | 63 | (349 ) | - | - |
| Foreign currency forwards (1) | 19 | 1,016 | 12 | (110 ) | - | - |
| Credit default swaps (2) | 14 | 220 | - | - | - | (65 ) |
| Total return swaps (1) | 2 | 156 | - | - | - | - |
| Put options (1) | 114 | 4,093 | 934 | - | - | - |
| Call options (based on LNC stock) (1) | 1 | 9 | - | - | - | - |
| Call options (based on S&P 500) (1) | 559 | 3,440 | 215 | - | - | - |

| | | | | | | |
|---|---|---|---|---|---|---|
| Variance swaps (1) | 36 | 26 | 66 | (22 ) | - | - |
| Currency futures (1) | 3,664 | 505 | - | - | - | - |
| Embedded derivatives: | | | | | | |
| Deferred compensation plans (3) | 6 | - | - | - | - | (332 ) |
| Indexed annuity contracts (4) | 108,119 | - | - | - | - | (419 ) |
| GLB embedded derivative reserves (4) | 261,309 | - | - | - | 308 | (984 ) |
| Reinsurance related embedded derivatives (5) | - | - | - | - | - | (31 ) |
| AFS securities embedded derivatives (1) | 2 | - | 19 | - | - | - |
| Total derivative instruments not designated and not qualifying as hedging instruments | 414,168 | 20,177 | 1,309 | (481 ) | 308 | (1,831 ) |
| Total derivative instruments | 414,268 | $ 21,561 | $ 1,555 | $ (545 ) | $ 308 | $ (1,885 ) |

(1) Reported in derivative investments on our Consolidated Balance Sheets.
(2) The asset is reported in derivative investments and the liability in long-term debt on our Consolidated Balance Sheets.
(3) Reported in other liabilities on our Consolidated Balance Sheets.
(4) Reported in future contract benefits on our Consolidated Balance Sheets.
(5) Reported in reinsurance related embedded derivatives on our Consolidated Balance Sheets.

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

| | Remaining Life as of June 30, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 1 Year | 1 – 5 Years | 5 – 10 Years | 10 – 30 Years | Over 30 Years | Total |
| Derivative Instruments Designated and Qualifying as Hedging Instruments | | | | | | |
| Cash flow hedges: | | | | | | |
| Interest rate swap agreements | $- | $73 | $247 | $531 | $28 | $879 |
| Foreign currency swaps | - | 94 | 165 | 81 | - | 340 |
| Total cash flow hedges | - | 167 | 412 | 612 | 28 | 1,219 |
| Fair value hedges: | | | | | | |
| Interest rate swap agreements | - | 800 | - | 375 | - | 1,175 |
| Equity collars | 49 | - | - | - | - | 49 |
| Total fair value hedges | 49 | 800 | - | 375 | - | 1,224 |
| Total derivative instruments designated and qualifying as hedging instruments | 49 | 967 | 412 | 987 | 28 | 2,443 |
| Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments | | | | | | |
| Interest rate cap agreements | 750 | - | - | - | - | 750 |
| Interest rate futures | 3,476 | - | - | - | - | 3,476 |
| Equity futures | 1,721 | - | - | - | - | 1,721 |
| Interest rate swap agreements | 138 | 2,087 | 2,154 | 3,464 | - | 7,843 |
| Credit default swaps | - | 40 | 120 | - | - | 160 |
| Total return swaps | 500 | 250 | - | - | - | 750 |
| Put options | - | 1,514 | 3,276 | - | - | 4,790 |
| Call options (based on S&P 500) | 2,865 | 807 | - | - | - | 3,672 |
| Variance swaps | - | 2 | 20 | - | - | 22 |
| Currency futures | 371 | - | - | - | - | 371 |
| Consumer price index swaps | 3 | 11 | 12 | 16 | 2 | 44 |
| Interest rate cap corridors | - | - | 5,400 | - | - | 5,400 |
| Total derivative instruments not designated and not qualifying as hedging instruments | 9,824 | 4,711 | 10,982 | 3,480 | 2 | 28,999 |
| Total derivative instruments with notional amounts | $9,873 | $5,678 | $11,394 | $4,467 | $30 | $31,442 |

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

| | For the Six Months Ended June 30, | |
|---|---|---|
| | 2010 | 2009 |
| Unrealized Gain (Loss) on Derivative Instruments | | |
| Balance as of beginning-of-year | $11 | $127 |
| Other comprehensive income (loss): | | |
| Unrealized holding gains (losses) arising during the period: | | |
| Cash flow hedges: | | |
| Interest rate swap agreements | (41) | 29 |
| Foreign currency swaps | 3 | (21) |
| Forward-starting interest rate swaps | - | 2 |
| Treasury locks | (29) | - |
| Fair value hedges: | | |
| Interest rate swap agreements | 2 | 2 |
| Net investment in foreign subsidiary | - | (80) |
| Change in foreign exchange rate adjustment | 32 | (16) |
| Change in DAC, VOBA, DSI and DFEL | 3 | 21 |
| Income tax benefit (expense) | 11 | (5) |
| Less: | | |
| Reclassification adjustment for gains (losses) included in net income: | | |
| Cash flow hedges: | | |
| Interest rate swap agreements (1) | 9 | 3 |
| Foreign currency swaps (1) | 1 | 1 |
| Treasury locks (2) | (2) | - |
| Fair value hedges: | | |
| Interest rate swap agreements (2) | 2 | 2 |
| Associated amortization of DAC, VOBA, DSI and DFEL | (1) | 1 |
| Income tax expense | (3) | (2) |
| Balance as of end-of-period | $(14) | $54 |

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

The gains (losses) on derivative instruments (in millions) recorded on our Consolidated Statements of Income (Loss) were as follows:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Derivative Instruments Designated and Qualifying as Hedging Instruments | | | | |
| Cash flow hedges: | | | | |
| Interest rate swap agreements (1) | $6 | $1 | $8 | $2 |
| Foreign currency swaps (1) | - | - | 1 | 1 |
| Total cash flow hedges | 6 | 1 | 9 | 3 |
| Fair value hedges: | | | | |
| Interest rate swap agreements (2) | 9 | 3 | 17 | 7 |
| Total derivative instruments designated and qualifying as hedging instruments | 15 | 4 | 26 | 10 |
| Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments | | | | |
| Interest rate cap corridors (3) | (11) | - | (11) | - |
| Interest rate futures (3) | 179 | (255) | 214 | (583) |
| Equity futures (3) | 105 | (563) | 12 | (314) |
| Interest rate swap agreements (3) | 322 | (468) | 303 | (779) |
| Foreign currency forwards (1) | - | (88) | 43 | (83) |
| Credit default swaps (1) | (17) | (7) | (7) | (23) |
| Total return swaps (4) | 47 | 18 | 51 | 9 |
| Put options (3) | 493 | (455) | 383 | (410) |
| Call options (based on S&P 500) (3) | (79) | 20 | (43) | 2 |
| Variance swaps (3) | 140 | (53) | 94 | (84) |
| Currency futures (3) | 8 | (1) | (7) | (1) |
| Consumer price index swaps (3) | 1 | - | - | - |
| Embedded derivatives: | | | | |
| Deferred compensation plans (4) | 9 | (26) | 1 | (21) |
| Indexed annuity contracts (3) | 56 | (11) | 15 | 11 |
| GLB embedded derivative reserves (3) | (1,174) | 1,533 | (993) | 1,832 |
| Reinsurance related embedded derivatives (3) | (46) | (61) | (62) | 15 |
| AFS securities embedded derivatives (1) | (1) | 2 | - | 3 |
| Total derivative instruments not designated and not qualifying as hedging instruments | 32 | (415) | (7) | (426) |
| Total derivative instruments | $47 | $(411) | $19 | $(416) |

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

The location in the Consolidated Statements of Income (Loss) where the gains (losses) are recorded for each of the derivative instruments discussed below is specified in the table above.

Derivative Instruments Designated and Qualifying as Cash Flow Hedges

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Ineffective portion recognized in realized gain (loss) | $- | $(1) | $- | $(1) |
| Gain (loss) recognized as a component of OCI with the offset to net investment income | 7 | 2 | 10 | 4 |

As of June 30, 2010, $2 million of the deferred net gains on derivative instruments in accumulated OCI were expected to be reclassified to earnings during the next twelve months. This reclassification would be due primarily to the receipt of interest payments associated with variable rate securities and forecasted purchases, payment of interest on our senior debt, the receipt of interest payments associated with foreign currency securities and the periodic vesting of stock appreciation rights ("SARs").

For the three months and six months ended June 30, 2010, there were no material reclassifications to earnings due to hedged firm commitments no longer deemed probable or due to hedged forecasted transactions that had not occurred by the end of the originally specified time period.

Interest Rate Swap Agreements

We use a portion of our interest rate swap agreements to hedge the interest rate risk of our exposure to floating rate bond coupon payments, replicating a fixed rate bond. An interest rate swap is a contractual agreement to exchange payments at one or more times based on the actual or expected price level, performance or value of one or more underlying interest rates. We are required to pay the counterparty the stream of variable interest payments based on the coupon payments from the hedged bonds, and in turn, receive a fixed payment from the counterparty at a predetermined interest rate. The gains or losses on interest rate swaps hedging our interest rate exposure on floating rate bond coupon payments are reclassified from accumulated OCI to net income (loss) as the related bond interest is accrued.

In addition, we use interest rate swap agreements to hedge our exposure to fixed rate bond coupon payments and the change in underlying asset values as interest rates fluctuate.

As of June 30, 2010, the latest maturity date for which we were hedging our exposure to the variability in future cash flows for these instruments was June 2042.

Foreign Currency Swaps

We use foreign currency swaps, which are traded over-the-counter, to hedge some of the foreign exchange risk of investments in fixed maturity securities denominated in foreign currencies. A foreign currency swap is a contractual agreement to exchange the currencies of two different countries at a specified rate of exchange in the future. The gains or losses on foreign currency swaps hedging foreign exchange risk exposure on foreign currency bond coupon payments are reclassified from accumulated OCI to net income (loss) as the related bond interest is accrued.

As of June 30, 2010, the latest maturity date for which we were hedging our exposure to the variability in future cash flows for these instruments was July 2022.

Derivative Instruments Designated and Qualifying as Fair Value Hedges

We designate and account for interest rate swap agreements and equity collars as fair value hedges, when they have met the requirements of the Derivatives and Hedging Topic of the FASB ASC. Information related to our fair value hedges (in millions) was as follows:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Ineffective portion recognized in realized gain (loss) | $- | $1 | $1 | $- |
| Gain (loss) recognized as a component of OCI with the offset to interest expense | 1 | 1 | 2 | 2 |

Interest Rate Swap Agreements

We use a portion of our interest rate swap agreements to hedge the risk of paying a higher fixed rate of interest on junior subordinated debentures issued to affiliated trusts and on senior debt than would be paid on long-term debt based on current interest rates in the marketplace. We are required to pay the counterparty a stream of variable interest payments based on the referenced index, and in turn, we receive a fixed payment from the counterparty at a predetermined interest rate. The net receipts or payments earned or owed from these interest rate swaps are recorded as an adjustment to the interest expense for the debt being hedged in the period it occurs. The changes in fair value of the interest rate swap agreements are recorded as an offsetting adjustment to derivative investments and long-term debt on our Consolidated Balance Sheets.

Equity Collars

We used an equity collar on four million shares of our Bank of America ("BOA") stock holdings. The equity collar is structured such that we purchased a put option on the BOA stock and simultaneously sold a call option with the identical maturity date as the put option. This structure effectively protects us from a price decline in the stock while allowing us to participate in some of the upside if the BOA stock appreciates over the time of the transaction. With the equity collar in place, we are able to pledge the BOA stock as collateral, which then allows us to advance a substantial portion of the stock's value, effectively monetizing the stock for liquidity purposes. This variable forward contract is scheduled to settle in September 2010, at which time we will be required to deliver shares or cash. If we choose to settle in shares, the number of shares to be delivered will be determined based on the volume-weighted average price of BOA common stock over a period of 10 trading days prior to settlement. The change in fair value of the equity collar is recorded in the period of change, along with the offsetting changes (when applicable) in fair value of the stock being hedged.

Derivative Instruments Designated and Qualifying as a Net Investment in a Foreign Subsidiary

We used foreign currency forwards to hedge a portion of our net investment in our former foreign subsidiary, Lincoln UK. The foreign currency forwards obligated us to deliver a specified amount of currency at a future date at a specified exchange rate. The foreign currency forwards outstanding as of December 31, 2008, were terminated on February 5, 2009. The gain on the termination of the foreign currency forwards of $38 million was recorded in OCI. During 2009, we entered into foreign currency forwards to hedge a significant portion of the foreign currency fluctuations associated with the expected proceeds from the sale of Lincoln UK. The loss upon the termination of these foreign currency contracts of $12 million was also recorded in OCI, and, subsequently, the OCI amounts above were recorded in income (loss) from discontinued operations, net of federal income taxes on our Consolidated Statements of Income (Loss) when the derivative instrument was terminated.

Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments

We use various other derivative instruments for risk management and income generation purposes that either do not qualify for hedge accounting treatment or have not currently been designated by us for hedge accounting treatment.

Interest Rate Cap Agreements

We use interest rate cap agreements to provide a level of protection from the effect of rising interest rates for our annuity business, within our Retirement Solutions – Annuities and Retirement Solutions – Defined Contribution segments. Interest rate cap agreements entitle us to receive quarterly payments from the counterparties on specified future reset dates, contingent on future interest rates. For each cap, the amount of such quarterly payments, if any, is determined by the excess of a market interest rate over a specified cap rate, multiplied by the notional amount divided by four. Our interest rate cap agreements provide an economic hedge of our annuity business. However, the interest rate cap agreements do not qualify for hedge accounting treatment.

Interest Rate Futures and Equity Futures

We use interest rate futures and equity futures contracts to hedge the liability exposure on certain options in variable annuity products. These futures contracts require payment between our counterparty and us on a daily basis for changes in the futures index price.

Interest Rate Swap Agreements

We use interest rate swap agreements to hedge the liability exposure on certain options in variable annuity products.

Foreign Currency Forwards

We used foreign currency forward contracts to hedge dividends received from our former subsidiary, Lincoln UK. The foreign currency forward contracts obligated us to deliver a specified amount of currency at a future date and a specified exchange rate. The contracts did not qualify for hedge accounting under the Derivatives and Hedging Topic of the FASB ASC.

Credit Default Swaps

We buy credit default swaps to hedge against a drop in bond prices due to credit concerns of certain bond issuers. A credit default swap allows us to put the bond back to the counterparty at par upon a default event by the bond issuer. A default event is defined as bankruptcy, failure to pay, obligation acceleration or restructuring. Our credit default swaps are not currently qualified for hedge accounting treatment.

We sold credit default swaps to offer credit protection to contract holders and investors. The credit default swaps hedge the contract holders and investors against a drop in bond prices due to credit concerns of certain bond issuers. A credit default swap allows the investor to put the bond back to us at par upon a default event by the bond issuer. A default event is defined as bankruptcy, failure to pay, obligation acceleration or restructuring.

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

| | | | As of June 30, 2010 | | | |
|---|---|---|---|---|---|---|
| Maturity | Reason for Entering | Nature of Recourse | Credit Rating of Under-lying Obligation (1) | Number of Instruments | Fair Value (2) | Maximum Potential Payout |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 12/20/2012 | | | | | | | |
| (3) | (5) | (6) | BBB+ | 4 | $ | - $ | 40 |
| 12/20/2016 | | | | | | | |
| (4) | (5) | (6) | BBB+ | 3 | | (20) | 65 |
| 03/20/2017 | | | | | | | |
| (4) | (5) | (6) | BBB- | 3 | | (10) | 55 |
| | | | | 10 | $ | (30) $ | 160 |

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| Maturity | Reason for Entering | Nature of Recourse | As of December 31, 2009<br>Credit Rating of Under-lying Obligation (1) | Number of Instruments | | Fair Value (2) | | Maximum Potential Payout |
|---|---|---|---|---|---|---|---|---|
| 03/20/2010 (3) | (7) | (6) | A- | 1 | $ | - | $ | 10 |
| 06/20/2010 (3) | (7) | (6) | A | 1 | | - | | 10 |
| 12/20/2012 (3) | (5) | (6) | BBB+ | 4 | | - | | 40 |
| 12/20/2016 (4) | (5) | (6) | B- | 2 | | (19) | | 48 |
| 03/20/2017 (4) | (5) | (6) | BB+ | 6 | | (46) | | 112 |
| | | | | 14 | $ | (65) | $ | 220 |

(1) Represents average credit ratings based on the midpoint of the applicable ratings among Moody's, S&P, and Fitch.
(2) Broker quotes are used to determine the market value of credit default swaps.
(3) These credit default swaps were sold to our contract holders, prior to 2007, where we determined there was a spread versus premium mismatch.
(4) These credit default swaps were sold to a counter party of the consolidated VIEs as discussed in Note 4.
(5) Credit default swap was entered into in order to generate income by providing default protection in return for a quarterly payment.
(6) Seller does not have the right to demand indemnification or compensation from third parties in case of a loss (payment) on the contract.
(7) Credit default swap was entered into in order to generate income by providing protection on a highly rated basket of securities in return for a quarterly payment.

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

| | | As of June 30, 2010 | | As of December 31, 2009 |
|---|---|---|---|---|
| Maximum potential payout | $ | 160 | $ | 220 |
| Less: | | | | |
| Counterparty thresholds | | 10 | | 30 |
| Maximum collateral potentially required to post | $ | 150 | $ | 190 |

Certain of our credit default swap agreements contain contractual provisions that allow for the netting of collateral with our counterparties related to all of our collateralized financing transactions that we have outstanding. If these netting agreements were not in place, we would have been required to post approximately $30 million as of June 30, 2010, after considering the fair values of the associated investments counterparties' credit ratings as compared to ours and specified thresholds that once exceeded result in the payment of cash.

Total Return Swaps

We use total return swaps to hedge 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.

Put Options

We use put options to hedge the liability exposure on certain options in variable annuity products. Put options are contracts that require counterparties to pay us at a specified future date the amount, if any, by which a specified equity index is less than the strike rate stated in the agreement, applied to a notional amount.

Call Options (Based on LNC Stock)

We use call options on our stock to hedge the expected increase in liabilities arising from SARs granted on our stock. Call options hedging vested SARs are not eligible for hedge accounting treatment.

Call Options (Based on S&P 500)

We use indexed annuity contracts to permit the holder to elect an interest rate return or an equity market component, where interest credited to the contracts is linked to the performance of the S&P 500. Contract holders may elect to rebalance index options at renewal dates, either annually or biannually. As of each renewal date, we have the opportunity to re-price the indexed component by establishing participation rates, subject to minimum guarantees. We purchase call options that are highly correlated to the portfolio allocation decisions of our contract holders, such that we are economically hedged with respect to equity returns for the current reset period. The mark-to-market of the options held generally offsets the change in value of the embedded derivative within the indexed annuity.

