

American Legacy III[®] C Share Lincoln Life & Annuity Variable Annuity Account H

(Registrant)

Lincoln Life & Annuity Company of New York (Depositor)

Statement of Additional Information (SAI)

This SAI should be read in conjunction with the American Legacy III[®] C Share prospectus of Lincoln Life & Annuity Variable Annuity Account H dated May 1, 2011. You may obtain a copy of the American Legacy III[®] C Share prospectus on request and without charge. Please write Lincoln Life & Annuity Company of New York, PO Box 2348, Fort Wayne, IN 46801-2348, or call 1-800-942-5500.

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This SAI is not a prospectus.

The date of this SAI is May 1, 2011.

Special Terms

The special terms used in this SAI are the ones defined in the Prospectus.

Services

Independent Registered Public Accounting Firm

Ernst & Young LLP, independent registered public accounting firm, Two Commerce Square, 2001 Market Street, Suite 4000, Philadelphia, Pennsylvania, 19103, has audited a) our financial statements of the VAA as of December 31, 2010; and b) our financial statements of Lincoln Life & Annuity Company of New York as of December 31, 2010, which are included in this SAI and Registration Statement. The aforementioned financial statements are included herein in reliance on Ernst & Young LLP's reports, given on their authority as experts in accounting and auditing.

Keeper of Records

All accounts, books, records and other documents which are required to be maintained for the VAA are maintained by us or by third parties responsible to Lincoln New York. We have entered into an agreement with The Bank of New York Mellon, One Mellon Bank Center, 500 Grant Street, Pittsburgh, Pennsylvania, 15258, to provide accounting services to the VAA. No separate charge against the assets of the VAA is made by us for this service. Administrative services necessary for the operations of the VAA and the contracts are currently provided by Lincoln Life. However, neither the assets of Lincoln Life nor the assets of LNC support the obligation of Lincoln New York under the contracts.

Principal Underwriter

Lincoln Financial Distributors, Inc., ("LFD"), an affiliate of Lincoln New York, serves as principal underwriter (the "Principal Underwriter") for the contracts, as described in the prospectus. The Principal Underwriter offers the contracts to the public on a continuous basis and anticipates continuing to offer the contracts, but reserves the right to discontinue the offering. The Principal Underwriter offers the contracts through sales representatives who are also associated with Lincoln Financial Advisors Corporation and/or Lincoln Financial Securities Corp. (collectively "LFN"), our affiliates. The Principal Underwriter also may enter into selling agreements with other broker-dealers ("Selling Firms") for the sale of the contracts. Sales representatives of Selling Firms are appointed as our insurance agents. LFD, acting as the Principal Underwriter, paid \$12,024,570, \$6,516,769 and \$7,517,425 to LFN and Selling Firms in 2008, 2009, and 2010 respectively, as sales compensation with respect to the contracts. The Principal Underwriter retained no underwriting commissions for the sale of the contracts.

Purchase of Securities Being Offered

The variable annuity contracts are offered to the public through licensed insurance agents who specialize in selling our products; through independent insurance brokers; and through certain securities brokers/dealers selected by us whose personnel are legally authorized to sell annuity products. There are no special purchase plans for any class of prospective buyers. However, under certain limited circumstances described in the prospectus under the section Charges and Other Deductions, any applicable account fee and/or surrender charge may be reduced or waived.

Both before and after the annuity commencement date, there are exchange privileges between subaccounts, and from the VAA to the general account (if available) subject to restrictions set out in the prospectus. See The Contracts, in the prospectus. No exchanges are permitted between the VAA and other separate accounts.

The offering of the contracts is continuous.

Interest Adjustment Example

Note: This example is intended to show how the interest adjustment calculation impacts the surrender value of a representative contract. The surrender charges, annual account fee, adjustment factor, and guaranteed minimum interest rate values shown here are generally different from those that apply to specific contracts, particularly those contracts that deduct an initial sales load or pay a bonus on deposits. Calculations of the interest adjustment in your contract, if applicable, will be based on the factors applicable to your contract. The interest adjustment may be referred to as a market value adjustment in your contract.

**SAMPLE CALCULATIONS FOR MALE 35 ISSUE
CASH SURRENDER VALUES**

Single Premium	\$50,000
Premium taxes	None
Withdrawals	None
Guaranteed Period	5 years
Guaranteed Interest Rate	3.50%
Annuity Date	Age 70
Index Rate A	3.50%
Index Rate B	4.00% End of contract year 1 3.50% End of contract year 2 3.00% End of contract year 3 2.00% End of contract year 4
Percentage adjustment to B	0.50%

Interest Adjustment Formula
$$\frac{(1 + \text{Index A})^n}{(1 + \text{Index B} + \% \text{ Adjustment})^n} - 1$$

n = Remaining Guaranteed Period

SURRENDER VALUE CALCULATION

<u>Contract Year</u>	(1) <u>Annuity Value</u>	(2) <u>1 + Interest Adjustment Formula</u>	(3) <u>Adjusted Annuity Value</u>	(4) <u>Minimum Value</u>	(5) <u>Greater of (3) & (4)</u>	(6) <u>Surrender Charge</u>	(7) <u>Surrender Value</u>
1	\$51,710	0.962268	\$49,759	\$50,710	\$50,710	\$4,250	\$46,460
2	\$53,480	0.985646	\$52,712	\$51,431	\$52,712	\$4,250	\$48,462
3	\$55,312	1.000000	\$55,312	\$52,162	\$55,312	\$4,000	\$51,312
4	\$57,208	1.009756	\$57,766	\$52,905	\$57,766	\$3,500	\$54,266
5	\$59,170	N/A	\$59,170	\$53,658	\$59,170	\$3,000	\$56,170

ANNUITY VALUE CALCULATION

<u>Contract Year</u>	<u>BOY* Annuity Value</u>	<u>Guaranteed Interest Rate</u>	<u>Annual Account Fee</u>	<u>EOY** Annuity Value</u>
1	\$50,000 x	1.035	- \$40	= \$51,710
2	\$51,710 x	1.035	- \$40	= \$53,480
3	\$53,480 x	1.035	- \$40	= \$55,312
4	\$55,312 x	1.035	- \$40	= \$57,208
5	\$57,208 x	1.035	- \$40	= \$59,170

SURRENDER CHARGE CALCULATION

<u>Contract Year</u>	<u>Surrender Charge Factor</u>	<u>Deposit</u>	<u>Surrender Charge</u>
1	8.5%	x \$50,000	= \$4,250
2	8.5%	x \$50,000	= \$4,250
3	8.0%	x \$50,000	= \$4,000
4	7.0%	x \$50,000	= \$3,500
5	6.0%	x \$50,000	= \$3,000

1 + INTEREST ADJUSTMENT FORMULA CALCULATION

<u>Contract Year</u>	<u>Index A</u>	<u>Index B</u>	<u>Adj Index B</u>	<u>N</u>	<u>Result</u>
1	3.50%	4.00%	4.50%	4	0.962268
2	3.50%	3.50%	4.00%	3	0.985646
3	3.50%	3.00%	3.50%	2	1.000000
4	3.50%	2.00%	2.50%	1	1.009756
5	3.50%	N/A	N/A	N/A	N/A