Variance Swaps

We use variance swaps to hedge the liability exposure on certain options in variable annuity products. Variance swaps are contracts entered into at no cost and whose payoff is the difference between the realized variance of an underlying index and the fixed variance rate determined as of inception.

Currency Futures

We use currency futures to hedge foreign exchange risk associated with certain options in variable annuity products. Currency futures exchange one currency for another at a specified date in the future at a specified exchange rate. These contracts do not qualify for hedge accounting treatment.

Consumer Price Index Swaps

We use consumer price index swaps to hedge the liability exposure on certain options in fixed/indexed annuity products. Consumer price index swaps are contracts entered into at no cost and whose payoff is the difference between the consumer price index inflation rate and the fixed rate determined as of inception.

Interest Rate Cap Corridors

We use interest rate cap corridors to provide a level of protection from the effect of rising interest rates for our annuity business, within our Retirement Solutions – Annuities and Retirement Solutions – Defined Contribution segments. Interest rate cap corridors involve purchasing an interest rate cap at a specific cap rate and selling an interest rate cap with a higher cap rate. For each corridor, the amount of quarterly payments, if any, is determined by the rate at which the underlying index rate resets above the original capped rate. The corridor limits the benefit the purchaser can receive as the related interest rate index rises above the higher capped rate. There is no additional liability to us other than the purchase price associated with the interest rate cap corridor. Our interest rate cap corridors provide an economic hedge of our annuity business. However, the interest rate cap corridors do not qualify for hedge accounting treatment.

Embedded Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments

Deferred Compensation Plans

We have certain deferred compensation plans that have embedded derivative instruments. The liability related to these plans varies based on the investment options selected by the participants. The liability related to certain investment options selected by the participants is marked-to-market through net income (loss).

Indexed Annuity Contracts

We distribute indexed annuity contracts that permit the holder to elect an interest rate return or an equity market component, where interest credited to the contracts is linked to the performance of the S&P 500. This feature represents an embedded derivative under the Derivatives and Hedging Topic of the FASB ASC. Contract holders may elect to rebalance index options at renewal dates, either annually or biannually. As of each renewal date, we have the opportunity to re-price the indexed component by establishing participation rates, subject to minimum guarantees. We purchase S&P 500 call options that are highly correlated to the portfolio allocation decisions of our contract holders, such that we are economically hedged with respect to equity returns for the current reset period. The mark-to-market of the options held generally offsets the change in value of the embedded derivative within the indexed annuity.

Guaranteed Living Benefit ("GLB") Embedded Derivative Reserves

We have certain GLB variable annuity products with GWB and GIB features that are embedded derivatives. Certain features of these guarantees, notably our GIB, 4LATER® and Lincoln Lifetime IncomeSMAdvantage features, have elements of both insurance benefits accounted for under the Financial Services – Insurance – Claim Costs and Liabilities for Future Policy Benefits Subtopic of the FASB ASC ("benefit reserves") and embedded derivatives accounted for under the Derivatives and Hedging and the Fair Value Measurements and Disclosures Topics of the FASB ASC ("embedded derivative reserves"). We calculate the value of the embedded derivative reserve and the benefit reserve based on the specific characteristics of each GLB feature. As of June 30, 2010, we had $24.4 billion of account values that were attributable to variable annuities with a GWB feature and $9.4 billion of account values that were attributable to variable annuities with a GIB feature.

We use a hedging strategy designed to mitigate the risk and income statement volatility caused by changes in the equity markets, interest rates and volatility associated with GWB and GIB features. The hedging strategy is designed such that changes in the value of the hedge contracts due to changes in equity markets, interest rates and implied volatilities move in the opposite direction of changes in embedded derivative reserves of the GWB and GIB caused by those same factors. As part of our current hedging program, equity markets, interest rates and volatility in market conditions are monitored on a daily basis. We rebalance our hedge positions based upon changes in these factors as needed. While we actively manage our hedge positions, these hedge positions may not be totally effective in offsetting changes in the embedded derivative reserve due to, among other things, differences in timing between when a market exposure changes and corresponding changes to the hedge positions, extreme swings in the equity markets and interest rates, market volatility, contract holder behavior, divergence between the performance of the underlying funds and the hedging indices, divergence between the actual and expected performance of the hedge instruments and our ability to purchase hedging instruments at prices consistent with our desired risk and return trade-off.

Reinsurance Related Embedded Derivatives

We have certain modified coinsurance arrangements and coinsurance with funds withheld reinsurance arrangements with embedded derivatives related to the withheld assets of the related funds. These derivatives are considered total return swaps with contractual returns that are attributable to various assets and liabilities associated with these reinsurance arrangements. Changes in the estimated fair value of these derivatives as they occur are recorded through net income (loss). Offsetting these amounts are corresponding changes in the estimated fair value of trading securities in portfolios that support these arrangements. During the first quarter of 2009, the portion of the embedded derivative liability related to the funds withheld reinsurance agreement on our disability income business was released due to the rescission of the underlying reinsurance agreement.

AFS Securities Embedded Derivatives

We own various debt securities that either contain call options to exchange the debt security for other specified securities of the borrower, usually common stock, or contain call options to receive the return on equity-like indexes. The change in fair value of these embedded derivatives flows through net income (loss).

Credit Risk

We are exposed to credit loss in the event of nonperformance by our counterparties on various derivative contracts and reflect assumptions regarding the credit or nonperformance risk. The nonperformance risk is based upon assumptions for each counterparty's credit spread over the estimated weighted average life of the counterparty exposure less collateral held. As of June 30, 2010, the nonperformance risk adjustment was $14 million. The credit risk associated with such agreements is minimized by purchasing such agreements from financial institutions with long-standing, superior performance records. Additionally, we maintain a policy of requiring all derivative contracts to be governed by an International Swaps and Derivatives Association ("ISDA") Master Agreement. We are required to maintain minimum ratings as a matter of routine practice in negotiating ISDA agreements. Under some ISDA agreements, our insurance subsidiaries have agreed to maintain certain financial strength or claims-paying ratings. A downgrade below these levels could result in termination of the derivatives contract, at which time any amounts payable by us would be dependent on the market value of the underlying derivative contract. In certain transactions, we and the counterparty have entered into a collateral support agreement requiring either party to post collateral when net exposures exceed pre-determined thresholds. These thresholds vary by counterparty and credit rating. We do not believe the inclusion of termination or collateralization events pose any material threat to the liquidity position of any insurance subsidiary of the Company. The amount of such exposure is essentially the net replacement cost or market value less collateral held for such agreements with each counterparty if the net market value is in our favor. As of June 30, 2010, the exposure was $308 million. The amounts recognized (in millions) by S&P credit rating of counterparty, for which we had the right to reclaim cash collateral or were obligated to return cash collateral, were as follows:

| | As of June 30, 2010 | | As of December 31, 2009 | |
|---|---|---|---|---|
| S&P Credit Rating of Counterparty | Collateral Posted by Counterparty (Held by LNC) | Collateral Posted by LNC (Held by Counter-party) | Collateral Posted by Counterparty (Held by LNC) | Collateral Posted by LNC (Held by Counter-party) |
| AAA | $ 19 | $ - | $ 3 | $ - |
| AA | 302 | - | 140 | - |
| AA- | 478 | - | 272 | (17) |
| A+ | 326 | (34) | 171 | (13) |
| A | 643 | (100) | 331 | (240) |
| | $ 1,768 | $ (134) | $ 917 | $ (270) |

7. Federal Income Taxes

The effective tax rate is a ratio of tax expense over pre-tax income (loss). The effective tax rate was 24% and 25% for the three and six months ended June 30, 2010, respectively. Because the pre-tax loss of $53 million and $716 million resulted in a tax benefit of $46 million and $122 million for the three and six months ended June 30, 2009, respectively, the effective tax rate was not meaningful. The effective tax rate on pre-tax income (loss) from continuing operations was lower than the prevailing corporate federal income tax rate. Differences in the effective rates and the U.S. statutory rate of 35% were the result of certain tax preferred investment income, separate account dividends-received deduction ("DRD"), foreign tax credits and other tax preference items. In addition, during the six months ended June 30, 2009, the effective tax rate was also impacted as a result of the goodwill impairment related to our Retirement Solutions – Annuities reporting segment, which did not have a corresponding tax effect.

Federal income tax benefit for the first six months of 2009 included an increase of $56 million related to favorable adjustments from the 2008 tax return, filed in the first quarter of 2009, relating primarily to the separate account DRD, foreign tax credits and other tax preference items.

The application of GAAP requires us to evaluate the recoverability of our deferred tax assets and establish a valuation allowance if necessary, to reduce our deferred tax asset to an amount that is more likely than not to be realizable. Considerable judgment and the use of estimates are required in determining whether a valuation allowance is necessary, and if so, the amount of such valuation allowance. In evaluating the need for a valuation allowance, we consider many factors, including: the nature and character of the deferred tax assets and liabilities; taxable income in prior carryback years; future reversals of temporary differences; the length of time carryovers can be utilized; and any tax planning strategies we would employ to avoid a tax benefit from expiring unused. Although realization is not assured, management believes it is more likely than not that the deferred tax assets, including our capital loss deferred tax asset, will be realized.

In the normal course of business, we are subject to examination by taxing authorities throughout the U.S. and the U.K. At any given time, we may be under examination by state, local or non-U.S. income tax authorities. During the second quarter of 2010, the IRS completed its examination for the tax years 2005 and 2006 resulting in a proposed assessment. We believe a 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 appeals would be material to our consolidated results of operations or financial condition.

8. Guaranteed Benefit Features

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

| | As of June 30, 2010 | As of December 31, 2009 |
|---|---|---|
| Return of Net Deposits | | |
| Total account value | $44,180 | $44,712 |
| Net amount at risk (1) | 2,820 | 1,888 |
| Average attained age of contract holders | 58 years | 57 years |
| Minimum Return | | |
| Total account value | $176 | $203 |
| Net amount at risk (1) | 70 | 65 |
| Average attained age of contract holders | 70 years | 69 years |
| Guaranteed minimum return | 5 % | 5 % |
| Anniversary Contract Value | | |
| Total account value | $20,265 | $21,431 |
| Net amount at risk (1) | 5,023 | 4,021 |
| Average attained age of contract holders | 66 years | 65 years |

(1) Represents the amount of death benefit in excess of the account balance. The increase in net amount at risk when comparing June 30, 2010, to December 31, 2009, was attributable primarily to the decline in equity markets and associated reduction in the account values.

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

| | For the Six Months Ended June 30, 2010 | 2009 |
|---|---|---|
| Balance as of beginning-of-year | $71 | $277 |
| Changes in reserves | 81 | 24 |
| Benefits paid | (46) | (119) |
| Balance as of end-of-period | $106 | $182 |

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

| | As of June 30, 2010 | As of December 31, 2009 |
|---|---|---|
| Asset Type | | |
| Domestic equity | $30,365 | $32,489 |
| International equity | 11,365 | 12,379 |
| Bonds | 11,114 | 9,942 |
| Money market | 6,828 | 6,373 |
| Total | $59,672 | $61,183 |
| | | |
| Percent of total variable annuity separate account values | 98% | 97% |

Future contract benefits also include reserves for our products with secondary guarantees for our products sold through our Insurance Solutions – Life Insurance segment. These UL and VUL products with secondary guarantees represented approximately 40% of permanent life insurance in force as of June 30, 2010, and approximately 52% and 57% of total sales for these products for the three and six months ended June 30, 2010.

## 9. Short-Term and Long-Term Debt

### Commercial Paper, Credit Facilities and Letters of Credit ("LOCs")

Commercial paper, credit facilities and LOC debt programs (in millions) were as follows:

| | | As of June 30, 2010 | |
|---|---|---|---|
| | Expiration Date | Maximum Available | Borrowings Outstanding |
| Credit Facilities | | | |
| Credit facility with the FHLBI (1) | N/A | $630 | $350 |
| 364-day revolving credit facility | Jun-11 | 500 | - (2) |
| Four-year revolving credit facility | Jun-14 | 1,500 | - |
| Ten-year LOC facility | Dec-19 | 550 | - |
| Total | | $3,180 | $350 |
| | | | |
| LOCs issued | | | $2,038 |

(1) Our borrowing capacity under this credit facility does not have an expiration date and continues while our investment in the FHLBI common stock remains outstanding. We have pledged securities, included in fixed maturity AFS securities on our Consolidated Balance Sheets, that are associated with this credit facility.

(2) As of June 30, 2010, we had commercial paper outstanding of $98 million backed by this facility, which reduced our available credit facility by a corresponding amount, but did not represent loans borrowed from the credit facility.

Effective as of June 9, 2010, the Company entered into two revolving credit facilities with a syndicate of banks. One agreement (the "Four-Year Agreement") allows for issuance of LOCs, as well as borrowings to finance any draws under the LOCs. The Four-Year Agreement is unsecured and has a commitment termination date of June 9, 2014. The

Four-Year Agreement must be used primarily to provide LOCs in support of certain life insurance reserves. The second agreement (the "364-Day Agreement," and together with the "Four-Year Agreement" the "credit facility") allows for borrowing or issuance of LOCs and may be used for general corporate purposes. The 364-Day Agreement is unsecured and has a commitment termination of June 8, 2011. LOCs issued under the credit facility may remain outstanding for one year following the applicable commitment termination date of each agreement. Because commitments associated with LOCs may expire unused, these amounts do not necessarily reflect our future cash funding requirements; however, the issuance of LOCs reduces availability of funds from the credit facilities. These LOCs support our reinsurance needs and specific treaties associated with our reinsurance business sold to Swiss Re in 2001. LOCs are used primarily to satisfy the U.S. regulatory requirements of domestic clients who have contracted with the reinsurance subsidiaries not domiciled in the U.S. and for reserve credit provided by our affiliated offshore reinsurance company to our domestic insurance companies for ceded business.

Effective as of June 9, 2010, the credit facility replaced our existing five-year revolving credit facility, under which the commitments were set to expire in the first quarter of 2011. The credit facility contains customary terms and conditions, including 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. The credit facility also includes financial covenants including: maintenance of a minimum consolidated net worth (as defined in the facility) equal to the sum of $9.2 billion plus fifty percent (50%) of the aggregate net proceeds of equity issuances received by us in accordance with the terms of the credit facility (other than net proceeds used to repay investments to the U.S. Department of Treasury ("U.S. Treasury") under the Capital Purchase Program ("CPP")); and a debt-to-capital ratio as defined in accordance with the credit facility not to exceed 0.35 to 1.00. Further, the credit facility contains customary events of default, subject to certain materiality thresholds and grace periods for certain of those events of default. The events of default include payment defaults, covenant defaults, material inaccuracies in representations and warranties, certain cross-defaults, bankruptcy and liquidation proceedings and other customary defaults. Upon an event of default, the credit facility provides that, among other things, the commitments may be terminated and the loans then outstanding may be declared due and payable. As of June 30, 2010, we were in compliance with all such covenants.

Issuance of Long-Term Debt

On June 18, 2010, we issued 4.30% fixed rate senior notes due 2015 ("2015 Notes") with a principal balance of $250 million. We have the option to repurchase the outstanding 2015 Notes by paying the greater of 100% of the principal amount of the 2015 Notes to be redeemed or the make-whole amount (as defined in the 2015 notes), plus in each case any accrued and unpaid interest as of the date of redemption.

Also on June 18, 2010, we issued 7.00% fixed rate senior notes due 2040 ("2040 Notes") with a principal balance of $500 million. We have the option to repurchase the outstanding 2040 Notes by paying the greater of 100% of the principal amount of the 2040 Notes to be redeemed or the make-whole amount (as defined in the 2040 notes), plus in each case any accrued and unpaid interest as of the date of redemption.

10. Contingencies and Commitments

See "Contingencies and Commitments" in Note 14 to the consolidated financial statements in our 2009 Form 10-K for a discussion of commitments and contingencies, which information is incorporated herein by reference.

Contingencies

Regulatory and Litigation Matters

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

In the ordinary course of its business, LNC and its subsidiaries are involved in various pending or threatened legal proceedings, including purported class actions, arising from the conduct of business. In some instances, these proceedings include claims for unspecified or substantial punitive damages and similar types of relief in addition to amounts for alleged contractual liability or requests for equitable relief. After consultation with legal counsel and a review of available facts, it is management's opinion that these proceedings, after consideration of any reserves and rights to indemnification, ultimately will be resolved without materially affecting the consolidated financial position of LNC. However, given the large and indeterminate amounts sought in certain of these proceedings and the inherent difficulty in predicting the outcome of such legal proceedings, including the proceeding described below, it is possible that an adverse outcome in certain matters could be material to our operating results for any particular reporting period.

Transamerica Investment Management, LLC and Transamerica Investments Services, Inc. v. Delaware Management Holdings, Inc. (dba Delaware Investments), Delaware Investment Advisers and certain individuals, was filed in the San Francisco County Superior Court on April 28, 2005.  The plaintiffs are seeking substantial compensatory and punitive damages.  The complaint alleges breach of fiduciary duty, breach of duty of loyalty, breach of contract, breach of the implied covenant of good faith and fair dealing, unfair competition, interference with prospective economic advantage, conversion, unjust enrichment and conspiracy, in connection with Delaware Investment Advisers' hiring of a portfolio management team from the plaintiffs.  We and the individual defendants dispute the allegations and are vigorously defending these actions.  As part of the purchase and sale agreement for Delaware described in Note 3, we agreed to retain control of and responsibility for this litigation.  Additionally, we have agreed to reimburse MBL for any expenses that may be incurred by Delaware in connection with this matter.

Commitments

Standby Real Estate Equity Commitments

Historically, we have entered into standby commitments, which obligated us to purchase real estate at a specified cost if a third-party sale did not occur within approximately one year after construction was completed. These commitments were used by a developer to obtain a construction loan from an outside lender on favorable terms. In return for issuing the commitment, we received an annual fee and a percentage of the profit when the property was sold. Our long-term expectation is that we will be obligated to fund a small portion of these commitments that remain outstanding. However, due to the current economic environment, we may experience increased funding obligations.

As of June 30, 2010, and December 31, 2009, we had standby real estate equity commitments totaling $86 million and $220 million, respectively. During the first six months of 2010, we funded commitments of $112 million and recorded a loss of $8 million reported within realized gain (loss) on our Consolidated Statements of Income (Loss).

We have suspended the practice of entering into new standby real estate commitments.

11. Shares and Stockholders' Equity

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Series A Preferred Stock | | | | |
| Balance as of beginning-of-period | 11,365 | 11,565 | 11,497 | 11,565 |
| Conversion of convertible preferred stock (1) | - | (8) | (132) | (8) |
| Balance as of end-of-period | 11,365 | 11,557 | 11,365 | 11,557 |
| | | | | |
| Series B Preferred Stock | | | | |
| Balance as of beginning-of-period | 950,000 | - | 950,000 | - |
| Redemption of Series B preferred stock | (950,000) | - | (950,000) | - |
| Balance as of end-of-period | - | - | - | - |
| | | | | |
| Common Stock | | | | |
| Balance as of beginning-of-period | 302,467,034 | 256,046,103 | 302,223,281 | 255,869,859 |
| Stock issued | 14,137,615 | 46,000,000 | 14,137,615 | 46,000,000 |
| Conversion of convertible preferred stock (1) | - | 128 | 2,112 | 128 |
| Stock compensation/issued for benefit plans | 57,831 | 50,610 | 317,565 | 246,769 |
| Retirement/cancellation of shares | - | (3,824) | (18,093) | (23,739) |
| Balance as of end-of-period | 316,662,480 | 302,093,017 | 316,662,480 | 302,093,017 |
| | | | | |
| Common stock as of end-of-period: | | | | |
| Assuming conversion of preferred stock | 316,844,320 | 302,277,929 | 316,844,320 | 302,277,929 |
| Diluted basis | 325,852,768 | 304,162,403 | 325,852,768 | 304,162,403 |

(1) Represents the conversion of Series A preferred stock into common stock.

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

Series B Preferred Stock Redemption

On June 30, 2010, we repurchased from the U.S. Treasury 950,000 shares of our Series B preferred stock, which we issued in connection with CPP, established as part of the Emergency Economic Stabilization Act of 2008. The repurchase of the Series B preferred stock resulted in a $131 million reduction to retained earnings and was deducted from income available to common stockholders in our calculation of earnings per share ("EPS"), representing the write-off of unamortized discount on the Series B preferred stock at liquidation. The U.S. Treasury continues to hold a warrant to purchase 13,049,451 shares of common stock at an exercise price of $10.92 per share. In addition, the annual dividends payable on the Series B preferred stock were eliminated as of June 30, 2010.

Common Stock Issued

On June 18, 2010, we closed on the issuance and sale of 14,137,615 shares of common stock at a price of $27.25 per share.

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Weighted-average shares, as used in basic calculation | 304,483,369 | 260,085,214 | 303,358,882 | 257,834,591 |
| Shares to cover exercise of CPP warrant | 13,049,451 | - | 13,049,451 | - |
| Shares to cover conversion of preferred stock | 181,840 | 184,970 | 182,645 | 185,005 |
| Shares to cover non-vested stock | 620,528 | 503,548 | 611,940 | 504,397 |
| Average stock options outstanding during the period | 824,066 | 294,415 | 802,341 | 154,634 |
| Assumed acquisition of shares with assumed proceeds from exercising CPP warrant | (5,015,012) | - | (5,221,717) | - |
| Assumed acquisition of shares with assumed proceeds and benefits from exercising stock options (at average market price for the year) | (535,667) | (223,683) | (525,529) | (117,648) |
| Shares repurchaseable from measured but unrecognized stock option expense | (192,996) | (4,433) | (177,687) | (3,450) |
| Average deferred compensation shares (1) | 1,196,054 | 1,573,741 | 1,275,743 | 1,556,369 |
| Weighted-average shares, as used in diluted calculation (2) | 314,611,633 | 262,413,772 | 313,356,069 | 260,113,898 |

(1) Effective April 30, 2010, we amended our non-director deferred compensation plans to allow participants the option to diversify from LNC stock to other investment alternatives. As a result of the amendment, we reclassified the cost basis of deferred units of LNC stock from common stock to other liabilities on our Consolidated Balance Sheet. Consequently, changes in the value of our stock are recorded in underwriting, acquisition, insurance and other expenses on our Consolidated Statement of Income (Loss). When calculating our weighted-average dilutive shares, we presume the investment option will be settled in cash and exclude the shares from our calculation, unless the effect of settlement in shares ("equity classification") would be more dilutive to our diluted EPS calculation. Our directors' deferred compensation plan was not amended; therefore, participants who select LNC stock for measuring the investment return attributable to their deferral amounts will be paid out in LNC stock, and the obligation to satisfy it is dilutive.

(2)

As a result of a loss from continuing operations for the three and six months end June 30, 2009, shares used in the EPS calculation represent basic shares, since using diluted shares would have been anti-dilutive to the calculation.

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 EPS and will be shown in the table above.

The numerator used in the calculation of our diluted EPS was adjusted down by $2 million, for the removal of the favorable mark-to-market adjustment for deferred units of LNC stock in our non-director deferred compensation plans included in net income for the three and six months ended June 30, 2010, due to the effect of equity classification being more dilutive to our diluted EPS calculation.

Accumulated OCI

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

| | For the Six Months Ended June 30, | |
|---|---|---|
| | 2010 | 2009 |
| Unrealized Gain (Loss) on AFS Securities | | |
| Balance as of beginning-of-year | $49 | $(2,654) |
| Cumulative effect from adoption of new accounting standards | 181 | (84) |
| Unrealized holding gains (losses) arising during the period | 2,691 | 2,799 |
| Change in foreign currency exchange rate adjustment | (32) | 17 |
| Change in DAC, VOBA, DSI and other contract holder funds | (1,070) | (1,011) |
| Income tax expense | (573) | (646) |
| Less: | | |
| Reclassification adjustment for gains (losses) included in net income | (27) | (332) |
| Reclassification adjustment for gains (losses) on derivatives included in net income | (2) | 29 |
| Associated amortization of DAC, VOBA, DSI and DFEL | (3) | 103 |
| Income tax benefit | 11 | 70 |
| Balance as of end-of-period | $1,267 | $(1,449) |
| Unrealized OTTI on AFS Securities | | |
| Balance as of beginning-of-year | $(115) | $- |
| (Increases) attributable to: | | |
| Cumulative effect from adoption of new accounting standards | - | (18) |
| Gross OTTI recognized in OCI during the period | (22) | (242) |
| Change in DAC, VOBA, DSI and DFEL | (2) | 50 |
| Income tax benefit | 8 | 67 |
| Decreases attributable to: | | |
| Sales, maturities or other settlements of AFS securities | 42 | 43 |
| Change in DAC, VOBA, DSI and DFEL | (10) | (5) |
| Income tax expense | (11) | (13) |
| Balance as of end-of-period | $(110) | $(118) |
| Unrealized Gain on Derivative Instruments | | |
| Balance as of beginning-of-year | $11 | $127 |
| Unrealized holding gains (losses) arising during the period | (65) | (68) |
| Change in foreign currency exchange rate adjustment | 32 | (16) |
| Change in DAC, VOBA, DSI and DFEL | 3 | 21 |
| Income tax benefit (expense) | 11 | (5) |
| Less: | | |
| Reclassification adjustment for gains (losses) included in net income | 10 | 6 |
| Associated amortization of DAC, VOBA, DSI and DFEL | (1) | 1 |
| Income tax expense | (3) | (2) |
| Balance as of end-of-period | $(14) | $54 |
| Foreign Currency Translation Adjustment | | |
| Balance as of beginning-of-year | $3 | $6 |
| Foreign currency translation adjustment arising during the period | (2) | 135 |
| Income tax expense | - | (49) |
| Balance as of end-of-period | $1 | $92 |

| | | |
|---|---|---|
| Funded Status of Employee Benefit Plans | | |
| Balance as of beginning-of-year | $(210) | $(282) |
| Adjustment arising during the period | 6 | (6) |
| Income tax benefit (expense) | (2) | 2 |
| Balance as of end-of-period | $(206) | $(286) |

12. Realized Gain (Loss)

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Total realized gain (loss) related to certain investments (1) | $(5) | $(154) | $(60) | $(288) |
| Realized gain (loss) related to certain derivative instruments, including those associated with our consolidated VIEs, and trading securities (2) | (46) | (13) | (33) | (8) |
| Indexed annuity net derivative results (3): | | | | |
| Gross gain | 4 | 9 | 9 | 9 |
| Associated amortization expense of DAC, VOBA, DSI and DFEL | (1) | (6) | (4) | (5) |
| Guaranteed living benefits (4): | | | | |
| Gross gain (loss) | 41 | (140) | 80 | (234) |
| Associated amortization income (expense) of DAC, VOBA, DSI and DFEL | (14) | 1 | (26) | (19) |
| Guaranteed death benefits (5): | | | | |
| Gross gain (loss) | 29 | (163) | 14 | (106) |
| Associated amortization income (expense) of DAC, VOBA, DSI and DFEL | (3) | 22 | (1) | 11 |
| Realized gain (loss) on sale of subsidiaries/businesses | - | 1 | - | 1 |
| Total realized gain (loss) | $5 | $(443) | $(21) | $(639) |

(1) See "Realized Gain (Loss) Related to Certain Investments" section in Note 5.

(2) Represents changes in the fair values of certain derivative investments (including the credit default swaps and contingent forwards associated with our consolidated VIEs), total return swaps (embedded derivatives that are theoretically included in our various modified coinsurance and coinsurance with funds withheld reinsurance arrangements that have contractual returns related to various assets and liabilities associated with these arrangements) and trading securities.

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

(4) Represents the net difference in the change in embedded derivative reserves of our GLB products and the change in the fair value of the derivative instruments we own to hedge, including the cost of purchasing the hedging instruments.

(5) Represents the change in the fair value of the derivatives used to hedge our GDB riders.

13. Stock-Based Incentive Compensation Plans

We sponsor various incentive plans for our employees, agents and directors that provide for the issuance of various equity awards including stock options, stock incentive awards ("performance shares"), salary paid in shares of our common stock ("salary shares"), SARs, restricted stock, restricted stock units and deferred stock units. In addition, as required under CPP, we have complied with enhanced compensation restrictions for certain executives and employees in granting compensation to those employees during our participation in the CPP. These compensation restrictions ceased to apply after our repurchase of the Series B preferred shares from the U.S Treasury as discussed in Note 11.

LNC stock-based awards granted were as follows:

| | For the Three Months Ended June 30, 2010 | For the Six Months Ended June 30, 2010 |
|---|---|---|
| Awards | | |
| 10-year LNC stock options | 24,560 | 208,491 |
| Non-employee director stock options | - | 29,183 |
| Non-employee agent stock options | 1,858 | 97,636 |
| Restricted stock units | 27,269 | 644,077 |
| SARs | - | 119,850 |
| Salary shares | 37,712 | 76,635 |
| Director deferred stock units | 8,889 | 15,821 |

14. Fair Value of Financial Instruments

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

| | As of June 30, 2010 | | As of December 31, 2009 | |
|---|---|---|---|---|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Assets | | | | |
| AFS securities: | | | | |
| Fixed maturity securities | $66,391 | $66,391 | $60,818 | $60,818 |
| VIEs' fixed maturity securities | 581 | 581 | - | - |
| Equity securities | 246 | 246 | 278 | 278 |
| Trading securities | 2,608 | 2,608 | 2,505 | 2,505 |
| Mortgage loans on real estate | 6,882 | 7,432 | 7,178 | 7,316 |
| Derivative investments | 1,989 | 1,989 | 1,010 | 1,010 |
| Other investments | 1,136 | 1,136 | 1,057 | 1,057 |
| Cash and invested cash | 3,700 | 3,700 | 4,025 | 4,025 |
| Separate account assets | 70,844 | 70,844 | 73,500 | 73,500 |
| Liabilities | | | | |
| Future contract benefits: | | | | |
| Indexed annuity contracts | (383) | (383) | (419) | (419) |
| GLB embedded derivative reserves | (1,669) | (1,669) | (676) | (676) |
| Other contract holder funds: | | | | |
| Remaining guaranteed interest and similar contracts | (1,072) | (1,072) | (940) | (940) |
| Account value of certain investment contracts | (25,131) | (26,069) | (24,114) | (24,323) |
| Short-term debt (1) | (99) | (99) | (350) | (349) |
| Long-term debt | (5,865) | (5,504) | (5,050) | (4,759) |
| Reinsurance related embedded derivatives | (92) | (92) | (31) | (31) |
| VIEs' liabilities | (297) | (297) | - | - |
| Other liabilities: | | | | |
| Deferred compensation plans | (319) | (319) | (332) | (332) |
| Credit default swaps | (30) | (30) | (65) | (65) |

(1) The difference between the carrying value and fair value of short-term debt as of December 31, 2009, related to current maturities of long-term debt.

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

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

Mortgage Loans on Real Estate

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

Other Investments

The carrying value of other investments approximates their fair value.  Other investments include LPs and other privately held investments that are accounted for using the equity method of accounting.

Other Contract Holder Funds

Other contract holder funds include remaining guaranteed interest and similar contracts and account values of certain investment contracts.  The fair value for the remaining guaranteed interest and similar contracts is estimated using discounted cash flow calculations as of the balance sheet date.  These calculations are based on interest rates currently offered on similar contracts with maturities that are consistent with those remaining for the contracts being valued.  As of June 30, 2010, and December 31, 2009, the remaining guaranteed interest and similar contracts carrying value approximates fair value.  The fair value of the account values of certain investment contracts is based on their approximate surrender value as of the balance sheet date.

Short-term and Long-term Debt

The fair value of long-term debt is based on quoted market prices or estimated using discounted cash flow analysis determined in conjunction with our incremental borrowing rate as of the balance sheet date for similar types of borrowing arrangements where quoted prices are not available.  For short-term debt, excluding current maturities of long-term debt, the carrying value approximates fair value.

Financial Instruments Carried at Fair Value

We did not have any assets or liabilities measured at fair value on a nonrecurring basis as of June 30, 2010, or December 31, 2009, and we noted no changes in our valuation methodologies between these periods.

The following summarizes our financial instruments carried at fair value (in millions) on a recurring basis by the fair value hierarchy levels described in Note 1 in our 2009 Form 10-K:

| | As of June 30, 2010 | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
| Assets | | | | |
| Investments: | | | | |
| Fixed maturity AFS securities: | | | | |
| Corporate bonds | $58 | $48,259 | $ 1,927 | $50,244 |
| U.S. Government bonds | 175 | 30 | 4 | 209 |
| Foreign government bonds | - | 382 | 92 | 474 |
| MBS: | | | | |
| CMOs | - | 5,919 | 29 | 5,948 |
| MPTS | - | 3,424 | 101 | 3,525 |
| CMBS | - | 2,014 | 119 | 2,133 |
| ABS CDOs | - | 1 | 156 | 157 |
| State and municipal bonds | - | 2,520 | 20 | 2,540 |
| Hybrid and redeemable preferred stocks | 12 | 1,074 | 75 | 1,161 |
| VIEs' fixed maturity securities | - | 581 | - | 581 |
| Equity AFS securities: | | | | |
| Banking securities | - | 119 | - | 119 |
| Insurance securities | 3 | - | 26 | 29 |
| Other financial services securities | - | 6 | 23 | 29 |
| Other securities | 33 | 2 | 34 | 69 |
| Trading securities | 2 | 2,529 | 77 | 2,608 |
| Derivative investments | - | (134) | 2,005 | 1,871 |
| Cash and invested cash | - | 3,700 | - | 3,700 |
| Separate account assets | - | 70,844 | - | 70,844 |
| Total assets | $283 | $141,270 | $ 4,688 | $146,241 |
| | | | | |
| Liabilities | | | | |
| Future contract benefits: | | | | |
| Indexed annuity contracts | $- | $- | $ (383) | $(383) |
| GLB embedded derivative reserves | - | - | (1,669) | (1,669) |
| Long-term debt - interest rate swap agreements | - | (118) | - | (118) |
| Reinsurance related embedded derivatives | - | (92) | - | (92) |
| VIEs' liabilities | - | - | (297) | (297) |
| Other liabilities: | | | | |
| Deferred compensation plans | - | - | (319) | (319) |
| Credit default swaps | - | - | (30) | (30) |
| Total liabilities | $- | $(210) | $ (2,698) | $(2,908) |

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| | As of December 31, 2009 | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Fair Value |
| Assets | | | | |
| Investments: | | | | |
| Fixed maturity AFS securities: | | | | |
| Corporate bonds | $57 | $43,234 | $ 2,088 | $45,379 |
| U.S. Government bonds | 158 | 34 | 3 | 195 |
| Foreign government bonds | - | 413 | 92 | 505 |
| MBS: | | | | |
| CMOs | - | 5,871 | 35 | 5,906 |
| MPTS | - | 2,965 | 101 | 3,066 |
| CMBS | - | 1,872 | 259 | 2,131 |
| ABS: | | | | |
| CDOs | - | 5 | 153 | 158 |
| CLNs | - | - | 322 | 322 |
| State and municipal bonds | - | 1,968 | - | 1,968 |
| Hybrid and redeemable preferred stocks | 15 | 1,035 | 138 | 1,188 |
| Equity AFS securities: | | | | |
| Banking securities | 23 | 124 | - | 147 |
| Insurance securities | 3 | - | 43 | 46 |
| Other financial services securities | - | 6 | 22 | 28 |
| Other securities | 34 | - | 23 | 57 |
| Trading securities | 3 | 2,411 | 91 | 2,505 |
| Derivative investments | - | (412) | 1,368 | 956 |
| Cash and invested cash | - | 4,025 | - | 4,025 |
| Separate account assets | - | 73,500 | - | 73,500 |
| Total assets | $293 | $137,051 | $ 4,738 | $142,082 |
| Liabilities | | | | |
| Future contract benefits: | | | | |
| Indexed annuity contracts | $- | $- | $ (419) | $(419) |
| GLB embedded derivative reserves | - | - | (676) | (676) |
| Long-term debt - interest rate swap agreements | - | (54) | - | (54) |
| Reinsurance related embedded derivatives | - | (31) | - | (31) |
| Other liabilities: | | | | |
| Deferred compensation plans | - | - | (332) | (332) |
| Credit default swaps | - | - | (65) | (65) |
| Total liabilities | $- | $(85) | $ (1,492) | $(1,577) |