MINIMUM VALUE CALCULATION

<u>Contract Year</u>		<u>Minimum Guaranteed Interest Rate</u>	<u>Annual Account Fee</u>	<u>Minimum Value</u>
1	\$50,000 x	1.015	- \$40	= \$50,710
2	\$50,710 x	1.015	- \$40	= \$51,431
3	\$51,431 x	1.015	- \$40	= \$52,162
4	\$52,162 x	1.015	- \$40	= \$52,905
5	\$52,905 x	1.015	- \$40	= \$53,658

*BOY = beginning of year

**EOY = end of year

Annuity Payouts

Variable Annuity Payouts

Variable annuity payouts will be determined on the basis of:

- the dollar value of the contract on the annuity commencement date less any applicable premium tax;
- the annuity tables contained in the contract;
- the type of annuity option selected; and
- the investment results of the fund(s) selected.

In order to determine the amount of variable annuity payouts, we make the following calculation:

- first, we determine the dollar amount of the first payout;
- second, we credit the contract with a fixed number of annuity units based on the amount of the first payout; and
- third, we calculate the value of the annuity units each period thereafter.

These steps are explained below.

The dollar amount of the first periodic variable annuity payout is determined by applying the total value of the accumulation units credited under the contract valued as of the annuity commencement date (less any premium taxes) to the annuity tables contained in the contract. The first variable annuity payout will be paid 14 days after the annuity commencement date. This day of the month will become the day on which all future annuity payouts will be paid. Amounts shown in the tables are based on an Individual Annuity Mortality Table on file with the New York Superintendent of Insurance, with an assumed investment return at the rate of 3%, 4%, or 5% per annum, depending on the terms of your contract. The first annuity payout is determined by multiplying the benefit per \$1,000 of value shown in the contract tables by the number of thousands of dollars of value accumulated under the contract. These annuity tables vary according to the form of annuity selected and the age of the annuitant at the annuity commencement date. The assumed interest rate is the measuring point for subsequent annuity payouts. If the actual net investment rate (annualized) exceeds the assumed interest rate, the payout will increase at a rate equal to the amount of such excess.

Conversely, if the actual rate is less than the assumed interest rate, annuity payouts will decrease. If the assumed rate of interest were to be increased, annuity payouts would start at a higher level but would decrease more rapidly or increase more slowly.

We may use sex distinct annuity tables in contracts that are not associated with employer sponsored plans and where not prohibited by law.

At an annuity commencement date, the contract is credited with annuity units for each subaccount on which variable annuity payouts are based. The number of annuity units to be credited is determined by dividing the amount of the first periodic payout by the value of an annuity unit in each subaccount selected. Although the number of annuity units is fixed by this process, the value of such units will vary with the value of the underlying fund. The amount of the second and subsequent periodic payouts is determined by multiplying

the contractowner's fixed number of annuity units in each subaccount by the appropriate annuity unit value for the valuation date ending 14 days prior to the date that payout is due.

The value of each subaccount's annuity unit will be set initially at an arbitrary dollar amount. The annuity unit value for each subaccount at the end of any valuation date is determined by multiplying the subaccount annuity unit value for the immediately preceding valuation date by the product of:

- The change in the accumulation unit value of the subaccount from one valuation period to the next, and
- A factor to neutralize the assumed investment return in the annuity table.

The value of the annuity units is determined as of a valuation date 14 days prior to the payment date in order to permit calculation of amounts of annuity payouts and mailing of checks in advance of their due dates. Such checks will normally be issued and mailed at least three days before the due date.

Proof of Age, Sex and Survival

We may require proof of age, sex, or survival of any payee upon whose age, sex, or survival payments depend.

Examples of Regular Income Payment Calculations

These examples will illustrate the impact of the length of the access period and the impact of a withdrawal on the regular income payments. These examples assume that the investment return is the same as the assumed investment return (AIR) to make the regular income payment calculations simpler to understand. The regular income payments will vary based on the investment performance of the underlying funds.

Annuitant	Male, Age 65	
Secondary Life	Female, Age 63	
Purchase Payment	\$200,000.00	
Regular Income Payment Frequency.....	Annual	
AIR.....	4.0%	
Hypothetical Investment Return.....	4.0%	
	<u>20-year Access Period</u>	<u>30-Year Access Period</u>
Regular Income Payment.....	\$10,600.94	\$9,974.48

A 10% withdrawal from the account value will reduce the regular income payments by 10% to \$9,540.85 with the 20-year access period and \$8,977.03 with the 30-year access period.

At the end of the 20-year access period, the remaining account value of \$109,921.94 (assuming no withdrawals) will be used to continue the \$10,600.94 regular income payment during the lifetime income period for the lives of the annuitant and secondary life. At the end of the 30-year access period, the remaining account value of \$66,884.77 (assuming no withdrawals) will be used to continue the \$9,974.48 regular income payment during the lifetime income period for the lives of the annuitant and secondary life. (Note: the regular income payments during the lifetime income period will vary with the investment performance of the underlying funds).

Determination of Accumulation and Annuity Unit Value

A description of the days on which accumulation and annuity units will be valued is given in the prospectus. The New York Stock Exchange's (NYSE) most recent announcement (which is subject to change) states that it will be closed on weekends and on these holidays: New Year's Day, Martin Luther King Day, President's Day, Good Friday, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, and Christmas Day. If any of these holidays occurs on a weekend day, the Exchange may also be closed on the business day occurring just before or just after the holiday. It may also be closed on other days.

Since the portfolios of some of the fund and series will consist of securities primarily listed on foreign exchanges or otherwise traded outside the United States, those securities may be traded (and the net asset value of those fund and series and of the variable account could therefore be significantly affected) on days when the investor has no access to those funds and series.

Capital Markets

In any particular year, our capital may increase or decrease depending on a variety of factors — the amount of our statutory income or losses (which is sensitive to equity market and credit market conditions), the amount of additional capital we must hold to support business growth, changes in reserving requirements, our inability to secure capital market solutions to provide reserve relief, such as

issuing letters of credit to support captive reinsurance structures, changes in equity market levels, the value of certain fixed-income and equity securities in our investment portfolio and changes in interest rates.

Advertising & Ratings

We may include in certain advertisements, endorsements in the form of a list of organizations, individuals or other parties which recommend Lincoln New York or the policies. Furthermore, we may occasionally include in advertisements comparisons of currently taxable and tax deferred investment programs, based on selected tax brackets, or discussions of alternative investment vehicles and general economic conditions.

Nationally recognized rating agencies rate the financial strength of our Company. The ratings do not imply approval of the product and do not refer to the performance of the product, or to the VAA, including underlying investment options. Ratings are not recommendations to buy our products. Each of the rating agencies reviews its ratings periodically. Accordingly, all ratings are subject to revision or withdrawal at any time by the rating agencies, and therefore, no assurance can be given that these ratings will be maintained. All ratings are on outlook stable. Our financial strength ratings, which are intended to measure our ability to meet contract holder obligations, are an important factor affecting public confidence in most of our products and, as a result, our competitiveness. A downgrade of our financial strength rating could affect our competitive position in the insurance industry by making it more difficult for us to market our products as potential customers may select companies with higher financial strength ratings and by leading to increased withdrawals by current customers seeking companies with higher financial strength ratings.

Additional Services

Dollar Cost Averaging (DCA) — You may systematically transfer, on a monthly basis or in accordance with other terms we make available, amounts from certain subaccounts, or the fixed side (if available) of the contract into the subaccounts or in accordance with other terms we make available. You may elect to participate in the DCA program at the time of application or at anytime before the annuity commencement date by completing an election form available from us. The minimum amount to be dollar cost averaged is \$1,500 over any period between six and 60 months. Once elected, the program will remain in effect until the earlier of:

- the annuity commencement date;
- the value of the amount being DCA'd is depleted; or
- you cancel the program by written request or by telephone if we have your telephone authorization on file.

We reserve the right to restrict access to this program at any time.

A transfer made as part of this program is not considered a transfer for purposes of limiting the number of transfers that may be made, or assessing any charges or interest adjustment which may apply to transfers. Upon receipt of an additional purchase payment allocated to the DCA fixed account, the existing program duration will be extended to reflect the end date of the new DCA program. However, the existing interest crediting rate will not be extended. The existing interest crediting rate will expire at its originally scheduled expiration date and the value remaining in the DCA account from the original amount as well as any additional purchase payments will be credited with interest at the standard DCA rate at the time. We reserve the right to discontinue this program at any time. DCA does not assure a profit or protect against loss.

Automatic Withdrawal Service (AWS) — AWS provides an automatic, periodic withdrawal of contract value to you. AWS may take place on either a monthly, quarterly, semi-annual or annual basis, as selected by the contractowner. You may elect to participate in AWS at the time of application or at any time before the annuity commencement date by sending a written request to us. The minimum contract value required to establish AWS is \$10,000. You may cancel or make changes to your AWS program at any time by sending a written request to us. If telephone authorization has been elected, certain changes may be made by telephone. Notwithstanding the requirements of the program, any withdrawal must be permitted under Section 401(a)(9) of the IRC for qualified plans or permitted under Section 72 of the IRC for non-qualified contracts.

Cross Reinvestment Program/Earnings Sweep Program — Under this option, account value in a designated variable subaccount of the contract that exceeds a certain baseline amount is automatically transferred to another specific variable subaccount(s) of the contract at specific intervals. You may elect to participate in the cross reinvestment program at the time of application or at any time before the annuity commencement date by sending a written request to us or by telephone if we have your telephone authorization on file. You designate the holding account, the receiving account(s), and the baseline amount. Cross reinvestment will continue until we receive authorization to terminate the program.

Portfolio Rebalancing — Portfolio rebalancing is an option, which, if elected by the contractowner, restores to a pre-determined level the percentage of the contract value, allocated to each variable subaccount. This pre-determined level will be the allocation initially selected when the contract was purchased, unless subsequently changed. The portfolio rebalancing allocation may be changed at any time by submitting a written request to us. If portfolio rebalancing is elected, all purchase payments allocated to the variable subaccounts must be subject to portfolio rebalancing. Portfolio rebalancing may take place on either a monthly, quarterly, semi-annual or annual basis, as selected by the contractowner. The contractowner may terminate the portfolio rebalancing program or re-enroll at any time by sending a written request to us. If telephone authorization has been elected, the contractowner may make these elections by phone. The portfolio rebalancing program is not available following the annuity commencement date.

Other Information

Due to differences in redemption rates, tax treatment or other considerations, the interests of contractowners under the variable life accounts could conflict with those of contractowners under the VAA. In those cases, where assets from variable life and variable annuity separate accounts are invested in the same fund(s) (i.e., where mixed funding occurs), the Boards of Directors of the fund involved will monitor for any material conflicts and determine what action, if any, should be taken. If it becomes necessary for any separate account to replace shares of any fund with another investment, that fund may have to liquidate securities on a disadvantageous basis. Refer to the prospectus for each fund for more information about mixed funding.

Financial Statements

The December 31, 2010 financial statements of the VAA and the December 31, 2010 financial statements of Lincoln New York appear on the following pages.

Lincoln Life & Annuity Variable Annuity Account H

Statements of assets and liabilities

December 31, 2010

<i>Subaccount</i>	<i>Investments</i>	<i>Contract Purchases Due From Lincoln Life & Annuity Company of New York</i>	<i>Total Assets</i>	<i>Contract Redemptions Due To Lincoln Life & Annuity Company of New York</i>	<i>Mortality & Expense Guarantee Charges Payable To Lincoln Life & Annuity Company of New York</i>	<i>Net Assets</i>
American Funds Asset Allocation Class 2	\$ 94,207,722	\$19,668	\$ 94,227,390	\$ —	\$3,872	\$ 94,223,518
American Funds Blue Chip Income & Growth Class 2	92,822,779	25,934	92,848,713	—	4,007	92,844,706
American Funds Bond Class 2	97,037,051	—	97,037,051	90,937	4,115	96,941,999
American Funds Cash Management Class 2	28,692,712	—	28,692,712	52,987	1,378	28,638,347
American Funds Global Bond Class 2	33,428,883	22,353	33,451,236	—	1,464	33,449,772
American Funds Global Discovery Class 2	13,064,283	5,843	13,070,126	—	575	13,069,551
American Funds Global Growth Class 2	63,633,464	4,300	63,637,764	—	2,755	63,635,009
American Funds Global Growth and Income Class 2	51,949,293	19,504	51,968,797	—	2,194	51,966,603
American Funds Global Small Capitalization Class 2	45,596,680	757	45,597,437	—	1,968	45,595,469
American Funds Growth Class 2	190,885,316	—	190,885,316	15,315	8,405	190,861,596
American Funds Growth-Income Class 2	166,086,299	11,467	166,097,766	—	7,109	166,090,657
American Funds High-Income Bond Class 2	36,383,751	—	36,383,751	5,717	1,519	36,376,515
American Funds International Class 2	82,690,179	13,854	82,704,033	—	3,653	82,700,380
American Funds International Growth and Income Class 2	6,395,977	23,950	6,419,927	—	295	6,419,632
American Funds New World Class 2	43,750,823	2,067	43,752,890	—	1,877	43,751,013
American Funds U.S. Government/AAA-Rated Securities Class 2	66,993,214	—	66,993,214	2,899	2,973	66,987,342
LVIP American Balanced Allocation Service Class	1,331,211	—	1,331,211	—	50	1,331,161
LVIP American Growth Allocation Service Class	1,196,077	—	1,196,077	—	50	1,196,027
LVIP American Income Allocation Service Class	825,126	—	825,126	—	33	825,093

See accompanying notes.