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

| | For the Three Months Ended June 30, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Beginning Fair Value | Items Included in Net Income | Gains (Losses) in OCI and other (1) | Sales, Issuances, Maturities, Settlements, Calls, Net | Transfers In or Out of Level 3, Net (2) | Ending Fair Value |
| Investments: (3) | | | | | | |
| Fixed maturity AFS securities: | | | | | | |
| Corporate bonds | $2,299 | $(5) | $21 | $(11) | $(377) | $1,927 |
| U.S. Government bonds | 2 | - | - | - | 2 | 4 |
| Foreign government bonds | 90 | - | 2 | - | - | 92 |
| MBS: | | | | | | |
| CMOs | 31 | (1) | 1 | (1) | (1) | 29 |
| MPTS | 174 | - | 3 | (76) | - | 101 |
| CMBS | 250 | (2) | 10 | (17) | (122) | 119 |
| ABS CDOs | 159 | - | 1 | (5) | 1 | 156 |
| State and municipal bonds | - | - | - | 20 | - | 20 |
| Hybrid and redeemable preferred stocks | 117 | 8 | (12) | (38) | - | 75 |
| Equity AFS securities: | | | | | | |
| Insurance securities | 30 | - | (4) | - | - | 26 |
| Other financial services securities | 27 | - | (4) | - | - | 23 |
| Other securities | 34 | - | - | - | - | 34 |
| Trading securities | 75 | - | 6 | (2) | (2) | 77 |
| Derivative investments | 1,281 | 620 | 5 | 99 | - | 2,005 |
| Future contract benefits: (4) | | | | | | |
| Indexed annuity contracts | (457) | 56 | - | 18 | - | (383) |
| GLB embedded derivative reserves | (495) | (1,174) | - | - | - | (1,669) |
| VIEs' liabilities | (229) | (68) | - | - | - | (297) |
| Other liabilities: | | | | | | |
| Deferred compensation plans | (300) | 9 | - | (28) | - | (319) |
| Credit default swaps (5) | (44) | (17) | - | 31 | - | (30) |
| Total, net | $3,044 | $(574) | $29 | $(10) | $(499) | $1,990 |

| | For the Three Months Ended June 30, 2009 | | | | | |
|---|---|---|---|---|---|---|
| | Beginning Fair Value | Items Included in Net Income | Gains (Losses) in OCI and other (1) | Sales, Issuances, Maturities, Settlements, Calls, Net | Transfers In or Out of Level 3, Net (2) | Ending Fair Value |
| Investments: (3) | | | | | | |
| Fixed maturity AFS securities: | | | | | | |
| Corporate bonds | $2,102 | $(18) | $109 | $(48) | $(153) | $1,992 |
| U.S. Government bonds | 3 | - | - | - | - | 3 |
| Foreign government bonds | 58 | - | (3) | (2) | 47 | 100 |
| MBS: | | | | | | |
| CMOs | 133 | (3) | 4 | 4 | (15) | 123 |
| MPTS | 8 | - | 1 | 145 | - | 154 |
| CMBS | 246 | 1 | 13 | (30) | - | 230 |
| ABS: | | | | | | |
| CDOs | 112 | (32) | 46 | (17) | - | 109 |
| CLNs | 82 | - | 137 | - | - | 219 |
| State and municipal bonds | 125 | - | (1) | 765 | 17 | 906 |
| Hybrid and redeemable preferred stocks | 89 | - | 6 | - | 3 | 98 |
| Equity AFS securities: | | | | | | |
| Insurance securities | 47 | 1 | 8 | (21) | - | 35 |
| Other financial services securities | 11 | - | 4 | - | - | 15 |
| Other securities | 23 | - | - | - | - | 23 |
| Trading securities | 78 | 3 | - | 7 | (2) | 86 |
| Derivative investments | 2,145 | (510) | (9) | (161) | - | 1,465 |
| Future contract benefits: (4) | | | | | | |
| Indexed annuity contracts | (253) | (11) | - | (30) | - | (294) |
| GLB embedded derivative reserves | (2,605) | 1,533 | - | - | - | (1,072) |
| Other liabilities: | | | | | | |
| Deferred compensation plans | (329) | (26) | - | (16) | - | (371) |
| Credit default swaps (5) | (67) | (7) | - | - | - | (74) |
| Total, net | $2,008 | $931 | $315 | $596 | $(103) | $3,747 |

| | For the Six Months Ended June 30, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Beginning Fair Value | Items Included in Net Income | Gains (Losses) in OCI and other (1) | Sales, Issuances, Maturities, Settlements, Calls, Net | Transfers In or Out of Level 3, Net (2) | Ending Fair Value |
| Investments: (3) | | | | | | |
| Fixed maturity AFS securities: | | | | | | |
| Corporate bonds | $2,088 | $(9) | $11 | $(119) | $(44) | $1,927 |
| U.S. Government bonds | 3 | - | - | (1) | 2 | 4 |
| Foreign government bonds | 92 | - | 2 | (3) | 1 | 92 |
| MBS: | | | | | | |
| CMOs | 35 | (2) | 1 | (3) | (2) | 29 |
| MPTS | 101 | - | 4 | (4) | - | 101 |
| CMBS | 259 | (2) | 20 | (36) | (122) | 119 |
| ABS: | | | | | | |
| CDOs | 153 | - | 11 | (11) | 3 | 156 |
| CLNs | 322 | - | 278 | - | (600) | - |
| State and municipal bonds | - | - | - | 20 | - | 20 |
| Hybrid and redeemable preferred stocks | 138 | 3 | (37) | (29) | - | 75 |
| Equity AFS securities: | | | | | | |
| Insurance securities | 43 | - | (4) | (13) | - | 26 |
| Other financial services securities | 22 | (3) | 4 | - | - | 23 |
| Other securities | 23 | - | - | 11 | - | 34 |
| Trading securities | 91 | 1 | (10) | (5) | - | 77 |
| Derivative investments | 1,368 | 489 | 7 | 141 | - | 2,005 |
| Future contract benefits: (4) | | | | | | |
| Indexed annuity contracts | (419) | 15 | - | 21 | - | (383) |
| GLB embedded derivative reserves | (676) | (993) | - | - | - | (1,669) |
| VIEs' liabilities | - | (72) | - | - | (225) | (297) |
| Other liabilities: | | | | | | |
| Deferred compensation plans | (332) | 1 | - | 12 | - | (319) |
| Credit default swaps (5) | (65) | (7) | - | 42 | - | (30) |
| Total, net | $3,246 | $(579) | $287 | $23 | $(987) | $1,990 |

| | For the Six Months Ended June 30, 2009 | | | | | |
|---|---|---|---|---|---|---|
| | Beginning Fair Value | Items Included in Net Income | Gains (Losses) in OCI and other (1) | Sales, Issuances, Maturities, Settlements, Calls, Net | Transfers In or Out of Level 3, Net (2) | Ending Fair Value |
| Investments: (3) | | | | | | |
| Fixed maturity AFS securities: | | | | | | |
| Corporate bonds | $2,357 | $(35) | $74 | $(60) | $(344) | $1,992 |
| U.S. Government bonds | 3 | - | - | - | - | 3 |
| Foreign government bonds | 60 | - | (5) | (3) | 48 | 100 |
| MBS: | | | | | | |
| CMOs | 161 | (5) | - | 5 | (38) | 123 |
| MPTS | 18 | - | 1 | 145 | (10) | 154 |
| CMBS | 244 | 1 | 17 | (32) | - | 230 |
| ABS: | | | | | | |
| CDOs | 151 | (31) | 7 | (18) | - | 109 |
| CLNs | 50 | - | 169 | - | - | 219 |
| State and municipal bonds | 125 | - | (2) | 766 | 17 | 906 |
| Hybrid and redeemable preferred stocks | 97 | - | (10) | 3 | 8 | 98 |
| Equity AFS securities: | | | | | | |
| Insurance securities | 51 | 1 | 3 | (20) | - | 35 |
| Other financial services securities | 20 | (3) | 1 | (3) | - | 15 |
| Other securities | 23 | 2 | (1) | (1) | - | 23 |
| Trading securities | 81 | (1) | - | 7 | (1) | 86 |
| Derivative investments | 2,148 | (486) | (9) | (188) | - | 1,465 |
| Future contract benefits: (4) | | | | | | |
| Indexed annuity contracts | (252) | 11 | - | (53) | - | (294) |
| GLB embedded derivative reserves | (2,904) | 1,832 | - | - | - | (1,072) |
| Other liabilities: | | | | | | |
| Deferred compensation plans | (336) | (21) | - | (14) | - | (371) |
| Credit default swaps (5) | (51) | (23) | - | - | - | (74) |
| Total, net | $2,046 | $1,242 | $245 | $534 | $(320) | $3,747 |

(1) The changes in fair value of the interest rate swaps are offset by an adjustment to derivative investments. See “Derivatives Instruments Designated and Qualifying as Fair Value Hedges” section in Note 6.

(2) Transfers in or out of Level 3 for AFS and trading securities are displayed at amortized cost as of the beginning-of-period. For AFS and trading securities, the difference between beginning-of-period amortized cost and beginning-of-period fair value was included in OCI and earnings, respectively, in prior periods.

(3) Amortization and accretion of premiums and discounts are included in net investment income on our Consolidated Statements of Income (Loss). Gains (losses) from sales, maturities, settlements and calls and OTTI are included in realized gain (loss) on our Consolidated Statements of Income (Loss).

(4) Gains (losses) from sales, maturities, settlements and calls are included in realized gain (loss) on our Consolidated Statements of Income (Loss).

(5)

Gains (losses) from sales, maturities, settlements and calls are included in net investment income on our Consolidated Statements of Income (Loss).

The following summarizes changes in unrealized gains (losses) included in net income, excluding any impact of amortization of DAC, VOBA, DSI and DFEL and changes in future contract benefits, related to financial instruments carried at fair value classified within Level 3 that we still held (in millions) as of June 30, 2010:

| | For the Three Months Ended June 30, 2010 | For the Six Months Ended June 30, 2010 |
|---|---|---|
| Investments: | | |
| Derivative investments (1) | $599 | $487 |
| Future contract benefits: | | |
| Indexed annuity contracts (1) | (78) | (5) |
| GLB embedded derivative reserves (1) | (1,130) | (910) |
| VIEs' liabilities (1) | (68) | (72) |
| Other liabilities: | | |
| Deferred compensation plans (2) | 9 | 1 |
| Credit default swaps (3) | (26) | (27) |
| Total, net | $(694) | $(526) |

(1) Included in realized gain (loss) on our Consolidated Statements of Income (Loss).
(2) Included in underwriting, acquisition, insurance and other expenses on our Consolidated Statements of Income (Loss).
(3) Included in net investment income on our Consolidated Statements of Income (Loss).

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

| | For the Three Months Ended June 30, 2010 | | |
|---|---|---|---|
| | Transfers In to Level 3 | Transfers Out of Level 3 | Total |
| Investments: | | | |
| Fixed maturity AFS securities: | | | |
| Corporate bonds | $39 | $(416) | $(377) |
| U.S. Government bonds | 2 | - | 2 |
| MBS: | | | |
| CMOs | - | (1) | (1) |
| CMBS | 3 | (125) | (122) |
| ABS CDOs | 1 | - | 1 |
| Trading securities | - | (2) | (2) |
| Total, net | $45 | $(544) | $(499) |

| | For the Six Months Ended June 30, 2010 | | |
|---|---|---|---|
| | Transfers In to Level 3 | Transfers Out of Level 3 | Total |
| Investments: | | | |
| Fixed maturity AFS securities: | | | |
| Corporate bonds | $ 143 | $ (187 ) | $ (44 ) |
| U.S. Government bonds | 2 | - | 2 |
| Foreign government bonds | 1 | - | 1 |
| MBS: | | | |
| CMOs | - | (2 ) | (2 ) |
| CMBS | 3 | (125 ) | (122 ) |
| ABS: | | | |
| CDOs | 3 | - | 3 |
| CLNs | - | (600 ) | (600 ) |
| VIEs' liabilities | (225 ) | - | (225 ) |
| Total, net | $ (73 ) | $ (914 ) | $ (987 ) |

Transfers in and out of Level 3 are generally the result of observable market information on a security no longer being available or becoming available to our pricing vendors. For the three months ended June 30, 2010, our corporate bonds and CMBS transfers in and out were attributable primarily to the securities' observable market information being available or no longer being available. For the six months ended June 30, 2010, our corporate bonds and CMBS transfers in and out were attributable primarily to the securities' observable market information being available or no longer being available, respectively, and for the CLNs transfer out of Level 3, it related to new accounting guidance that is discussed in Note 4. For the three and six months ended June 30, 2010, there were no significant transfers between Level 1 and 2 of the fair value hierarchy.

15. Segment Information

We provide products and services in two operating businesses and report results through four business segments as follows:

| Business | Corresponding Segments |
|---|---|
| Retirement Solutions | Annuities |
| | Defined Contribution |
| | |
| Insurance Solutions | Life Insurance |
| | Group Protection |

We also have Other Operations, which includes the financial data for operations that are not directly related to the business segments. Our reporting segments reflect the manner by which our chief operating decision makers view and manage the business. The following is a brief description of these segments and Other Operations.

Retirement Solutions

The Retirement Solutions business provides its products through two segments: Annuities and Defined Contribution. The Annuities segment provides tax-deferred investment growth and lifetime income opportunities for its clients by offering individual fixed annuities, including indexed annuities and variable annuities. The Defined Contribution segment provides employer-sponsored variable and fixed annuities and mutual-fund based programs in the 401(k), 403(b) and 457 marketplaces.

Insurance Solutions

The Insurance Solutions business provides its products through two segments: Life Insurance and Group Protection. The Life Insurance segment offers wealth protection and transfer opportunities through term insurance, a linked-benefit product (which is a UL policy linked with riders that provide for long-term care costs) and both single and survivorship versions of UL and VUL, including corporate-owned UL and VUL insurance and bank-owned UL and VUL insurance products. The Group Protection segment offers group life, disability and dental insurance to employers, and its 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.

Other Operations

Other Operations includes investments related to the excess capital in our insurance subsidiaries; investments in media properties and other corporate investments; benefit plan net liability; the unamortized deferred gain on indemnity reinsurance related to the sale of reinsurance to Swiss Re in 2001; the results of certain disability income business due to the rescission of a reinsurance agreement with Swiss Re; the Institutional Pension business, which is a closed-block of pension business, the majority of which was sold on a group annuity basis, and is currently in run-off; and debt costs. We are actively managing our remaining radio station clusters to maximize performance and future value.

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

- Realized gains and losses associated with the following (“excluded realized loss”):

  - § Sale or disposal of securities;
  - § Impairments of securities;
  - § Change in the fair value of derivative instruments, embedded derivatives within certain reinsurance arrangements and our trading securities;
  - § Change in the fair value of the derivatives we own to hedge our GDB riders within our variable annuities;
  - § Change in the GLB embedded derivative reserves, net of the change in the fair value of the derivatives we own to hedge the changes in the embedded derivative reserves; and
  - § Changes in the fair value of the embedded derivative liabilities related to index call options we may purchase in the future to hedge contract holder index allocations applicable to future reset periods for our indexed annuity products accounted for under the Derivatives and Hedging and the Fair Value Measurements and Disclosures Topics of the FASB ASC.
- Change in reserves accounted for under the Financial Services – Insurance – Claim Costs and Liabilities for Future Policy Benefits Subtopic of the FASB ASC resulting from benefit ratio unlocking on our GDB and GLB riders (“benefit ratio unlocking”);
- Income (loss) from the initial adoption of new accounting standards;
- Income (loss) from reserve changes (net of related amortization) on business sold through reinsurance;
- Gain (loss) on early extinguishment of debt;
- Losses from the impairment of intangible assets; and
- Income (loss) from discontinued operations.

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

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

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

Segment information (in millions) was as follows:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Revenues | | | | |
| Operating revenues: | | | | |
| Retirement Solutions: | | | | |
| Annuities | $645 | $552 | $1,275 | $1,074 |
| Defined Contribution | 245 | 224 | 486 | 441 |
| Total Retirement Solutions | 890 | 776 | 1,761 | 1,515 |
| Insurance Solutions: | | | | |
| Life Insurance | 1,135 | 1,003 | 2,263 | 2,078 |
| Group Protection | 470 | 443 | 915 | 864 |
| Total Insurance Solutions | 1,605 | 1,446 | 3,178 | 2,942 |
| Other Operations | 121 | 115 | 245 | 222 |
| Excluded realized gain (loss), pre-tax | (11) | (455) | (52) | (662) |
| Amortization of deferred gains from reserve changes on business sold through reinsurance, pre-tax | 1 | 1 | 1 | 2 |
| Amortization income of DFEL associated with benefit ratio unlocking, pre-tax | (1) | - | (1) | (4) |
| Total revenues | $2,605 | $1,883 | $5,132 | $4,015 |

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Net Income (Loss) | | | | |
| Income (loss) from operations: | | | | |
| Retirement Solutions: | | | | |
| Annuities | $116 | $65 | $235 | $139 |
| Defined Contribution | 36 | 28 | 72 | 57 |
| Total Retirement Solutions | 152 | 93 | 307 | 196 |
| Insurance Solutions: | | | | |
| Life Insurance | 151 | 133 | 288 | 275 |
| Group Protection | 23 | 34 | 44 | 59 |
| Total Insurance Solutions | 174 | 167 | 332 | 334 |
| Other Operations | (36) | (53) | (73) | (160) |
| Excluded realized gain (loss), after-tax | (7) | (296) | (34) | (432) |
| Gain on early extinguishment of debt, after-tax | - | - | - | 42 |
| Income from reserve changes (net of related amortization) on business sold through reinsurance, after-tax | - | - | 1 | - |
| Impairment of intangibles, after-tax | - | 1 | - | (603) |
| Benefit ratio unlocking, after-tax | (31) | 81 | (25) | 29 |
| Income (loss) from continuing operations, after-tax | 252 | (7) | 508 | (594) |
| Income (loss) from discontinued operations, after-tax | 3 | (154) | 31 | (146) |
| Net income (loss) | $255 | $(161) | $539 | $(740) |

16. Supplemental Disclosures of Cash Flow

For details related to our business dispositions, see Note 3.

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

The following Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the financial condition as of June 30, 2010, compared with December 31, 2009, and the results of operations for the three and six months ended June 30, 2010, compared with the corresponding periods in 2009 of Lincoln National Corporation and its consolidated subsidiaries.  Unless otherwise stated or the context otherwise requires, "LNC," "Lincoln," "Company," "we," "our" or "us" refers to Lincoln National Corporation and its consolidated subsidiaries.  The MD&A is provided as a supplement to, and should be read in conjunction with our consolidated financial statements and the accompanying notes to the consolidated financial statements ("Notes") presented in "Part I – Item 1. Financial Statements"; our Form 10-K for the year ended December 31, 2009 ("2009 Form 10-K"), including the sections entitled "Part I – Item 1A. Risk Factors," "Part II – Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Part II – Item 8. Financial Statements and Supplementary Data"; our quarterly reports on Form 10-Q filed in 2010; and our current reports on Form 8-K filed in 2010.