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Statements of operations

Year Ended December 31, 2010

<i>Subaccount</i>	<i>Dividends from Investment Income</i>	<i>Mortality and Expense Guarantee Charges</i>	<i>Net Investment Income (Loss)</i>
American Funds Asset Allocation Class 2	\$1,755,990	\$(1,329,504)	\$ 426,486
American Funds Blue Chip Income & Growth Class 2	1,494,976	(1,330,914)	164,062
American Funds Bond Class 2	2,893,262	(1,488,616)	1,404,646
American Funds Cash Management Class 2	—	(485,309)	(485,309)
American Funds Global Bond Class 2	935,332	(481,909)	453,423
American Funds Global Discovery Class 2	63,814	(194,352)	(130,538)
American Funds Global Growth Class 2	868,644	(909,856)	(41,212)
American Funds Global Growth and Income Class 2	1,206,484	(700,041)	506,443
American Funds Global Small Capitalization Class 2	663,252	(622,285)	40,967
American Funds Growth Class 2	1,243,086	(2,720,659)	(1,477,573)
American Funds Growth-Income Class 2	2,293,003	(2,396,067)	(103,064)
American Funds High-Income Bond Class 2	2,567,691	(514,230)	2,053,461
American Funds International Class 2	1,583,638	(1,238,472)	345,166
American Funds International Growth and Income Class 2	121,052	(86,142)	34,910
American Funds New World Class 2	607,159	(590,640)	16,519
American Funds U.S. Government/AAA-Rated Securities Class 2	1,208,531	(1,061,221)	147,310
LVIP American Balanced Allocation Service Class	—	(1,065)	(1,065)
LVIP American Growth Allocation Service Class	—	(700)	(700)
LVIP American Income Allocation Service Class	—	(823)	(823)

See accompanying notes.

<i>Net Realized Gain (Loss) on Investments</i>	<i>Dividends from Net Realized Gain on Investments</i>	<i>Total Net Realized Gain (Loss) on Investments</i>	<i>Net Change in Unrealized Appreciation or Depreciation on Investments</i>	<i>Net Increase (Decrease) in Net Assets Resulting from Operations</i>
\$ (1,137,519)	\$ —	\$ (1,137,519)	\$ 9,983,917	\$ 9,272,884
(1,908,787)	—	(1,908,787)	10,473,078	8,728,353
376,737	—	376,737	2,377,987	4,159,370
(254,830)	—	(254,830)	149,724	(590,415)
221,882	—	221,882	169,005	844,310
(40,218)	—	(40,218)	1,019,182	848,426
144,430	—	144,430	5,724,802	5,828,020
(855,575)	—	(855,575)	4,960,887	4,611,755
(459,220)	—	(459,220)	7,851,380	7,433,127
(1,854,747)	—	(1,854,747)	30,665,522	27,333,202
(2,688,505)	—	(2,688,505)	17,558,339	14,766,770
279,022	—	279,022	1,891,276	4,223,759
(1,042,956)	—	(1,042,956)	5,153,109	4,455,319
3,943	157,817	161,760	141,489	338,159
580,288	—	580,288	5,095,309	5,692,116
904,147	335,504	1,239,651	990,728	2,377,689
754	—	754	14,184	13,873
3	—	3	11,595	10,898
(11)	—	(11)	5,698	4,864

Statements of changes in net assets

Years Ended December 31, 2009 and 2010

	<i>American Funds Asset Allocation Class 2 Subaccount</i>	<i>American Funds Blue Chip Income & Growth Class 2 Subaccount</i>	<i>American Funds Bond Class 2 Subaccount</i>	<i>American Funds Cash Management Class 2 Subaccount</i>
NET ASSETS AT JANUARY 1, 2009	\$79,814,050	\$63,448,349	\$58,335,108	\$ 61,547,970
Changes From Operations:				
• Net investment income (loss)	727,255	415,247	1,382,463	(764,250)
• Net realized gain (loss) on investments	(4,101,967)	(5,204,994)	(1,420,341)	(514,243)
• Net change in unrealized appreciation or depreciation on investments	<u>20,105,146</u>	<u>21,634,648</u>	<u>7,298,132</u>	<u>245,636</u>
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS	16,730,434	16,844,901	7,260,254	(1,032,857)
Change From Unit Transactions:				
Accumulation Units:				
• Contract purchases	2,509,836	4,598,901	7,331,063	7,325,818
• Contract withdrawals	(6,599,529)	(4,276,735)	(6,240,834)	(8,109,971)
• Contract transfers	<u>(200,268)</u>	<u>1,239,403</u>	<u>18,423,771</u>	<u>(21,931,953)</u>
	(4,289,961)	1,561,569	19,514,000	(22,716,106)
Annuity Reserves:				
• Annuity payments	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM UNIT TRANSACTIONS	(4,289,961)	1,561,569	19,514,000	(22,716,106)
TOTAL INCREASE (DECREASE) IN NET ASSETS	<u>12,440,473</u>	<u>18,406,470</u>	<u>26,774,254</u>	<u>(23,748,963)</u>
NET ASSETS AT DECEMBER 31, 2009	92,254,523	81,854,819	85,109,362	37,799,007
Changes From Operations:				
• Net investment income (loss)	426,486	164,062	1,404,646	(485,309)
• Net realized gain (loss) on investments	(1,137,519)	(1,908,787)	376,737	(254,830)
• Net change in unrealized appreciation or depreciation on investments	<u>9,983,917</u>	<u>10,473,078</u>	<u>2,377,987</u>	<u>149,724</u>
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS	9,272,884	8,728,353	4,159,370	(590,415)
Change From Unit Transactions:				
Accumulation Units:				
• Contract purchases	2,295,212	5,376,356	8,320,632	1,329,018
• Contract withdrawals	(7,601,819)	(5,591,506)	(6,537,117)	(6,251,199)
• Contract transfers	<u>(1,997,282)</u>	<u>2,476,684</u>	<u>5,889,752</u>	<u>(3,648,064)</u>
	(7,303,889)	2,261,534	7,673,267	(8,570,245)
Annuity Reserves:				
• Annuity payments	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM UNIT TRANSACTIONS	(7,303,889)	2,261,534	7,673,267	(8,570,245)
TOTAL INCREASE (DECREASE) IN NET ASSETS	<u>1,968,995</u>	<u>10,989,887</u>	<u>11,832,637</u>	<u>(9,160,660)</u>
NET ASSETS AT DECEMBER 31, 2010	<u>\$94,223,518</u>	<u>\$92,844,706</u>	<u>\$96,941,999</u>	<u>\$ 28,638,347</u>

See accompanying notes.