In this report, in addition to providing consolidated revenues and net income (loss), we also provide segment operating revenues and income (loss) from operations because we believe they are meaningful measures of revenues and the profitability of our operating segments.  Income (loss) from operations is net income recorded in accordance with United States of America generally accepted accounting principles ("GAAP") excluding the after-tax effects of the following items, as applicable:

- Realized gains and losses associated with the following ("excluded realized gain (loss)"):
  - Sales or disposals of securities;
  - Impairments of securities;
  - Change in the fair value of derivative investments, embedded derivatives within certain reinsurance arrangements and our trading securities;
  - Change in the fair value of the derivatives we own to hedge our guaranteed death benefit ("GDB") riders within our variable annuities, which is referred to as "GDB derivatives results";
  - Change in the fair value of the embedded derivatives of our guaranteed living benefit ("GLB") riders within our variable annuities accounted for under the Derivatives and Hedging and the Fair Value Measurements and Disclosures Topics of the Financial Accounting Standards Board ("FASB") Accounting Standards CodificationTM ("ASC") ("embedded derivative reserves"), net of the change in the fair value of the derivatives we own to hedge the changes in the embedded derivative reserves, the net of which is referred to as "GLB net derivative results"; and
  - Changes in the fair value of the embedded derivative liabilities related to index call options we may purchase in the future to hedge contract holder index allocations applicable to future reset periods for our indexed annuity products accounted for under the Derivatives and Hedging and the Fair Value Measurements and Disclosures Topics of the FASB ASC ("indexed annuity forward-starting option").
- Change in reserves accounted for under the Financial Services – Insurance – Claim Costs and Liabilities for Future Policy Benefits Subtopic of the FASB ASC resulting from benefit ratio unlocking on our GDB and GLB riders ("benefit ratio unlocking");
- Income (loss) from the initial adoption of new accounting standards;
- Income (loss) from reserve changes (net of related amortization) on business sold through reinsurance;
- Gain (loss) on early extinguishment of debt;
- Losses from the impairment of intangible assets; and
- Income (loss) from discontinued operations.

Income (loss) from operations available to common stockholders is net income (loss) available to common stockholders (used in the calculation of earnings (loss) per share) in accordance with GAAP, excluding the after-tax effects of the items above and the acceleration of our Series B preferred stock discount as a result of redemption prior to five years from the date of issuance.

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

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

Operating revenues and income (loss) from operations are the financial performance measures we use to evaluate and assess the results of our segments. Accordingly, we report operating revenues and income (loss) from operations by segment in Note 15. Our management and Board of Directors believe that operating revenues and income (loss) from operations explain the results of our ongoing businesses in a manner that allows for a better understanding of the underlying trends in our current businesses because the excluded items are unpredictable and not necessarily indicative of current operating fundamentals or future performance of the business segments, and, in many instances, decisions regarding these items do not necessarily relate to the operations of the individual segments. In addition, we believe that our definitions of operating revenues and income (loss) from operations will provide investors with a more valuable measure of our performance because it better reveals trends in our business.

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

Certain reclassifications have been made to prior periods' financial information.

## FORWARD-LOOKING STATEMENTS – CAUTIONARY LANGUAGE

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

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

- Deterioration in general economic and business conditions that may affect account values, investment results, guaranteed benefit liabilities, premium levels, claims experience and the level of pension benefit costs, funding and investment results;
- Economic declines and credit market illiquidity could cause us to realize additional impairments on investments and certain intangible assets, including goodwill and a valuation allowance against deferred tax assets, which may reduce future earnings and/or affect our financial condition and ability to raise additional capital or refinance existing debt as it matures;
- Uncertainty about the impact of existing or new stimulus legislation on the economy;
- The restrictions, oversight, cost and other consequences of being a savings and loan holding company, including from the supervision, regulation and examination by the Office of Thrift Supervision ("OTS"), and arising from our participation in the U.S. Department of the Treasury's, or the "U.S. Treasury," Capital Purchase Program ("CPP") certain requirements of which may continue to apply to us so long as U.S. Treasury holds the warrant that we issued as a part of our participation in the CPP even after Lincoln's repurchase of the preferred stock issued to the Treasury as part of the CPP;
- Legislative, regulatory or tax changes, both domestic and foreign, that affect the cost of, or demand for, our subsidiaries' products, the required amount of reserves and/or surplus, or otherwise affect our ability to conduct business, including changes to statutory reserves and/or risk-based capital ("RBC") requirements related to secondary guarantees under universal life and variable annuity products such as Actuarial Guideline 43 ("AG43," also known as Commissioners Annuity Reserve Valuation Method for Variable Annuities or "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 us, and the outcome of any legal or regulatory proceedings, such as: adverse actions related to present or past business practices common in businesses in which we compete;

adverse decisions in significant actions including, but not limited to, actions brought by federal and state authorities and extra-contractual and class action damage cases; new decisions that result in changes in law; and unexpected trial court rulings;

- Changes in or sustained low interest rates causing a reduction of investment income, the margins of our subsidiaries' fixed annuity and life insurance businesses and demand for their products;
- A decline in the equity markets causing a reduction in the sales of our subsidiaries' products, a reduction of asset-based fees that our subsidiaries charge on various investment and insurance products, an acceleration of amortization of deferred acquisition costs ("DAC"), value of business acquired ("VOBA"), deferred sales inducements ("DSI") and DFEL and an increase in liabilities related to guaranteed benefit features of our subsidiaries' variable annuity products;
- Ineffectiveness of our various hedging strategies used to offset the impact of changes in the value of liabilities due to changes in the level and volatility of the equity markets and interest rates;
- A deviation in actual experience regarding future persistency, mortality, morbidity, interest rates or equity market returns from the assumptions used in pricing our subsidiaries' products, in establishing related insurance reserves and in elevated impairments on investments and amortization of intangible assets that may cause an increase in reserves and/or a reduction in assets, resulting in a corresponding decrease in net income;
- Changes in GAAP that may result in unanticipated changes to our net income;
- Lowering of one or more of our debt ratings issued by nationally recognized statistical rating organizations and the adverse impact such action may have on our ability to raise capital and on its liquidity and financial condition;
- Λοωερινγ οφ ονε ορ μορε οφ τηε ινσυρερ φινανχιαλ στρενγτη ρατινγσ οφ ουρ ινσυρανχε συβσιδιαριεσ ανδ τηε αδϖερσε ιμπαχτ συχη αχτιον μαψ ηαϖε ον τηε πρεμιυμ ωριτινγσ, πολιχψ ρετεντιον, προφιταβιλιτψ οφ ουρ ινσυρανχε συβσιδιαριεσ ανδ λιθυιδιτψ;

- Significant credit, accounting, fraud or corporate governance issues that may adversely affect the value of certain investments in our portfolios requiring that we realize losses on such investments;
- The impact of acquisitions and divestitures, restructurings, product withdrawals and other unusual items, including our ability to integrate acquisitions and to obtain the anticipated results and synergies from acquisitions;
- The adequacy and collectibility of reinsurance that we have purchased;
- Acts of terrorism, a pandemic, war or other man-made and natural catastrophes that may adversely affect our businesses and the cost and availability of reinsurance;
- Competitive conditions, including pricing pressures, new product offerings and the emergence of new competitors, that may affect the level of premiums and fees that our subsidiaries can charge for their products;
- The unknown impact on our subsidiaries' businesses resulting from changes in the demographics of their client base, as aging baby-boomers move from the asset-accumulation stage to the asset-distribution stage of life; and
- Loss of key management, financial planners or wholesalers.

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

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

## INTRODUCTION

### Executive Summary

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

We provide products and services in two operating businesses and report results through four business segments as follows:

| Business | Corresponding Segments |
|---|---|
| Retirement Solutions | Annuities |
| | Defined Contribution |
| | |
| Insurance Solutions | Life Insurance |
| | Group Protection |

These operating businesses and their segments are described in "Part I – Item 1. Business" of our 2009 Form 10-K.

We also have Other Operations, which includes the financial data for operations that are not directly related to the business segments. Other Operations also includes investments related to the excess capital in our insurance subsidiaries; investments in media properties and other corporate investments; benefit plan net liability; the unamortized deferred gain on indemnity reinsurance related to the sale of reinsurance to Swiss Re in 2001; the results of certain disability income business due to the rescission of a reinsurance agreement with Swiss Re; our run-off Institutional Pension business; and debt costs.

Our former Lincoln UK and Investment Management segments are reported in discontinued operations for all periods presented. See "Acquisitions and Dispositions" in our 2009 Form 10-K and Note 3 for more information.

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



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Current Market Conditions

Recent unfavorable market conditions including, but not limited to, the following concerns are weighing on the U.S. economy:

- High unemployment, shrinking unemployment benefits and weak job creation, all leading to lower disposable income that is necessary to fuel economic growth;
- Stressed capital and credit markets in Europe, and the impact of the expiration of the European Central Bank's 12-month liquidity facility on July 1, 2010, that had provided liquidity to euro area banks following the global financial crisis, as many banks still cannot access the short-term commercial paper market;
- Reports of an economic slowdown in China as policymakers have taken steps to slow lending due to concerns that the rapid expansion of its real estate sector could constitute a price bubble;
- Slowing U.S. housing market despite historically low housing prices and mortgage rates that have sunk to levels not seen in more than a half-century believed to be due in part to the tightening of mortgage lending standards and the April 30, 2010, expiration of the federal tax credit;
- Declining equity markets; and
- Sinking consumer confidence.

For these reasons, concerns exist that the economy is at risk of slipping into a "double-dip" recession (i.e., a continuous recession that is punctuated by a period of growth and then followed by a further decline in the economy). The National Bureau of Economic Research ("NBER"), a panel of economists charged with officially designating business cycles, announced in April 2010 that it cannot yet declare an end to the recession that began in December 2007. The market conditions during this time were characterized by extreme volatility and disruption that affected both equity market returns and interest rates as credit spreads widened across asset classes and reduced liquidity in the credit markets, and some of these economic issues appear to be resurfacing as mentioned above, thereby making the timing of an upward turn in the economy harder to discern than in the past. An NBER committee stated that a determination of the "trough" date based on current data would be premature.

The markets have primarily impacted us in the following areas:

Capital

During the second quarter of 2010, we addressed two matters that we believe had been depressing our stock price: our participation in the CPP and the upcoming maturity of credit facilities in the first quarter of 2011 related to letters of credit ("LOCs") supporting our life insurance business that could have remained outstanding until the first quarter of 2012. On June 30, 2010, after consultation with the OTS, we repurchased our Series B preferred stock that we had issued to the U.S. Treasury as part of our participation in the CPP, primarily as a result of the improvements in the economy and capital markets, as well as the strength of our business model and our capital position. We funded the $950 million liquidation value of the stock with net proceeds of approximately $368 million from a common stock offering, proceeds from a $250 million five-year senior notes offering and cash held at our holding company that was attributable primarily to proceeds from the sale of Delaware Management Holdings, Inc. ("Delaware"). As a result of repurchasing the preferred stock, we accelerated the remaining accretion of the preferred stock issuance discount of $131 million and recorded a corresponding charge to retained earnings and income (loss) available to common stockholders in the calculation of earnings per common share. Following the repayment, the U.S. Treasury continues to hold a warrant to purchase 13,049,451 shares of our common stock at an exercise price of $10.92 per share.
We notified the U.S. Treasury that we will not repurchase the warrant, which under the terms of the agreement between the parties acts as U.S. Treasury's notice to us of its intention to sell the warrant. In addition, we secured $2 billion of bank credit facilities as discussed in "Results of Insurance Solutions – Insurance Solutions – Life Insurance – Income from Operations – Strategies to Address Statutory Reserve Strain," "Review of Consolidated Financial Condition –

Liquidity and Capital Resources – Financing Activities" and Note 9. We also completed a 30-year senior notes offering of $500 million, the proceeds of which will be used as part of a long-term financing solution supporting UL business with secondary guarantees. For more information about our common stock and debt issuances, see "Review of Consolidated Financial Condition" below.

During May and June of 2010, Moody's Investors Service ("Moody's"), Fitch Ratings ("Fitch") and A.M. Best Co. ("A.M. Best") all improved their outlook on our company to stable from negative, and Standard & Poor's ("S&P")outlook remained stable. For more information about ratings, see "Part I – Item 1. Business – Ratings" in our 2009 Form 10-K and our Form 8-K filed on June 2, 2010.

Even with our actions, our improving ratings and our ability to produce solid results in our core businesses over the past several quarters, the price of our common stock remained volatile and declined to close at $24.29 on June 30, 2010, after trading at a high of $33.55 during the first six months of 2010. We believe the recent volatility and decline in our stock price is more a result of the current macro economic conditions discussed above that are impacting our peer group and the entire market as opposed to factors that are unique to our company.

In the face of these global economic challenges, we continue to focus on building our businesses through these difficult markets and beyond by developing and introducing high quality products, expanding distribution in new and existing key accounts and channels and targeting market segments that have high growth potential while maintaining a disciplined approach to managing our expenses. However, the prior significant decline in the equity markets continues to constrain growth of average account values despite higher deposits and net flows during the first six months of 2010 than in the comparable period of 2009.

Interest Rate Risk on Fixed Insurance Business

Because the profitability of our fixed annuity, UL, VUL and defined contribution insurance business depends in part on interest rate spreads, interest rate fluctuations could negatively affect our profitability. Changes in interest rates may reduce both our profitability from spread businesses and our return on invested capital. Some of our products, principally our fixed annuities, UL and VUL, have interest rate guarantees that expose us to the risk that changes in interest rates or prolonged low interest rates will reduce our spread, or the difference between the amounts that we are required to pay under the contracts and the amounts we are able to earn on our general account investments intended to support our obligations under the contracts. Although we have been proactive in our investment strategies, product designs, crediting rate strategies and overall asset-liability practices to mitigate the risk of unfavorable consequences in this type of environment, declines in our spread, or instances where the returns on our general account investments are not enough to support the interest rate guarantees on these products, could have an adverse effect on our businesses or results of operations. We discuss the earnings impact of interest rates below in “Part I – Item 3. Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk on Fixed Insurance Business – Falling Rates” and “Part II – Item 1A. Risk Factors – Changes in interest rates and sustained low interest rates may cause interest rate spreads to decrease and changes in interest rates may also result in increased contract withdrawals.”

Earnings from Account Values

Our asset-gathering segments – Retirement Solutions – Annuities and Retirement Solutions – Defined Contribution – are the most sensitive to the equity markets, as well as, to a lesser extent, our Insurance Solutions – Life Insurance segment. We discuss the earnings impact of the equity markets on account values and the related asset-based earnings below in “Part I – Item 3. Quantitative and Qualitative Disclosures About Market Risk – Equity Market Risk – Impact of Equity Market Sensitivity.” From December 31, 2009, to June 30, 2010, our account values were down $996 million driven primarily by a significant decline in equity markets during the month of June, partially offset by strong deposits and positive net flows. While the end of period S&P 500 Index® (“S&P 500”) as of June 30, 2010, was lower than as of December 31, 2009, the daily average S&P 500 increased 1% during this time.

Investment Income on Alternative Investments

Our alternative investments portfolio consists primarily of hedge funds and various limited partnership investments. See “Critical Accounting Policies and Estimates – Investments – Valuation of Alternative Investments” in our 2009 Form 10-K and “Consolidated Investments – Alternative Investments” below for additional information on our investment portfolio.

Variable Annuity Hedge Program Results

We offer variable annuity products with living benefit guarantees. As described in “Critical Accounting Policies and Estimates – Derivatives – Guaranteed Living Benefits” in our 2009 Form 10-K, we use derivative instruments to hedge our exposure to the risks and earnings volatility that result from the GLB embedded derivatives in certain of our variable annuity products. The change in fair value of these instruments tends to move in the opposite direction of the change in embedded derivative reserves. These results are excluded from the Retirement Solutions – Annuities and Defined Contribution segments' operating revenues and income from operations. See "Realized Gain (Loss) – Operating Realized Gain (Loss) – GLB" for information on our methodology for calculating the non-performance risk ("NPR"), which affects the discount rate used in the calculation of the GLB embedded derivative reserve.

We also offer variable products with death benefit guarantees. As described in "Critical Accounting Policies and Estimates – Future Contract Benefits and Other Contract Holder Obligations – Guaranteed Death Benefits" in our 2009 Form 10-K, we use derivative instruments to attempt to hedge the income statement impact in the opposite direction of the GDB benefit ratio unlocking for movements in equity markets. These results are excluded from income (loss) from operations.

Credit Losses, Impairments and Unrealized Losses

Related to our investments in fixed income and equity securities, we experienced net realized losses that reduced net income by $14 million and $18 million for the three and six months ended June 30, 2010, respectively, and included credit-related write-downs of securities for other-than-temporary impairments ("OTTI") of $7 million and $42 million, respectively. Although economic conditions have improved, we expect a continuation of some level of OTTI. If we were to experience another period of weakness in the economic environment like we did in late 2008 and early 2009, it could lead to increased credit defaults, resulting in additional write-downs of securities for OTTI.

Increased liquidity in several market segments and improved credit fundamentals (i.e., market improvement and narrowing credit spreads) as of June 30, 2010, compared to December 31, 2009, have resulted in the $1.0 billion decrease in gross unrealized losses on the available-for-sale (“AFS”) fixed maturity securities in our general account as of June 30, 2010.

Issues and Outlook

For the remainder of 2010, significant issues include:

- Potential unstable credit markets that can impact our financing alternatives, spreads and other-than-temporary securities impairments;
- Potential volatile equity markets that have a significant impact on our hedge program performance and revenues;
- Continuation of the low interest rate environment, which affects the investment margins and reserve levels for many of our products, such as fixed annuities, UL and the fixed portion of defined contribution and VUL business;
- Continuation of global economic challenges;
- Achieving continued sales success with our portfolio of products, including marketplace acceptance of new variable annuity features, as well as retaining management and wholesaler talent to maintain our competitive position;
- Evolving treatment of reserve financing by rating agencies; and
- Continuing focus by the government on tax, financial and healthcare reform including potential changes in company dividends-received deduction (“DRD”) calculations, which may affect the value and profitability of our products and overall earnings.

In the face of these issues and potential issues, we expect to focus on the following throughout the remainder of 2010:

- Continuing to explore additional financing strategies addressing the statutory reserve strain related to our secondary guarantee UL products in order to manage our capital position effectively in accordance with our pricing guidelines;
- Increasing our product development activities together with identifying future product development initiatives, with a focus on further reducing risk related to guaranteed benefit riders available with certain variable annuity contracts;
- Evaluating opportunities for strategic investments in our businesses to grow revenues and further spur productivity, particularly in Retirement Solutions – Defined Contribution and Insurance Solutions – Group Protection, with technology upgrades and new products for the voluntary market and an expanded distribution focus for our group business;
- Managing our expenses aggressively through process improvement initiatives combined with continued financial discipline and execution excellence throughout our operations;
- Closely monitoring ongoing changes in the legal and regulatory environment; and
- Closely monitoring our capital and liquidity positions taking into account the fragile economic recovery and changing statutory accounting and reserving practices.

For additional factors that could cause actual results to differ materially from those set forth in this section, see “Part I – Item 1A. Risk Factors” in our 2009 Form 10-K and “Forward-Looking Statements – Cautionary Language” above.

## Critical Accounting Policies and Estimates

The MD&A included in our 2009 Form 10-K contains a detailed discussion of our critical accounting policies and estimates. The following information updates the "Critical Accounting Policies and Estimates" provided in our 2009 Form 10-K and, accordingly, should be read in conjunction with the "Critical Accounting Policies and Estimates" discussed in our 2009 Form 10-K.

DAC, VOBA, DSI and DFEL

Our DAC, VOBA, DSI and DFEL balances (in millions) by business segment as of June 30, 2010, were as follows:

| | Retirement Solutions | | Insurance Solutions | | |
|---|---|---|---|---|---|
| | Annuities | Defined Contribution | Life Insurance | Group Protection | Total |
| DAC and VOBA | | | | | |
| Gross | $2,668 | $ 514 | $6,582 | $166 | $9,930 |
| Unrealized (gain) loss | (512) | (139) | (744) | - | (1,395) |
| Carrying value | $2,156 | $ 375 | $5,838 | $166 | $8,535 |
| | | | | | |
| DSI | | | | | |
| Gross | $331 | $ 2 | $- | $- | $333 |
| Unrealized (gain) loss | (44) | - | - | - | (44) |
| Carrying value | $287 | $ 2 | $- | $- | $289 |
| | | | | | |
| DFEL | | | | | |
| Gross | $205 | $ - | $1,292 | $- | $1,497 |
| Unrealized gain (loss) | (4) | - | (185) | - | (189) |
| Carrying value | $201 | $ - | $1,107 | $- | $1,308 |

AFS securities and certain derivatives are stated at fair value with unrealized gains and losses included within accumulated other comprehensive income (loss), net of associated DAC, VOBA, DSI, other contract holder funds and deferred income taxes. The unrealized balances in the table above represent the DAC, VOBA, DSI and DFEL balances for these effects of unrealized gains and losses on AFS securities and certain derivatives as of the end-of-period.

On a quarterly basis, we may record an adjustment to the amounts included within our Consolidated Balance Sheets for DAC, VOBA, DSI and DFEL with an offsetting benefit or charge to revenue or expense for the impact of the difference between future expected gross profits ("EGPs") used in the prior quarter and the emergence of actual and updated future EGPs in the current quarter ("retrospective unlocking"). In addition, in the third quarter of each year, we conduct our annual comprehensive review of the assumptions and the projection models used for our estimates of future gross profits underlying the amortization of DAC, VOBA, DSI and DFEL and the calculations of the embedded derivatives and reserves for life insurance and annuity products with living benefit and death benefit guarantees. These assumptions include investment margins, mortality, retention, rider utilization and maintenance expenses (costs associated with maintaining records relating to insurance and individual and group annuity contracts and with the processing of premium collections, deposits, withdrawals and commissions). Based on our review, the cumulative balances of DAC, VOBA, DSI and DFEL, included on our Consolidated Balance Sheets, are adjusted with an offsetting benefit or charge to revenue or amortization expense to reflect such change ("prospective unlocking – assumption changes"). We may have prospective unlocking in other quarters as we become aware of information that warrants updating outside of our annual comprehensive review. We may also identify and implement actuarial modeling refinements ("prospective unlocking – model refinements") that result in increases or decreases to the carrying values of DAC, VOBA, DSI, DFEL, embedded derivatives and reserves for life insurance and annuity products with living benefit and death benefit guarantees. The primary distinction between retrospective and prospective unlocking is that retrospective unlocking is driven by the difference between actual gross profits compared to EGPs each period, while prospective unlocking is driven by changes in assumptions or projection models related to our projections of future EGPs.

In discussing our results of operations below in this MD&A, we refer to favorable and unfavorable unlocking. With respect to DAC, VOBA and DSI, favorable unlocking refers to a decrease in the amortization expense in the period, whereas unfavorable unlocking refers to an increase in the amortization expense in the period. With respect to DFEL, favorable unlocking refers to an increase in the amortization income in the period, whereas unfavorable unlocking refers to a decrease in the amortization income in the period. With respect to the calculations of the embedded derivatives and reserves for life insurance and annuity products with living benefit and death benefit guarantees, favorable unlocking refers to a decrease in reserves in the period, whereas unfavorable unlocking refers to an increase in reserves in the period.

We amortize DAC, VOBA, DSI and DFEL in proportion to our EGPs. When actual gross profits are higher in the period than expected, we recognize more amortization than planned. When actual gross profits are lower in the period than expected, we recognize less amortization than planned. In a calendar year where the gross profits for a certain group of policies, or "cohorts," are expected to be negative, our actuarial process limits, or floors, the amortization expense offset to zero.

During the first quarter of 2010, there was a $21 million favorable prospective unlocking of DAC and VOBA from assumption changes due to including an estimate in our models for rider fees related to our annuity products with living benefit guarantees. Additionally, during the second quarter of 2010, we revised this estimate, which resulted in an additional $5 million favorable prospective unlocking of DAC and VOBA.

Because equity market movements have a significant impact on the value of variable annuity and VUL products and the fees earned on these accounts, EGPs could increase or decrease with movements in the equity markets; therefore, significant and sustained changes in equity markets have had and could in the future have an impact on DAC, VOBA, DSI and DFEL amortization for our variable annuity, annuity-based 401(k) business and VUL business.

As equity markets do not move in a systematic manner, we reset the baseline of account values from which EGPs are projected, which we refer to as our "reversion to the mean" ("RTM") process. Under our 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 our variable annuity, annuity-based 401(k) and VUL blocks of business. Because future equity market returns are unpredictable, the underlying premise of this process is that best estimate projections of future EGPs 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, DFEL and changes in future contract benefits. 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.

The stochastic modeling performed for our variable annuity blocks of business as described above is used to develop a range of reasonably possible future EGPs. We compare the range of the present value of the future EGPs from the stochastic modeling to that used in our amortization model. A set of intervals around the mean of these scenarios is utilized to calculate two separate statistical ranges of reasonably possible EGPs. These intervals are then compared again to the present value of the EGPs used in the amortization model. If the present value of EGP assumptions utilized for amortization were to exceed the margin of the reasonable range of statistically calculated EGPs, a revision of the EGPs used to calculate amortization would occur. If a revision is deemed necessary, future EGPs would be re-projected using the current account values at the end of the period during which the revision occurred along with a revised long-term annual equity market gross return assumption such that the re-projected EGPs would be our best estimate of EGPs.

Notwithstanding these intervals, if a severe decline or advance in equity markets were to occur or should other circumstances, including contract holder behavior, suggest that the present value of future EGPs no longer represents our best estimate, we could determine that a revision of the EGPs is necessary.

Our practice is not necessarily to unlock immediately after exceeding the first of the two statistical ranges, but, rather, if we stay between the first and second statistical range for several quarters, we would likely unlock. Additionally, if we exceed the ranges as a result of a short-term market reaction, we would not necessarily unlock. However, if the second statistical range is exceeded for more than one quarter, it is likely that we would unlock. While this approach reduces adjustments to DAC, VOBA, DSI and DFEL due to short-term equity market fluctuations, significant changes in the equity markets that extend beyond one or two quarters could result in a significant favorable or unfavorable unlocking.

Our long-term equity market growth assumption rate is 9%, which is used in the determination of DAC, VOBA, DSI and DFEL amortization for the variable component of our variable annuity and VUL products, as this component is related primarily to underlying investments in equity funds within the separate accounts.  This variable appreciation rate is before the deduction of our contract fees.  Although the piercing of the outer corridor does not automatically result in a resetting of our RTM assumption, if economic conditions change significantly, additional unlocking of our RTM assumptions could be possible in future periods.  However, if we were to have unlocked our RTM assumption in the corridor as of June 30, 2010, for our Retirement Solutions business, we would have recorded a favorable prospective unlocking of approximately $150 million, pre-tax, as a result of improved market conditions since our last unlock of RTM in the fourth quarter of 2008.

Goodwill and Other Intangible Assets

Goodwill and intangible assets with indefinite lives are not amortized, but are subject to impairment tests conducted at least annually.  Intangibles that do not have indefinite lives are amortized over their estimated useful lives.  We are required to perform a two-step test in our evaluation of the carrying value of goodwill.  In Step 1 of the evaluation, the fair value of each reporting unit is determined and compared to the carrying value of the reporting unit.  If the fair value is greater than the carrying value, then the carrying value of the reporting unit is deemed to be recoverable, and Step 2 is not required.  If the fair value estimate is less than the carrying value, it is an indicator that impairment may exist, and Step 2 is required.  In Step 2, the reporting unit's goodwill implied fair value is determined.  The reporting unit's fair value as determined in Step 1 is assigned to all of its net assets (recognized and unrecognized) as if the reporting unit were acquired in a business combination as of the date of the impairment test.  If the implied fair value of the reporting unit's goodwill is lower than its carrying amount, goodwill is impaired and written down to its fair value.  Refer to Note 10 of our consolidated financial statements within our 2009 Form 10-K for goodwill and intangible assets by reporting unit.

The fair values of our insurance and annuities businesses are comprised of two components:  the value of new business and the value of in-force business.  Factors could cause us to believe our estimated fair value of the total business may be lower than the carrying value and trigger a Step 1 test, but may not require a step 2 test, and even if it does, not result in a goodwill impairment under the Step 2 test because the Step 2 test is focused on supporting the fair value of the goodwill asset.  The value of new business supports the valuation of our goodwill asset.  Our Life Insurance reporting unit's implied fair value of goodwill is most sensitive to new business production levels and discount rates.  Factors that could impact production levels include mix of new business, customer acceptance of our products and distribution strength.  Recent declines in interest rates have applied downward pressure to the interest rate inputs used in the discount rate calculation.  Spread compression and other impacts to profitability caused by lower interest rates have a much more significant impact on the valuation of in-force business than the valuation of new business.  The impact of interest rate movements on the value of new business is primarily related to the discount rate, because the cash flows for new business are not as sensitive to interest rates as our in-force business.

While threats to future profitability can theoretically cause an increase to the discount rate, a drop in the risk-free interest rates will also lower the cost of capital used in calculating the discount rate applied to the business.  Our sensitivity disclosures for the effect that changes in valuation assumptions could have on our estimate of our reporting units' fair value, therefore, provide sensitivities to both discount rates and new business generation and do not isolate interest rates.  For such disclosures, see "Critical Accounting Policies and Estimates – Goodwill and Other Intangible Assets" in our 2009 Form 10-K.

As discussed above in "Current Market Conditions – Stock Price," our stock price has been unfavorably affected by the current market conditions.  At this time, we believe the decline in our stock price neither corresponds to a decline in the estimated fair value of our reporting units nor provides an indicator that requires us to perform an interim impairment test to reassess our conclusions related to goodwill recoverability since our annual evaluation as of October 1, 2009, due primarily to the following:

- The price of our common stock as of June 30, 2010, was slightly higher than its price as of October 1, 2009, and although our volatility has increased it recently, it has not occurred for a prolonged period of time;
- Lower debt yields have applied downward pressure to the discount rate calculation;
- During the second quarter of 2010, we repurchased our Series B preferred stock that we had issued through the CPP and secured $2 billion of bank credit facilities as well as completed a senior notes offering of $500 million, the proceeds of which will be used as part of a long-term financing solution supporting UL business with secondary guarantees; each of these matters had previously been weighing on the estimated fair value of our reporting units;
- We have experienced improving ratings since October 1, 2009;
- We have produced solid results in our core businesses over the past several quarters, and our earnings projections and expectations for future sales have not deteriorated since our annual evaluation;
- We have not experienced higher impairments on invested assets than assumed in our projections; and
- The key assumptions used in our estimates of fair value have not significantly changed from October 1, 2009.

We will continue to monitor the current market conditions, and if they were to deteriorate to levels experienced during the end of 2008 and the first quarter of 2009, and, in particular, if our share price were to remain below book value per share for an extended period of time or deteriorate further, we may need to perform interim goodwill impairment tests in addition to our annual test as of October 1, 2010.

Consolidation of Variable Interest Entities

We have investments in two credit-linked notes ("CLNs") that are deemed to be variable interest entities ("VIEs"). Effective January 1, 2010, in accordance with new accounting guidance (see Note 2), we determined that we are the primary beneficiary of these VIEs. As such, we reflected the financial condition and results of operations of these VIEs in our consolidated financial statements and recorded a cumulative effect adjustment of $169 million, after-tax, to the beginning balance of retained earnings as of January 1, 2010.

We use assumptions, estimates and judgments similar to those used for our investments and derivatives in determining the results of operations and financial position of these VIEs. In addition, we use judgments in concluding whether we are the primary beneficiary of these VIEs. Specifically, judgment is required in situations where our economic interest in the VIE is significantly greater than our stated power to direct the activities that most significantly impact the economic performance of the VIE.

See Note 4 for more detail regarding the consolidation of these VIEs.

Investments

Investment Valuation

As of June 30, 2010, we evaluated the markets that our securities trade in and concluded that none were inactive. We will continue to re-evaluate this conclusion, as needed, based on market conditions. We use an internationally recognized pricing service as our primary pricing source, and we generally do not obtain multiple prices for our financial instruments. We generally use prices from the pricing service rather than broker quotes as we have documentation from the pricing service on the observable market inputs that they use to determine the prices in contrast to the broker quotes where we have limited information on the pricing inputs. As of June 30, 2010, we only obtained multiple prices for 36 available-for-sale and trading securities. These multiple prices were primarily related to instances where the vendor was providing a price for the first time and we also received a broker quote. In these instances, we used the price from the pricing service due to the higher reliability as discussed above. As of June 30, 2010, we used broker quotes for 173 securities as our final price source, representing less than 4% of total securities owned.

Derivatives

We use derivative instruments to manage a variety of equity market and interest rate risks that are inherent in many of our life insurance and annuity products. Assessing the effectiveness of these hedging programs and evaluating the carrying values of the related derivatives often involve a variety of assumptions and estimates. We use derivatives to hedge equity market risks, interest rate risk and foreign currency exposures that are embedded in our annuity and life insurance product liabilities or investment portfolios. Derivatives held as of June 30, 2010, contain industry standard terms. Our accounting policies for derivatives and the potential impact on interest spreads in a falling rate environment are discussed in "Part I – Item 3. Quantitative and Qualitative Disclosures About Market Risk" and Note 6 of this report and "Part II – Item 7A. Quantitative and Qualitative Disclosures About Market Risk" and Note 6 to the consolidated financial statements in our 2009 Form 10-K.

Guaranteed Living Benefits

As of June 30, 2010, the fair values of the embedded derivative reserves, before adjustment for the required NPR factors, for the guaranteed withdrawal benefit ("GWB") feature, the i4LIFE® Advantage guaranteed income benefit ("GIB") feature and the 4LATER® Advantage GIB feature were $1.1 billion, $427 million and $286 million, respectively. See "Realized Gain (Loss) – Operating Realized Gain (Loss) – GLB" for information on how we determine our NPR.

As of June 30, 2010, the fair value of our derivative assets, which hedge both our GLB and GDB features, and including margins generated by futures contracts, was $2.2 billion. As of June 30, 2010, the sum of all GLB liabilities at fair value, excluding the NPR adjustment, and GDB reserves was $1.9 billion, comprised of $1.8 billion for GLB liabilities and $105 million for the GDB reserves. The fair value of the hedge assets exceeded the liabilities by $265 million. However, the relationship of hedge assets to the liabilities for the guarantees may vary in any given reporting period due to market conditions, hedge performance and/or changes to the hedging strategy.

Approximately 42% of our variable annuity account values contain a GWB rider as of June 30, 2010. Declines in the equity markets increase our exposure to potential benefits under the GWB contracts, leading to an increase in our existing liability for those benefits. For example, a GWB contract is "in the money" if the contract holder's account balance falls below the guaranteed amount. As of June 30, 2010, and June 30, 2009, 83% and 75% respectively, of all GWB in-force contracts were "in the money," and our exposure to the guaranteed amounts, after reinsurance, as of June

30, 2010, and June 30, 2009, was $3.1 billion and $4.0 billion, respectively. Our exposure before reinsurance for these same periods was $3.5 billion and $4.5 billion, respectively. The ultimate amount to be paid by us related to GWB guarantees is uncertain and could be significantly more or less than $3.1 billion, net of reinsurance.

For information on our GLB and GDB hedging results, see our discussion in "Realized Gain (Loss)" below.

The following table presents our estimates of the potential instantaneous impact to realized gain (loss), which could result from sudden changes that may occur in equity markets, interest rates and implied market volatilities (in millions) at the levels indicated in the table and excludes the net cost of operating the hedging program. The amounts represent the estimated difference between the change in the portion of GLB reserves that is calculated on a fair value basis and the change in the value of the underlying hedge instruments after the amortization of DAC, VOBA, DSI and DFEL and taxes. These impacts do not include any estimate of retrospective or prospective unlocking that could occur, nor do they estimate any change in the NPR component of the GLB reserve or any estimate of impacts to our GLB benefit ratio unlocking. These estimates are based upon the recorded reserves as of June 30, 2010, and the related hedge instruments in place as of that date. The effects presented in the table below are not representative of the aggregate impacts that could result if a combination of such changes to equity market returns, interest rates and implied volatilities occurred.

| | In-Force Sensitivities | | | |
|---|---|---|---|---|
| | -20% | -10% | -5% | 5% |
| Equity market return | $ (55) | $ (14) | $ (4) | $ (3) |
| | -50 bps | -25 bps | +25 bps | +50 bps |
| Interest rates | $ (12) | $ (3) | $ (2) | $ (9) |
| | -4% | -2% | 2% | 4% |
| Implied volatilities | $ 25 | $ 13 | $ (16) | $ (33) |

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

| | Assumptions of Changes In | | | Hypothetical |
|---|---|---|---|---|
| | Equity Market Return | Interest Rate Yields | Market Implied Volatilities | Impact to Net Income |
| Scenario 1 | -5 % | -12.5 bps | +1 % | $ (16) |
| Scenario 2 | -10 % | -25.0 bps | +2 % | (45) |
| Scenario 3 | -20 % | -50.0 bps | +4 % | (151) |

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

- The analysis is only valid as of June 30, 2010, due to changing market conditions, contract holder activity, hedge positions and other factors;
- The analysis assumes instantaneous shifts in the capital market factors and no ability to rebalance hedge positions prior to the market changes;
- The analysis assumes constant exchange rates and implied dividend yields;
- Assumptions regarding shifts in the market factors, such as assuming parallel shifts in interest rate and implied volatility term structures, may be overly simplistic and not indicative of actual market behavior in stress scenarios;
- It is very unlikely that one capital market sector (e.g., equity markets) will sustain such a large instantaneous movement without affecting other capital market sectors; and
- The analysis assumes that there is no tracking or basis risk between the funds and/or indices affecting the GLBs and the instruments utilized to hedge these exposures. Tracking or basis risk in the second quarter of 2010 increased earnings by $4 million.