<i>American Funds Global Bond Class 2 Subaccount</i>	<i>American Funds Global Discovery Class 2 Subaccount</i>	<i>American Funds Global Growth Class 2 Subaccount</i>	<i>American Funds Global Growth and Income Class 2 Subaccount</i>	<i>American Funds Global Small Capitalization Class 2 Subaccount</i>	<i>American Funds Growth Class 2 Subaccount</i>	<i>American Funds Growth-Income Class 2 Subaccount</i>	<i>American Funds High-Income Bond Class 2 Subaccount</i>	<i>American Funds International Class 2 Subaccount</i>
\$14,343,109	\$ 6,655,394	\$41,557,580	\$30,450,902	\$22,335,889	\$106,078,459	\$122,731,332	\$21,382,325	\$56,225,709
30,213 (29,833)	(94,154) (762,737)	(47,587) (2,313,623)	373,453 (3,061,294)	(373,793) (3,310,008)	(1,136,337) (7,735,690)	124,428 (8,152,679)	1,698,014 (1,461,230)	(18,683) (4,335,411)
<u>1,272,593</u>	<u>4,441,233</u>	<u>18,723,379</u>	<u>14,296,656</u>	<u>16,857,444</u>	<u>50,266,653</u>	<u>43,718,275</u>	<u>8,581,904</u>	<u>26,542,435</u>
1,272,973	3,584,342	16,362,169	11,608,815	13,173,643	41,394,626	35,690,024	8,818,688	22,188,341
3,153,251 (727,683)	420,329 (535,184)	2,977,122 (2,808,223)	2,835,218 (1,773,033)	1,718,775 (1,934,261)	9,507,373 (7,071,717)	7,273,987 (8,101,824)	1,327,270 (2,586,977)	4,625,312 (3,563,356)
<u>6,088,621</u>	<u>2,875,374</u>	<u>(26,915)</u>	<u>2,665,461</u>	<u>3,268,484</u>	<u>10,683,504</u>	<u>(741,547)</u>	<u>4,223,280</u>	<u>(1,991,224)</u>
8,514,189	2,760,519	141,984	3,727,646	3,052,998	13,119,160	(1,569,384)	2,963,573	(929,268)
—	—	—	—	—	—	—	(5,420)	—
—	—	—	—	—	—	—	(5,420)	—
<u>8,514,189</u>	<u>2,760,519</u>	<u>141,984</u>	<u>3,727,646</u>	<u>3,052,998</u>	<u>13,119,160</u>	<u>(1,569,384)</u>	<u>2,958,153</u>	<u>(929,268)</u>
<u>9,787,162</u>	<u>6,344,861</u>	<u>16,504,153</u>	<u>15,336,461</u>	<u>16,226,641</u>	<u>54,513,786</u>	<u>34,120,640</u>	<u>11,776,841</u>	<u>21,259,073</u>
24,130,271	13,000,255	58,061,733	45,787,363	38,562,530	160,592,245	156,851,972	33,159,166	77,484,782
453,423 221,882	(130,538) (40,218)	(41,212) 144,430	506,443 (855,575)	40,967 (459,220)	(1,477,573) (1,854,747)	(103,064) (2,688,505)	2,053,461 279,022	345,166 (1,042,956)
<u>169,005</u>	<u>1,019,182</u>	<u>5,724,802</u>	<u>4,960,887</u>	<u>7,851,380</u>	<u>30,665,522</u>	<u>17,558,339</u>	<u>1,891,276</u>	<u>5,153,109</u>
844,310	848,426	5,828,020	4,611,755	7,433,127	27,333,202	14,766,770	4,223,759	4,455,319
5,250,663 (1,700,146)	614,362 (787,493)	3,519,934 (2,929,634)	3,936,287 (2,620,680)	2,075,264 (2,274,081)	9,169,950 (10,436,168)	6,922,747 (11,252,866)	1,779,080 (3,385,431)	4,405,752 (5,054,542)
<u>4,924,674</u>	<u>(605,999)</u>	<u>(845,044)</u>	<u>251,878</u>	<u>(201,371)</u>	<u>4,202,367</u>	<u>(1,197,966)</u>	<u>606,589</u>	<u>1,409,069</u>
8,475,191	(779,130)	(254,744)	1,567,485	(400,188)	2,936,149	(5,528,085)	(999,762)	760,279
—	—	—	—	—	—	—	(6,648)	—
—	—	—	—	—	—	—	(6,648)	—
<u>8,475,191</u>	<u>(779,130)</u>	<u>(254,744)</u>	<u>1,567,485</u>	<u>(400,188)</u>	<u>2,936,149</u>	<u>(5,528,085)</u>	<u>(1,006,410)</u>	<u>760,279</u>
<u>9,319,501</u>	<u>69,296</u>	<u>5,573,276</u>	<u>6,179,240</u>	<u>7,032,939</u>	<u>30,269,351</u>	<u>9,238,685</u>	<u>3,217,349</u>	<u>5,215,598</u>
<u>\$33,449,772</u>	<u>\$13,069,551</u>	<u>\$63,635,009</u>	<u>\$51,966,603</u>	<u>\$45,595,469</u>	<u>\$190,861,596</u>	<u>\$166,090,657</u>	<u>\$36,376,515</u>	<u>\$82,700,380</u>

Statements of changes in net assets (continued)

Years Ended December 31, 2009 and 2010

	<i>American Funds International Growth and Income Class 2 Subaccount</i>	<i>American Funds New World Class 2 Subaccount</i>	<i>American Funds U.S. Government/ AAA-Rated Securities Class 2 Subaccount</i>	<i>LVIP American Balanced Allocation Service Class Subaccount</i>
NET ASSETS AT JANUARY 1, 2009	\$ 75,282	\$22,717,746	\$49,800,556	\$ —
Changes From Operations:				
• Net investment income (loss)	9,505	12,570	538,033	—
• Net realized gain (loss) on investments	142,243	(1,583,183)	1,024,910	—
• Net change in unrealized appreciation or depreciation on investments	341,996	12,238,755	(1,170,981)	—
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS	493,744	10,668,142	391,962	—
Change From Unit Transactions:				
Accumulation Units:				
• Contract purchases	987,478	2,022,799	6,476,789	—
• Contract withdrawals	(154,431)	(1,543,096)	(5,167,342)	—
• Contract transfers	1,966,629	2,206,636	2,423,721	—
	2,799,676	2,686,339	3,733,168	—
Annuity Reserves:				
• Annuity payments	—	—	—	—
	—	—	—	—
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM UNIT TRANSACTIONS	2,799,676	2,686,339	3,733,168	—
TOTAL INCREASE (DECREASE) IN NET ASSETS	3,293,420	13,354,481	4,125,130	—
NET ASSETS AT DECEMBER 31, 2009	3,368,702	36,072,227	53,925,686	—
Changes From Operations:				
• Net investment income (loss)	34,910	16,519	147,310	(1,065)
• Net realized gain (loss) on investments	161,760	580,288	1,239,651	754
• Net change in unrealized appreciation or depreciation on investments	141,489	5,095,309	990,728	14,184
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS	338,159	5,692,116	2,377,689	13,873
Change From Unit Transactions:				
Accumulation Units:				
• Contract purchases	1,623,421	2,919,839	6,361,053	690,465
• Contract withdrawals	(212,511)	(2,517,882)	(4,718,139)	(144)
• Contract transfers	1,301,861	1,584,713	9,041,053	626,967
	2,712,771	1,986,670	10,683,967	1,317,288
Annuity Reserves:				
• Annuity payments	—	—	—	—
	—	—	—	—
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM UNIT TRANSACTIONS	2,712,771	1,986,670	10,683,967	1,317,288
TOTAL INCREASE (DECREASE) IN NET ASSETS	3,050,930	7,678,786	13,061,656	1,331,161
NET ASSETS AT DECEMBER 31, 2010	\$6,419,632	\$43,751,013	\$66,987,342	\$1,331,161

See accompanying notes.