## Acquisitions and Dispositions

For information about acquisitions and divestitures, see Note 3 in this report and "Part I – Item 1. Business – Acquisitions and Dispositions," "Part II – Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Acquisitions and Dispositions" and Note 3 to the consolidated financial statements in our 2009 Form 10-K.

RESULTS OF CONSOLIDATED OPERATIONS

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

| | For the Three Months Ended June 30, | | | For the Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Revenues | | | | | | |
| Insurance premiums | $551 | $542 | 2% | $1,083 | $1,050 | 3% |
| Insurance fees | 793 | 691 | 15% | 1,581 | 1,392 | 14% |
| Net investment income | 1,120 | 971 | 15% | 2,226 | 1,984 | 12% |
| Realized gain (loss): | | | | | | |
| Total OTTI losses on securities | (11) | (221) | 95% | (88) | (431) | 80% |
| Portion of loss recognized in OCI | - | 103 | -100% | 24 | 192 | -88% |
| Net OTTI losses on securities recognized in earnings | (11) | (118) | 91% | (64) | (239) | 73% |
| Realized gain (loss), excluding OTTI losses on securities | 16 | (325) | 105% | 43 | (400) | 111% |
| Total realized gain (loss) | 5 | (443) | 101% | (21) | (639) | 97% |
| Amortization of deferred gain on business sold through reinsurance | 19 | 18 | 6% | 38 | 37 | 3% |
| Other revenues and fees | 117 | 104 | 13% | 225 | 191 | 18% |
| Total revenues | 2,605 | 1,883 | 38% | 5,132 | 4,015 | 28% |
| Benefits and Expenses | | | | | | |
| Interest credited | 613 | 607 | 1% | 1,231 | 1,234 | 0% |
| Benefits | 839 | 575 | 46% | 1,618 | 1,495 | 8% |
| Underwriting, acquisition, insurance and other expenses | 754 | 694 | 9% | 1,467 | 1,338 | 10% |
| Interest and debt expense | 69 | 61 | 13% | 137 | 61 | 125% |
| Impairment of intangibles | - | (1) | 100% | - | 603 | -100% |
| Total benefits and expenses | 2,275 | 1,936 | 18% | 4,453 | 4,731 | -6% |
| Income (loss) from continuing operations before taxes | 330 | (53) | NM | 679 | (716) | 195% |
| Federal income tax expense (benefit) | 78 | (46) | 270% | 171 | (122) | 240% |
| Income (loss) from continuing operations | 252 | (7) | NM | 508 | (594) | 186% |
| Income (loss) from discontinued operations, net of federal income taxes | 3 | (154) | 102% | 31 | (146) | 121% |
| Net income (loss) | $255 | $(161) | 258% | $539 | $(740) | 173% |

| | For the Three Months Ended June 30, 2010 | 2009 | Change | For the Six Months Ended June 30, 2010 | 2009 | Change |
|---|---|---|---|---|---|---|
| Revenues | | | | | | |
| Operating revenues: | | | | | | |
| Retirement Solutions: | | | | | | |
| Annuities | $645 | $552 | 17% | $1,275 | $1,074 | 19% |
| Defined Contribution | 245 | 224 | 9% | 486 | 441 | 10% |
| Total Retirement Solutions | 890 | 776 | 15% | 1,761 | 1,515 | 16% |
| Insurance Solutions: | | | | | | |
| Life Insurance | 1,135 | 1,003 | 13% | 2,263 | 2,078 | 9% |
| Group Protection | 470 | 443 | 6% | 915 | 864 | 6% |
| Total Insurance Solutions | 1,605 | 1,446 | 11% | 3,178 | 2,942 | 8% |
| Other Operations | 121 | 115 | 5% | 245 | 222 | 10% |
| Excluded realized gain (loss), pre-tax | (11) | (455) | 98% | (52) | (662) | 92% |
| Amortization of deferred gain arising from reserve changes on business sold through reinsurance, pre-tax | 1 | 1 | 0% | 1 | 2 | -50% |
| Amortization income of DFEL associated with benefit ratio unlocking, pre-tax | (1) | - | NM | (1) | (4) | 75% |
| Total revenues | $2,605 | $1,883 | 38% | $5,132 | $4,015 | 28% |

| | For the Three Months Ended June 30, 2010 | 2009 | Change | For the Six Months Ended June 30, 2010 | 2009 | Change |
|---|---|---|---|---|---|---|
| Net Income (Loss) | | | | | | |
| Income (loss) from operations: | | | | | | |
| Retirement Solutions: | | | | | | |
| Annuities | $116 | $65 | 78% | $235 | $139 | 69% |
| Defined Contribution | 36 | 28 | 29% | 72 | 57 | 26% |
| Total Retirement Solutions | 152 | 93 | 63% | 307 | 196 | 57% |
| Insurance Solutions: | | | | | | |
| Life Insurance | 151 | 133 | 14% | 288 | 275 | 5% |
| Group Protection | 23 | 34 | -32% | 44 | 59 | -25% |
| Total Insurance Solutions | 174 | 167 | 4% | 332 | 334 | -1% |
| Other Operations | (36) | (53) | 32% | (73) | (160) | 54% |
| Excluded realized gain (loss), after-tax | (7) | (296) | 98% | (34) | (432) | 92% |
| Gain on early extinguishment of debt, after-tax | - | - | NM | - | 42 | -100% |

| | | | | | | |
|---|---|---|---|---|---|---|
| Income from reserve changes (net of related amortization) on business sold through reinsurance, after-tax | - | - | NM | 1 | - | NM |
| Impairment of intangibles, after-tax | - | 1 | -100% | - | (603) | 100% |
| Benefit ratio unlocking, after-tax | (31) | 81 | NM | (25) | 29 | NM |
| Income (loss) from continuing operations, after-tax | 252 | (7) | NM | 508 | (594) | 186% |
| Income (loss) from discontinued operations, after-tax | 3 | (154) | 102% | 31 | (146) | 121% |
| Net income (loss) | $255 | $(161) | 258% | $539 | $(740) | 173% |

| | For the Three Months Ended June 30, | | | For the Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Deposits | | | | | | |
| Retirement Solutions: | | | | | | |
| Annuities | $2,823 | $2,625 | 8 % | $5,099 | $4,813 | 6 % |
| Defined Contribution | 1,374 | 1,130 | 22 % | 2,681 | 2,691 | 0 % |
| Insurance Solutions - Life Insurance | 1,063 | 1,020 | 4 % | 2,140 | 2,077 | 3 % |
| Total deposits | $5,260 | $4,775 | 10 % | $9,920 | $9,581 | 4 % |
| | | | | | | |
| Net Flows | | | | | | |
| Retirement Solutions: | | | | | | |
| Annuities | $1,153 | $1,035 | 11 % | $1,728 | $1,465 | 18 % |
| Defined Contribution | 182 | 256 | -29 % | 291 | 913 | -68 % |
| Insurance Solutions - Life Insurance | 650 | 540 | 20 % | 1,252 | 1,097 | 14 % |
| Total net flows | $1,985 | $1,831 | 8 % | $3,271 | $3,475 | -6 % |

| | As of June 30, | | |
|---|---|---|---|
| | 2010 | 2009 | Change |
| Account Values | | | |
| Retirement Solutions: | | | |
| Annuities | $73,324 | $63,054 | 16 % |
| Defined Contribution | 35,040 | 31,327 | 12 % |
| Insurance Solutions - Life Insurance | 31,965 | 30,622 | 4 % |
| Total account values | $140,329 | $125,003 | 12 % |

Comparison of the Three Months Ended June 30, 2010 to 2009

Net income increased due primarily to the following:

- Loss from discontinued operations of $154 million during the second quarter of 2009 driven primarily by the loss on disposition of our Lincoln UK segment partially offset by income from discontinued operations related to our former Lincoln UK and Investment Management segments (see Note 3 for more information on our discontinued operations).
- Higher net investment income and relatively flat interest credited, excluding unlocking, driven primarily by:
  - § Higher average fixed account values, including the fixed portion of variable annuity contracts, attributable primarily to positive net flows, partially offset by transfers from fixed to variable since the second quarter of 2009;
  - § More favorable investment income on surplus and alternative investments and higher prepayment and bond makewhole premiums (see "Additional Information" and "Consolidated Investments – Alternative Investments" and "Consolidated Investments – Commercial Mortgage Loan Prepayment and Bond Makewhole Premiums" below for more information);
  - § Higher invested assets driven primarily by favorable net flows on fixed account values, including the fixed portion of variable, and to a lesser extent issuances of common stock and debt subsequent to June 30, 2009; and
  - § Actions implemented to reduce interest crediting rates and holding lower cash balances in the second quarter of 2010 that increased our portfolio yields;

- A decrease in realized losses on our AFS securities attributable primarily to lower OTTI due to overall improvement in the credit markets;
- Higher earnings from our variable annuity and mutual fund (within our Defined Contribution segment) products as a result of increases in the equity markets;
- The overall unfavorable GDB derivative results, excluding unlocking, during the second quarter of 2009 due primarily to sporadic large movements in rates and equities that caused non-linear changes in the liability relative to the derivatives utilized in the hedge program and by other items (see "Realized Gain (Loss)" below for more information on our GDB derivatives results);
- The overall unfavorable GLB net derivatives results, excluding unlocking, during the second quarter of 2009 due primarily to increases in interest rates and our over-hedged position for a period of time in 2009 (see "Realized Gain (Loss)" below for more information on our GLB liability and derivative performance); and
- A $5 million favorable prospective unlocking of DAC and VOBA during the second quarter of 2010 from assumption changes due to revising the estimate in our models for rider fees related to our annuity products with living benefit guarantees.

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

- An increase in federal income tax expense due primarily to an increase in earnings, partially offset by favorable separate account DRD, foreign tax credit adjustments and other items that impacted the effective tax rate in the second quarter of 2010;
- Higher benefits due primarily to an increase in the change in GDB reserves from an increase in our expected GDB benefit payments attributable primarily to the decrease in account values due to unfavorable equity markets, unfavorable claims incidence and termination experience in the long-term disability product line of our Group Protection segment and less favorable mortality in our Life Insurance segment;
- A $21 million unfavorable retrospective unlocking of DAC, VOBA, DSI, DFEL and the reserves for life insurance and annuity products with living benefit and death benefit guarantees during the second quarter of 2010 compared to a $31 million favorable retrospective unlocking during the second quarter of 2009:
  - § The unfavorable retrospective unlocking during the second quarter of 2010 was due primarily to the increase in the change in GDB reserves as a result of the impact of unfavorable equity markets on our variable account values partially offset by higher equity market performance, higher expense assessments and lower lapses than our model projections assumed; and
  - § The favorable retrospective unlocking during second quarter of 2009 was due primarily to the decrease in the change in GDB reserves as a result of variable account growth;

§ Higher DAC and VOBA amortization, net of interest and excluding unlocking, due primarily to a higher amortization rate from the reduction of projected EGPs being applied to the higher actual gross profits in the second quarter of 2010, discussed below in “Retirement Solutions – Annuities – Additional Information”;

- Higher underwriting, acquisition, insurance and other expenses, excluding amortization of DAC and VOBA, due primarily to:
  - § Higher account value-based trail commissions driven by positive net flows and the impact of favorable equity markets on account values;
  - § Investments in strategic initiatives in the second quarter of 2010; and
  - § Higher interest and debt expenses as a result of an increase in interest rates that affect our variable rate borrowings and higher average balances of outstanding debt in 2010; partially offset by
  - § Restructuring charges related to expense reduction initiatives in the second quarter of 2009, and lower expenses attributable to our U.S. pension plans in the second quarter of 2010 as compared to the corresponding period in 2009; and

§ The unfavorable realized loss related to certain derivative instruments and trading securities during the second quarter of 2010 attributable primarily to spreads widening on corporate credit default swaps, which affected the derivative instruments related to our consolidated VIEs, partially offset by gains on our trading securities due to the decline in interest rates.

Comparison of the Six Months Ended June 30, 2010 to 2009

Net income increased due primarily to the following:

- Impairment of goodwill in the first quarter of 2009 of $600 million for Retirement Solutions – Annuities due to continued market volatility, the corresponding increase in discount rates and lower annuity sales (see “Critical Accounting Policies and Estimates – Goodwill and Other Intangible Assets” in our 2009 Form 10-K for additional information on our goodwill impairment); however, this non-cash impairment did not impact our liquidity;
- Income from discontinued operations of $31 million during the first six months of 2010 as compared to a loss from discontinued operations of $146 million during the first six months of 2009 related to our former Lincoln UK and Investment Management segments (see Note 3 for more information on our discontinued operations);
- Higher net investment income and relatively flat interest credited, excluding unlocking and the impact of the rescission of the reinsurance agreement in the first quarter of 2009 mentioned below, driven primarily by:

- § Higher average fixed account values, including the fixed portion of variable annuity contracts, attributable primarily to positive net flows, partially offset by transfers from fixed to variable since the second quarter of 2009;
- § More favorable investment income on surplus and alternative investments and higher prepayment and bond makewhole premiums (see “Additional Information” and “Consolidated Investments – Alternative Investments” and “Consolidated Investments – Commercial Mortgage Loan Prepayment and Bond Makewhole Premiums” below for more information);
- § Higher invested assets driven primarily by favorable net flows on fixed account values, including the fixed portion of variable, and to a lesser extent issuances of common stock and debt subsequent to June 30, 2009; and
- § Actions implemented to reduce interest crediting rates and holding lower cash balances in the first six months of 2010 that increased our portfolio yields;

- Higher earnings from our variable annuity and mutual fund (within our Defined Contribution segment) products as a result of increases in the equity markets;
- Α δεχρεασε ιν ρεαλιζεδ λοσσεσ ον ουρ ΑΦΣ σεχυριτιεσ αττριβυταβλε πριμαριλψ το λοωερ OTTI δυε το οϖεραλλ ιμπροϖεμεντ ιν τηε χρεδιτ μαρκετσ;

- A $5 million favorable retrospective unlocking of DAC, VOBA, DSI, DFEL and the reserves for life insurance and annuity products with living benefit and death benefit guarantees during the first six months of 2010 compared to a $103 million unfavorable retrospective unlocking during the first six months of 2009:
  - § The favorable retrospective unlocking during the first six months of 2010 was due primarily to higher equity market performance, higher expense assessments and lower lapses than our model projections assumed partially offset by the increase in the change in GDB reserves as a result of the impact of unfavorable equity markets on our variable account values; and
  - § The unfavorable retrospective unlocking during the first six months of 2009 was due primarily to the overall performance of our GLB derivative program (see "Realized Gain (Loss)" below for more information on our GLB derivative performance) and the impact of lower equity market performance and higher lapses than our model projections assumed, partially offset by the favorable change in the fair value of GDB derivatives;
- The overall unfavorable GLB net derivatives results, excluding unlocking, during the first six months of 2009 due primarily to increases in interest rates and our over-hedged position for a period of time in 2009 (see "Realized Gain (Loss)" below for more information on our GLB liability and derivative performance);
- The $64 million unfavorable impact from the rescission in the first quarter of 2009 of the reinsurance agreement on certain disability income business sold to Swiss Re, as discussed in "Results of Other Operations" below;
- The overall unfavorable GDB derivative results, excluding unlocking, during the first six months of 2009 due primarily to sporadic large movements in rates and equities that caused non-linear changes in the liability relative to the derivatives utilized in the hedge program and by other items (see "Realized Gain (Loss)" below for more information on our GDB derivatives results); and
- A $26 million favorable prospective unlocking of DAC and VOBA during the first six months of 2010 from assumption changes due to including an estimate in our models for rider fees related to our annuity products with living benefit guarantees.

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

- Higher DAC and VOBA amortization, net of interest and excluding unlocking, due primarily to a higher amortization rate from the reduction of projected EGPs being applied to the higher actual gross profits in the first six months of 2010, discussed below in "Retirement Solutions – Annuities – Additional Information";
- An increase in federal income tax expense due primarily to an increase in earnings and favorable tax return true-ups in the first quarter of 2009 driven by the separate account DRD, foreign tax credit adjustments and other items;
- Higher benefits, excluding the impact of the rescission of the reinsurance agreement in the first quarter of 2009 mentioned above, due primarily to an increase in the change in GDB reserves from an increase in our expected GDB benefit payments attributable primarily to the decrease in account values due to unfavorable equity markets, adverse mortality in our Life Insurance and Group Protection segments and unfavorable claims incidence and termination experience in the long-term disability product line of our Group Protection segment;
- A $42 million gain in the first quarter of 2009 associated with the early extinguishment of long-term debt;
- Higher underwriting, acquisition, insurance and other expenses, excluding amortization of DAC and VOBA, due primarily to:
  - § Higher account value-based trail commissions driven by positive net flows and the impact of favorable equity markets on account values;
  - § Investments in strategic initiatives during the first six months of 2010; and
  - § Higher interest and debt expenses as a result of an increase in interest rates that affect our variable rate borrowings and higher average balances of outstanding debt in 2010; partially offset by
  - § Restructuring charges related to expense reduction initiatives in the first six months of 2009, and lower expenses attributable to our U.S. pension plans in the first six months of 2010 as compared to the corresponding period in 2009; and
- The unfavorable realized loss related to certain derivative instruments and trading securities during the first six months of 2010 attributable primarily to spreads widening on corporate credit default swaps, which affected the

derivative instruments related to our consolidated VIEs, partially offset by gains on our trading securities due to the decline in interest rates.

The foregoing items are discussed in further detail in results of operations by segment discussions and "Realized Gain (Loss)" below. In addition, for a discussion of the earnings impact of the equity markets, see "Part I – Item 3. Quantitative and Qualitative Disclosures About Market Risk – Equity Market Risk – Impact of Equity Market Sensitivity."

RESULTS OF RETIREMENT SOLUTIONS

The Retirement Solutions business provides its products through two segments: Annuities and Defined Contribution. The Retirement Solutions – Annuities segment provides tax-deferred investment growth and lifetime income opportunities for its clients by offering individual fixed annuities, including indexed annuities, and variable annuities. The Retirement Solutions – Defined Contribution segment provides employer-sponsored variable and fixed annuities and mutual-fund based programs in the 401(k), 403(b) and 457 marketplaces.

For factors that could cause actual results to differ materially from those set forth in this section, see "Part I – Item 1A. Risk Factors" in our 2009 Form 10-K and "Forward-Looking Statements – Cautionary Language" above.