Notes to financial statements

December 31, 2010

1. Accounting Policies and Variable Account Information

The Variable Account: Lincoln Life & Annuity Variable Annuity Account H (the Variable Account) is a segregated investment account of Lincoln Life & Annuity Company of New York (the Company) and is registered as a unit investment trust with the Securities and Exchange Commission under the Investment Company Act of 1940, as amended. The operations of the Variable Account, which commenced on June 1, 2000, are part of the operations of the Company. The Variable Account consists of six products as follows:

- American Legacy III
- American Legacy III C Share
- American Legacy III Plus
- American Legacy III View
- American Legacy Shareholder's Advantage
- American Legacy Design

The assets of the Variable Account are owned by the Company. The Variable Account's assets support the annuity contracts and may not be used to satisfy liabilities arising from any other business of the Company.

Basis of Presentation: The accompanying financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for unit investment trusts.

Accounting Estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions affecting the reported amounts as of the date of the financial statements. Those estimates are inherently subject to change and actual results could differ from those estimates. Included among the material (or potentially material) reported amounts that require use of estimates is the fair value of certain assets.

Investments: The assets of the Variable Account are divided into variable subaccounts, each of which may be invested in shares of one of nineteen mutual funds (the Funds) of two diversified, open-ended management investment companies, each Fund with its own investment objective. The Funds are:

American Funds Insurance Series (American Funds):
American Funds Asset Allocation Class 2 Fund
American Funds Blue Chip Income & Growth Class 2 Fund
American Funds Bond Class 2 Fund
American Funds Cash Management Class 2 Fund

American Funds Global Bond Class 2 Fund
American Funds Global Discovery Class 2 Fund
American Funds Global Growth Class 2 Fund
American Funds Global Growth and Income Class 2 Fund
American Funds Global Small Capitalization Class 2 Fund
American Funds Growth Class 2 Fund
American Funds Growth-Income Class 2 Fund
American Funds High-Income Bond Class 2 Fund
American Funds International Class 2 Fund
American Funds International Growth and Income Class 2 Fund
American Funds New World Class 2 Fund
American Funds U.S. Government/AAA-Rated Securities Class 2 Fund
Lincoln Variable Insurance Products Trust (LVIP)*:
LVIP American Balanced Allocation Service Class Fund
LVIP American Growth Allocation Service Class Fund
LVIP American Income Allocation Service Class Fund

* Denotes an affiliate of the Company.

Investments in the Funds are stated at fair value as determined by the closing net asset value per share on December 31, 2010. The difference between cost and net asset value is reflected as unrealized appreciation or depreciation of investments.

The Variable Account's investments in the Funds are valued in accordance with the Fair Value Measurements and Disclosure Topic of the Financial Accounting Standards Board Accounting Standards Codification (Topic). The Topic defines fair value as the price that the Variable Account would receive to sell an asset or pay to transfer a liability in an orderly transaction between market participants at the measurement date. The Topic also establishes a framework for measuring fair value and a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset or liability. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the reporting entity. Unobservable inputs reflect the reporting entity's own assessment regarding the assumptions market participants would use in pricing the asset or liability and are developed based on the best information available in the circumstances. The Variable Account's investments in the Funds are assigned a level based upon the observability of the inputs which are significant to the overall valuation. The three-tier hierarchy of inputs is summarized below.

Level 1 - inputs to the valuation methodology are quoted prices in active markets

Level 2 - inputs to the valuation methodology are observable, directly or indirectly

Notes to financial statements (continued)

1. Accounting Policies and Variable Account Information (continued)

Level 3 - inputs to the valuation methodology are unobservable and reflect assumptions on the part of the reporting entity

The Variable Account's investments in the Funds are valued within the fair value hierarchy as Level 2. Net asset value is quoted by the Funds as derived by the fair value of the Funds' underlying investments. The Funds are not considered Level 1 as they are not traded in the open market; rather the Company sells and redeems shares at net asset value with the Funds.

Investment transactions are accounted for on a trade-date basis. The cost of investments sold is determined by the average cost method.

Dividends: Dividends paid to the Variable Account are automatically reinvested in shares of the Funds on the payable date. Dividend income is recorded on the ex-dividend date.

Federal Income Taxes: Operations of the Variable Account form a part of and are taxed with operations of the Company, which is taxed as a "life insurance company" under the Internal Revenue Code. The Variable Account will not be taxed as a regulated investment company under Subchapter M of the Internal Revenue Code, as amended. Under current federal income tax law, no federal income taxes are payable or receivable with respect to the Variable Account's net investment income and the net realized gain (loss) on investments.

Annuity Reserves: Reserves on contracts not involving life contingencies are calculated using an assumed investment return of 3%, 4%, 5% or 6%, as approved in each state. Reserves on contracts involving life contingencies are calculated using a modification of the 1983a Individual Mortality Table and an assumed investment return of 3%, 4%, 5% or 6%, as approved in each state.

Investment Fund Changes: During 2010, the LVIP American Balanced Allocation Service Class Fund, the LVIP American Growth Allocation Service Class Fund, and the LVIP American Income Allocation Service Class Fund became available as investment options for account contract owners. Accordingly, the 2010 statements of operations and statements of changes in net assets and total return and investment income ratios in note 3 for these subaccounts are for the period from the commencement of operations to December 31, 2010.

2. Mortality and Expense Guarantees and Other Transactions with Affiliates

Amounts are paid to the Company for mortality and expense guarantees at a percentage of the current value of the Variable Account each day. The ranges of rates are as follows for the six contract types within the Variable Account:

- American Legacy III at a daily rate of .0034247% to .0076712% (1.25% to 2.80% on an annual basis)
- American Legacy III C-Share at a daily rate of .0038356% to .0087671% (1.40% to 3.20% on an annual basis)
- American Legacy III Plus at a daily rate of .0038356% to .0083562% (1.40% to 3.05% on an annual basis)
- American Legacy III View at a daily rate of .0038356% to .0086301% (1.40% to 3.15% on an annual basis)
- American Legacy Shareholder's Advantage at a daily rate of .0016438% to .0063014% (.60% to 2.30% on an annual basis)
- American Legacy Design at a daily rate of .0030137% to .0084932% (1.10% to 3.10% on an annual basis)

Proceeds retained from the sales of annuity contracts for contract charges and surrender charges for the years ended December 31, 2010 and 2009, amounted to \$4,731,863 and \$4,761,097, respectively.

For the Shareholder's Advantage product, a front-end load or sales charge is applied as a percentage (5.75% maximum) to all gross purchase payments. For the years ended December 31, 2010 and 2009, sales charges were \$260,763 and \$250,873, respectively.

The Company is responsible for all sales and general and administrative expenses applicable to the Variable Account.

Notes to financial statements (continued)

3. Financial Highlights

A summary of the fee rates, unit values, units outstanding, net assets and total return and investment income ratios for variable annuity contracts as of and for each year or period in the five years ended December 31, 2010, follows:

<i>Subaccount</i>	<i>Year</i>	<i>Commencement Date(1)</i>	<i>Minimum Fee Rate(2)</i>	<i>Maximum Fee Rate(2)</i>	<i>Minimum Unit Value(3)</i>	<i>Maximum Unit Value(3)</i>	<i>Units Outstanding</i>	<i>Net Assets</i>	<i>Minimum Total Return(4)</i>	<i>Maximum Total Return(4)</i>	<i>Investment Income Ratio(5)</i>
American Funds Asset Allocation Class 2											
	2010		0.60%	2.85%	\$ 1.36	\$15.17	29,727,971	\$ 94,223,518	9.35%	11.83%	1.97%
	2009		0.60%	2.85%	1.23	13.62	34,027,287	92,254,523	20.56%	23.24%	2.37%
	2008		0.60%	2.80%	1.01	11.10	37,899,464	79,814,050	-31.46%	-29.93%	2.51%
	2007		0.60%	2.80%	1.45	15.92	44,038,015	120,680,130	3.87%	5.92%	2.27%
	2006		0.60%	2.55%	1.38	14.67	44,661,524	100,231,577	11.89%	13.97%	2.45%
American Funds Blue Chip Income & Growth Class 2											
	2010		0.60%	2.85%	1.05	14.77	27,091,441	92,844,706	9.17%	11.65%	1.77%
	2009		0.60%	2.85%	0.95	13.28	28,589,448	81,854,819	24.44%	27.20%	2.18%
	2008		0.60%	2.80%	0.75	10.49	30,968,039	63,448,349	-38.26%	-36.89%	2.18%
	2007		0.60%	2.80%	1.21	16.70	32,495,663	89,813,546	-0.54%	1.42%	2.63%
	2006		0.60%	2.55%	1.20	16.54	33,676,916	73,621,849	14.58%	16.71%	1.14%
American Funds Bond Class 2											
	2010		0.60%	2.85%	1.31	12.47	23,534,563	96,941,999	3.51%	5.81%	3.06%
	2009		0.60%	2.80%	1.25	11.84	23,285,311	85,109,362	9.50%	11.93%	3.51%
	2008		0.60%	2.80%	1.13	10.62	21,171,141	58,335,108	-11.85%	-9.89%	5.85%
	2007		0.60%	2.80%	1.27	11.84	21,980,959	56,460,365	0.73%	2.71%	8.07%
	2006		0.60%	2.55%	1.25	11.58	20,644,245	42,984,794	4.71%	6.35%	3.79%
American Funds Cash Management Class 2											
	2010		0.60%	2.80%	1.00	10.82	8,659,593	28,638,347	-3.11%	-0.95%	0.00%
	2009		0.60%	2.80%	1.02	10.94	10,614,900	37,799,007	-3.09%	-0.93%	0.18%
	2008		0.60%	2.80%	1.04	11.06	16,132,163	61,547,970	-0.82%	1.28%	1.93%
	2007		0.60%	2.70%	1.04	10.93	8,756,223	33,241,269	1.99%	4.09%	8.20%
	2006		0.60%	2.65%	1.01	10.52	3,309,805	7,820,599	2.57%	4.01%	1.82%
American Funds Global Bond Class 2											
	2010		0.60%	2.85%	11.77	12.88	2,706,956	33,449,772	2.33%	4.60%	3.19%
	2009		0.60%	2.80%	11.50	12.31	2,026,999	24,130,271	6.66%	9.04%	1.80%
	2008		0.60%	2.80%	10.78	11.29	1,296,204	14,343,109	0.62%	2.86%	5.05%
	2007	1/11/07	0.60%	2.80%	10.71	10.98	528,879	5,743,161	-0.19%	9.22%	8.05%
American Funds Global Discovery Class 2											
	2010		0.60%	2.80%	1.32	13.69	2,467,183	13,069,551	7.11%	9.42%	0.53%
	2009		0.60%	2.80%	1.21	12.52	2,910,878	13,000,255	47.11%	50.01%	0.61%
	2008		0.60%	2.55%	0.82	8.31	2,391,225	6,655,394	-46.47%	-45.41%	0.77%
	2007		0.60%	2.55%	1.52	19.60	2,646,187	12,323,788	14.38%	16.52%	1.09%
	2006		0.60%	2.45%	1.31	17.04	2,323,988	7,234,646	14.91%	16.71%	1.06%
American Funds Global Growth Class 2											
	2010		0.60%	2.85%	1.11	19.59	14,397,099	63,635,009	8.66%	11.08%	1.51%
	2009		0.60%	2.80%	1.01	17.86	15,990,853	58,061,733	38.38%	41.45%	1.46%
	2008		0.60%	2.80%	0.72	12.78	17,506,686	41,557,580	-40.09%	-38.76%	1.95%
	2007		0.60%	2.80%	1.18	21.14	18,407,033	59,179,783	11.85%	14.16%	2.88%
	2006		0.60%	2.65%	1.04	18.75	18,459,895	40,333,673	17.28%	19.71%	0.85%
American Funds Global Growth and Income Class 2											
	2010		0.60%	2.85%	10.44	11.58	4,687,742	51,966,603	8.64%	11.12%	2.66%
	2009		0.60%	2.85%	9.61	10.42	4,545,543	45,787,363	35.80%	38.89%	2.60%
	2008		0.60%	2.85%	7.09	7.51	4,158,350	30,450,902	-42.79%	-41.52%	2.31%
	2007		0.60%	2.80%	12.56	12.83	3,002,247	37,949,595	10.49%	12.00%	2.41%
	2006	6/5/06	0.60%	2.55%	11.32	11.46	1,007,565	11,479,166	0.81%	17.58%	1.27%
American Funds Global Small Capitalization Class 2											
	2010		0.60%	2.85%	1.38	25.96	7,884,041	45,595,469	18.98%	21.68%	1.68%
	2009		0.60%	2.85%	1.14	21.61	8,710,600	38,562,530	56.77%	60.33%	0.30%
	2008		0.60%	2.85%	0.72	13.64	9,080,618	22,335,889	-54.81%	-53.80%	0.00%
	2007		0.60%	2.80%	1.57	29.91	9,955,787	45,429,099	18.49%	20.70%	2.97%
	2006		0.60%	2.45%	1.31	25.09	10,452,089	31,235,545	21.42%	23.31%	0.45%