Retirement Solutions – Annuities

Income from Operations

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

| | For the Three Months Ended June 30, | | | | For the Six Months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | 2009 | Change | | 2010 | 2009 | Change | |
| Operating Revenues | | | | | | | | |
| Insurance premiums (1) | $10 | $32 | -69 | % | $20 | $60 | -67 | % |
| Insurance fees | 270 | 196 | 38 | % | 530 | 378 | 40 | % |
| Net investment income | 272 | 244 | 11 | % | 542 | 484 | 12 | % |
| Operating realized gain (loss) | 16 | 12 | 33 | % | 31 | 23 | 35 | % |
| Other revenues and fees (2) | 77 | 68 | 13 | % | 152 | 129 | 18 | % |
| Total operating revenues | 645 | 552 | 17 | % | 1,275 | 1,074 | 19 | % |
| Operating Expenses | | | | | | | | |
| Interest credited | 177 | 170 | 4 | % | 353 | 334 | 6 | % |
| Benefits | 41 | 67 | -39 | % | 85 | 143 | -41 | % |
| Underwriting, acquisition, insurance and other expenses | 282 | 239 | 18 | % | 542 | 458 | 18 | % |
| Total operating expenses | 500 | 476 | 5 | % | 980 | 935 | 5 | % |
| Income from operations before taxes | 145 | 76 | 91 | % | 295 | 139 | 112 | % |
| Federal income tax expense | 29 | 11 | 164 | % | 60 | - | | NM |
| Income from operations | $116 | $65 | 78 | % | $235 | $139 | 69 | % |

(1) Includes primarily our single premium immediate annuities, which have a corresponding offset in benefits for changes in reserves.
(2) Consists primarily of broker-dealer earnings that are subject to market volatility.

Comparison of the Three Months Ended June 30, 2010 to 2009

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

•

Higher insurance fees driven primarily by higher average daily variable account values due to more favorable equity markets;

- Higher net investment income, partially offset by higher interest credited, excluding unlocking, driven primarily by:
  - § Higher average fixed account values, including the fixed portion of variable annuity contracts, attributable primarily to positive net flows;
  - § More favorable investment income on alternative investments within our surplus portfolio and higher prepayment and bond makewhole premiums (see "Additional Information", "Consolidated Investments – Alternative Investments" and "Consolidated Investments – Commercial Mortgage Loan Prepayment and Bond Makewhole Premiums" below for more information); and
  - § Holding lower cash balances in the second quarter of 2010 that increased our portfolio yields (see discussion in "Additional Information" below);

- A $21 million favorable retrospective unlocking of DAC, VOBA, DSI, DFEL and reserves for our guarantee riders during the second quarter of 2010, partially offset by higher DAC, VOBA, DSI and DFEL amortization, net of interest and excluding unlocking, compared to a $5 million favorable retrospective unlocking during the second quarter of 2009:
  - § The favorable retrospective unlocking during the second quarter of 2010 was due primarily to higher equity market performance, higher expense assessments and lower lapses than our model projections assumed;
  - § The higher amortization during the second quarter of 2010 was due primarily to a higher amortization rate from the reduction of projected EGPs for this segment being applied to the higher actual gross profits in the second quarter of 2010 (discussed in "Additional Information" below), discussed below; and
  - § The favorable retrospective unlocking during the second quarter of 2009 was due primarily to lower lapses and the impact of higher equity market performance than our model projections assumed;
- A $5 million favorable prospective unlocking of DAC and VOBA during the second quarter of 2010 from assumption changes due to revising the estimate in our models for rider fees related to our annuity products with living benefit guarantees; and
- Lower benefits from a decrease in the change in GDB reserves due to a decrease in our expected GDB benefit payments attributable primarily to the increase in account values above guaranteed levels due to the more favorable equity markets.

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

- Higher underwriting, acquisition, insurance and other expenses, excluding amortization of DAC and VOBA, due primarily to:
  - § Higher account value-based trail commissions driven by the effect of favorable equity markets on account values and positive net flows; and
  - § An increase in the allocation of overhead costs to this segment, discussed in "Additional Information" below; and
- An increase in federal income tax expense due primarily to an increase in earnings.

Comparison of the Six Months Ended June 30, 2010 to 2009

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

- Higher insurance fees driven primarily by higher average daily variable account values due to more favorable equity markets;
- A $44 million favorable retrospective unlocking of DAC, VOBA, DSI, DFEL and reserves for our guarantee riders during the first six months of 2010, partially offset by higher DAC, VOBA, DSI and DFEL amortization, net of interest and excluding unlocking, compared to a $2 million unfavorable retrospective unlocking during the first six months of 2009:
  - § The favorable retrospective unlocking during the first six months of 2010 was due primarily to higher equity market performance, higher expense assessments and lower lapses than our model projections assumed;
  - § The higher amortization during the first six months of 2010 was due primarily to a higher amortization rate from the reduction of projected EGPs for this segment being applied to the higher actual gross profits (discussed in "Additional Information" below), discussed below; and
  - § The unfavorable retrospective unlocking during the first six months of 2009 was due primarily to higher lapses, higher death benefit costs and the impact of lower equity market performance than our model projections assumed;
- A $26 million favorable prospective unlocking of DAC and VOBA during the first six months of 2010 from assumption changes due to including an estimate in our models for rider fees related to our annuity products with living benefit guarantees;
- Higher net investment income, partially offset by higher interest credited, excluding unlocking, driven primarily by:

- § Higher average fixed account values, including the fixed portion of variable annuity contracts, attributable primarily to positive net flows;
- § More favorable investment income on alternative investments within our surplus portfolio and higher prepayment and bond makewhole premiums (see "Additional Information", "Consolidated Investments – Alternative Investments" and "Consolidated Investments – Commercial Mortgage Loan Prepayment and Bond Makewhole Premiums" below for more information); and
- § Holding lower cash balances during the first six months of 2010 that increased our portfolio yields (see discussion in "Additional Information" below); and

- Lower benefits from a decrease in the change in GDB reserves due to a decrease in our expected GDB benefit payments attributable primarily to the increase in account values above guaranteed levels due to the more favorable equity markets.

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

- An increase in federal income tax expense due primarily to an increase in earnings and favorable tax return true-ups in the first quarter of 2009 driven by the separate account DRD, foreign tax credit adjustments and other items; and
- Higher underwriting, acquisition, insurance and other expenses, excluding amortization of DAC and VOBA, due primarily to:
  - § Higher account value-based trail commissions driven by positive net flows; and
  - § An increase in the allocation of overhead costs to this segment, discussed in "Additional Information" below.

Additional Information

We are in the process of completing a conversion of our actuarial valuation systems to a uniform valuation platform. This conversion will harmonize methods and processes and involves an upgrade to a critical platform for our financial reporting and analysis capabilities. As part of this conversion process, we are harmonizing assumptions and methods of calculations that exist between similar blocks of business within our actuarial models. This exercise may result in material one-time gain and loss adjustments to our results of operations and may result in changes to earnings trends. Although we expect some differences to emerge as a result of this exercise, based upon the current status of these efforts, we are not able to provide an estimate or range of the effects to our results of operations from any differences that may exist upon completion of the conversion. We expect to substantially complete the most critical phases of the conversion by the end of 2010. In the third quarter of each year, we also conduct our annual comprehensive review of the assumptions and models used for our estimates of future gross profits underlying the amortization of DAC, VOBA, DSI and DFEL and the calculations of the embedded derivatives and reserves for annuity products with living benefit and death benefit guarantees. See "Critical Accounting Policies and Estimates – DAC, VOBA, DSI and DFEL" in our 2009 Form 10-K for a detailed discussion of our prospective unlocking process.

Prior to the second quarter of 2009, the equity markets unfavorably impacted our average variable account values and the resulting fees earned on these accounts. Additionally, weaker credit fundamentals negatively impacted our investment margins and increased our realized losses on investments, including OTTI. As a result, we recorded prospective unlocking during the fourth quarter of 2008 related to our RTM process, as discussed in "Critical Accounting Policies – DAC, VOBA, DSI and DFEL" in our 2009 Form 10-K. This RTM unlocking that occurred at an equity market trough had the impact of lowering the projected EGPs for this segment, thereby increasing our rate of amortization, results in higher DAC, VOBA, DSI and DFEL amortization and lower earnings for this segment.

Fixed annuity deposits moderated in the fourth quarter of 2009 and the first six months of 2010, as customers shifted deposits back into variable annuity products as equity markets improved, and we expect this trend will continue during the remainder of 2010 with improving economic conditions.

We allocated more overhead costs to this segment during the first six months of 2010, and this trend will continue for the remainder of 2010, as the disposal of our Lincoln UK and Investment Management businesses resulted in a reallocation of overhead expenses to our remaining businesses. See "Acquisitions and Dispositions" in our 2009 Form 10-K for additional details. Additionally, we plan to make strategic investments during 2010 that will also result in higher expenses.

During the volatile markets experienced in late 2008 and early 2009, we implemented a short-term liquidity strategy of maintaining higher cash balances that reduced our portfolio yields by 33 basis points and 37 basis points during the three and six months ended June 30, 2009, respectively. As we progressed through 2009, we reduced these excess cash balances, thereby increasing our portfolio yields; therefore, there was no impact to our portfolio yields for the three and six months ended June 30, 2010.

We experienced a favorable decline in expenses attributable to our U.S. pension plans during the first six months of 2010 when compared to the corresponding period in 2009, and this trend will continue for the remainder of 2010. For additional information, see "Critical Accounting Policies and Estimates – Pension and Other Postretirement Benefit Plans" in our 2009 Form 10-K.

New deposits are an important component of net flows and key to our efforts to grow our business. Although deposits do not significantly impact current period income from operations, they are an important indicator of future profitability.

The other component of net flows relates to the retention of the business. An important measure of retention is the lapse rate, which compares the amount of withdrawals to the average account values. The overall lapse rate for our annuity products was 7% for the three and six months ended June 30, 2010, compared to 8% and 9% for the corresponding periods in 2009.

See Note 8 for information on contractual guarantees to contract holders related to GDB features for our Retirement Solutions business.

Our fixed annuity business includes products with discretionary crediting rates that are reset on an annual basis and are not subject to surrender charges. Our ability to retain annual reset annuities will be subject to current competitive conditions at the time interest rates for these products reset. We expect to manage the effects of spreads on near-term income from operations through portfolio management and, to a lesser extent, crediting rate actions, which assumes no significant changes in net flows into or out of our fixed accounts or other changes that may cause interest rate spreads to differ from our expectations. For information on interest rate spreads and the interest rate risk due to falling interest rates, see "Part I – Item 3. Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk on Fixed Insurance Business – Falling Rates" and "Part II – Item 1A. Risk Factors – Changes in interest rates and sustained low interest rates may cause interest rate spreads to decrease and changes in interest rates may also result in increased contract withdrawals."

We provide information about this segment's operating revenue and operating expense line items, the period in which amounts are recognized, key drivers of changes and historical details underlying the line items and their associated drivers below. For detail on the operating realized gain (loss), see "Realized Gain (Loss)" below.

Insurance Fees

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

| | For the Three Months Ended June 30, | | | For the Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Insurance Fees | | | | | | |
| Mortality, expense and other assessments | $273 | $200 | 37% | $536 | $381 | 41% |
| Surrender charges | 10 | 9 | 11% | 20 | 18 | 11% |
| DFEL: | | | | | | |
| Deferrals | (20) | (12) | -67% | (37) | (23) | -61% |
| Retrospective unlocking | 1 | - | NM | - | 2 | -100% |
| Amortization, net of interest, excluding unlocking | 6 | (1) | NM | 11 | - | NM |
| Total insurance fees | $270 | $196 | 38% | $530 | $378 | 40% |

| | As of June 30, | | |
|---|---|---|---|
| | 2010 | 2009 | Change |
| Account Values | | | |
| Variable portion of variable annuities | $53,921 | $45,523 | 18% |
| Fixed portion of variable annuities | 3,896 | 3,899 | 0% |
| Total variable annuities | 57,817 | 49,422 | 17% |
| Fixed annuities, including indexed | 16,501 | 14,697 | 12% |
| Fixed annuities ceded to reinsurers | (994) | (1,065) | 7% |
| Total fixed annuities | 15,507 | 13,632 | 14% |
| Total account values | $73,324 | $63,054 | 16% |

| | For the Three Months Ended June 30, | | | For the Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Averages | | | | | | |
| Daily variable account values, excluding the fixed portion of variable | $56,788 | $43,828 | 30% | $56,301 | $41,445 | 36% |
| Daily S&P 500 | 1,134.42 | 893.53 | 27% | 1,127.97 | 852.32 | 32% |

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| | For the Three Months Ended June 30, | | | For the Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Net Flows on Account Values | | | | | | |
| Variable portion of variable annuity deposits | $1,322 | $851 | 55% | $2,460 | $1,678 | 47% |
| Variable portion of variable annuity withdrawals | (1,214) | (944) | -29% | (2,429) | (1,937) | -25% |
| Variable portion of variable annuity net flows | 108 | (93) | 216% | 31 | (259) | 112% |
| Fixed portion of variable annuity deposits | 864 | 875 | -1% | 1,591 | 1,634 | -3% |
| Fixed portion of variable annuity withdrawals | (102) | (131) | 22% | (200) | (285) | 30% |
| Fixed portion of variable annuity net flows | 762 | 744 | 2% | 1,391 | 1,349 | 3% |
| Total variable annuity deposits | 2,186 | 1,726 | 27% | 4,051 | 3,312 | 22% |
| Total variable annuity withdrawals | (1,316) | (1,075) | -22% | (2,629) | (2,222) | -18% |
| Total variable annuity net flows | 870 | 651 | 34% | 1,422 | 1,090 | 30% |
| Fixed indexed annuity deposits | 522 | 651 | -20% | 846 | 1,018 | -17% |
| Fixed indexed annuity withdrawals | (111) | (187) | 41% | (235) | (401) | 41% |
| Fixed indexed annuity net flows | 411 | 464 | -11% | 611 | 617 | -1% |
| Other fixed annuity deposits | 115 | 248 | -54% | 202 | 483 | -58% |
| Other fixed annuity withdrawals | (243) | (328) | 26% | (507) | (725) | 30% |
| Other fixed annuity net flows | (128) | (80) | -60% | (305) | (242) | -26% |
| Total annuity deposits | 2,823 | 2,625 | 8% | 5,099 | 4,813 | 6% |
| Total annuity withdrawals | (1,670) | (1,590) | -5% | (3,371) | (3,348) | -1% |
| Total annuity net flows | $1,153 | $1,035 | 11% | $1,728 | $1,465 | 18% |

| | For the Three Months Ended June 30, | | | For the Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Other Changes to Account Values | | | | | | |
| Interest credited and change in market value on variable, excluding the fixed portion of variable | $(4,802) | $5,733 | NM | $(3,050) | $3,717 | NM |
| Transfers to the variable portion of variable annuity products from the fixed portion of | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| variable annuity products | 800 | 582 | 37% | 1,572 | 1,140 | 38% |

We charge contract holders mortality and expense assessments on variable annuity accounts to cover insurance and administrative expenses. These assessments are a function of the rates priced into the product and the average daily variable account values. Average daily account values are driven by net flows and the equity markets. In addition, for our fixed annuity contracts and for some variable contracts, we collect surrender charges when contract holders surrender their contracts during their surrender charge periods to protect us from premature withdrawals. Insurance fees include charges on both our variable and fixed annuity products, but exclude the attributed fees on our GLB products; see "Realized Gain (Loss) – Operating Realized Gain (Loss) – GLB" below for discussion of these attributed fees.

Net Investment Income and Interest Credited

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

| | For the Three Months Ended June 30, 2010 | For the Three Months Ended June 30, 2009 | Change | For the Six Months Ended June 30, 2010 | For the Six Months Ended June 30, 2009 | Change |
|---|---|---|---|---|---|---|
| Net Investment Income | | | | | | |
| Fixed maturity securities, mortgage loans on real estate and other, net of investment expenses | $245 | $235 | 4% | $493 | $458 | 8% |
| Commercial mortgage loan prepayment and bond makewhole premiums (1) | 4 | - | NM | 5 | 1 | NM |
| Alternative investments (2) | - | - | NM | - | (1) | 100% |
| Surplus investments (3) | 23 | 9 | 156% | 44 | 26 | 69% |
| Total net investment income | $272 | $244 | 11% | $542 | $484 | 12% |
| | | | | | | |
| Interest Credited | | | | | | |
| Amount provided to contract holders | $183 | $178 | 3% | $365 | $352 | 4% |
| DSI deferrals | (18) | (19) | 5% | (37) | (34) | -9% |
| Interest credited before DSI amortization | 165 | 159 | 4% | 328 | 318 | 3% |
| DSI amortization: | | | | | | |
| Retrospective unlocking | (2) | - | NM | (4) | 2 | NM |
| Amortization, excluding unlocking | 14 | 11 | 27% | 29 | 14 | 107% |
| Total interest credited | $177 | $170 | 4% | $353 | $334 | 6% |

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

| | For the Three Months Ended June 30, 2010 | For the Three Months Ended June 30, 2009 | Basis Point Change | For the Six Months Ended June 30, 2010 | For the Six Months Ended June 30, 2009 | Basis Point Change |
|---|---|---|---|---|---|---|
| Interest Rate Spread | | | | | | |
| Fixed maturity securities, mortgage loans on real estate and other, net of investment expenses | 5.47% | 5.44% | 3 | 5.54% | 5.36% | 18 |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Commercial mortgage loan prepayment and bond make whole premiums | 0.09 | % | 0.01 | % | 8 | | 0.06 | % | 0.01 | % | 5 | |
| Alternative investments | 0.00 | % | 0.00 | % | - | | 0.00 | % | -0.01 | % | 1 | |
| Net investment income yield on reserves | 5.56 | % | 5.45 | % | 11 | | 5.60 | % | 5.36 | % | 24 | |
| Interest rate credited to contract holders | 3.51 | % | 3.81 | % | (30 | ) | 3.51 | % | 3.83 | % | (32 | ) |
| Interest rate spread | 2.05 | % | 1.64 | % | 41 | | 2.09 | % | 1.53 | % | 56 | |

Note: The yields, rates and spreads above are calculated using whole dollars instead of dollars rounded to millions.

| | For the Three Months Ended June 30, | | | For the Six Months Ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Other Information | | | | | | |
| Average invested assets on reserves | $17,970 | $17,249 | 4% | $17,814 | $17,082 | 4% |
| Average fixed account values, including the fixed portion of variable | 19,754 | 17,728 | 11% | 19,625 | 17,453 | 12% |
| Transfers to the fixed portion of variable annuity products from the variable portion of | | | | | | |