Notes to financial statements (continued)

3. Financial Highlights (continued)

<i>Subaccount</i>	<i>Year</i>	<i>Commencement Date(1)</i>	<i>Minimum Fee Rate(2)</i>	<i>Maximum Fee Rate(2)</i>	<i>Minimum Unit Value(3)</i>	<i>Maximum Unit Value(3)</i>	<i>Units Outstanding</i>	<i>Net Assets</i>	<i>Minimum Total Return(4)</i>	<i>Maximum Total Return(4)</i>	<i>Investment Income Ratio(5)</i>
American Funds Growth Class 2											
	2010		0.60%	2.85%	\$ 0.97	\$17.22	43,591,768	\$190,861,596	15.35%	17.97%	0.73%
	2009		0.60%	2.85%	0.83	14.67	46,772,009	160,592,245	35.56%	38.58%	0.69%
	2008		0.60%	2.80%	0.60	10.63	47,801,820	106,078,459	-45.52%	-44.31%	0.91%
	2007		0.60%	2.80%	1.09	19.18	50,359,312	158,488,676	9.41%	11.68%	0.85%
	2006		0.60%	2.65%	0.99	17.25	52,537,780	116,077,079	7.33%	9.56%	0.91%
American Funds Growth-Income Class 2											
	2010		0.60%	2.85%	1.26	14.72	46,100,122	166,090,657	8.30%	10.76%	1.49%
	2009		0.60%	2.85%	1.15	13.35	51,949,166	156,851,972	27.55%	30.46%	1.63%
	2008		0.60%	2.85%	0.89	10.28	57,389,349	122,731,332	-39.57%	-38.22%	1.77%
	2007		0.60%	2.80%	1.46	16.71	63,782,930	192,929,488	2.30%	4.41%	1.59%
	2006		0.60%	2.65%	1.41	16.08	66,726,787	164,555,778	12.19%	14.51%	1.73%
American Funds High-Income Bond Class 2											
	2010		0.60%	2.85%	1.69	15.01	7,058,751	36,376,515	11.90%	14.38%	7.57%
	2009		0.60%	2.80%	1.49	13.29	7,658,410	33,159,166	35.11%	38.11%	7.60%
	2008		0.60%	2.80%	1.09	9.74	7,422,899	21,382,325	-25.94%	-24.29%	7.47%
	2007		0.60%	2.80%	1.45	13.03	7,885,425	27,236,297	-1.17%	0.73%	11.96%
	2006		0.60%	2.50%	1.46	13.10	8,001,873	21,575,622	8.24%	9.93%	5.88%
American Funds International Class 2											
	2010		0.60%	2.85%	1.02	21.28	16,111,680	82,700,380	4.22%	6.59%	2.06%
	2009		0.60%	2.85%	0.97	20.21	17,718,791	77,484,782	39.05%	42.22%	1.57%
	2008		0.60%	2.85%	0.68	14.39	19,895,711	56,225,709	-43.72%	-42.47%	2.11%
	2007		0.60%	2.80%	1.20	25.33	21,125,343	85,317,292	16.88%	19.30%	1.69%
	2006		0.60%	2.65%	1.01	21.50	21,021,382	54,262,924	15.87%	18.27%	1.97%
American Funds International Growth and Income Class 2											
	2010		0.60%	2.85%	15.40	16.16	406,617	6,419,632	3.92%	6.28%	2.39%
	2009		0.60%	2.85%	15.00	15.06	224,252	3,368,702	37.54%	38.09%	2.35%
	2008	11/25/08	1.40%	1.80%	10.90	10.91	6,903	75,282	0.78%	12.02%	0.07%
American Funds New World Class 2											
	2010		0.60%	2.85%	2.31	29.42	5,362,321	43,751,013	14.62%	17.17%	1.61%
	2009		0.60%	2.80%	1.98	25.42	5,618,927	36,072,227	45.52%	48.76%	1.61%
	2008		0.60%	2.80%	1.34	17.30	5,664,179	22,717,746	-43.97%	-42.72%	1.55%
	2007		0.60%	2.80%	2.37	30.59	5,887,998	37,257,390	29.01%	31.42%	3.43%
	2006		0.60%	2.45%	1.81	23.57	5,487,163	20,429,185	30.03%	31.80%	1.51%
American Funds U.S. Government/AAA-Rated Securities Class 2											
	2010		0.60%	2.85%	1.24	12.58	11,911,173	66,987,342	2.78%	5.11%	1.85%
	2009		0.60%	2.85%	1.20	12.02	11,257,657	53,925,686	-0.33%	1.89%	2.61%
	2008		0.60%	2.80%	1.18	11.85	11,975,842	49,800,556	4.66%	6.98%	3.63%
	2007		0.60%	2.80%	1.12	11.13	8,905,914	23,069,620	3.91%	5.85%	8.04%
	2006		0.60%	2.45%	1.07	10.56	7,542,447	13,906,481	1.75%	3.13%	3.89%
LVIP American Balanced Allocation Service Class											
	2010	12/3/10	0.75%	1.65%	10.57	10.61	125,786	1,331,161	0.70%	1.06%	0.00%
LVIP American Growth Allocation Service Class											
	2010	12/3/10	0.75%	1.90%	10.66	10.72	111,980	1,196,027	0.81%	1.34%	0.00%
LVIP American Income Allocation Service Class											
	2010	12/3/10	0.75%	1.65%	10.35	10.39	79,629	825,093	0.55%	0.68%	0.00%

- (1) Reflects less than a full year of activity. Funds were first received in this option on the commencement date noted or the option was inactive at the date funds were received.
- (2) These amounts represent the annualized minimum and maximum contract expenses of the separate account, consisting primarily of mortality and expense charges, for each period indicated. The ratios include only those expenses that result in a direct reduction to unit values. Charges made directly to contract owner accounts through the redemption of units and expenses of the underlying funds have been excluded.
- (3) As the unit value is presented as a range of minimum to maximum values, for only those subaccounts which existed for the entire year, some individual contract unit values may not be within the ranges presented as a result of partial year activity.

Notes to financial statements (continued)

3. Financial Highlights (continued)

- (4) These amounts represent the total return, including changes in value of mutual funds, and reflect deductions for all items included in the fee rate. The total return does not include contract charges deducted directly from policy account values. The total return is not annualized. As the total return is presented as a range of minimum to maximum values, for only those subaccounts which existed for the entire year, some individual contract total returns may not be within the ranges presented as a result of partial year activity.
- (5) These amounts represent the dividends, excluding distributions of capital gains, received by the subaccount from the underlying mutual fund, net of management fees assessed by the fund manager, divided by the average net assets. These ratios exclude those expenses, such as mortality and expense guarantee charges, that result in direct reductions in the unit values. The recognition of investment income by the subaccount is affected by the timing of the declaration of dividends by the underlying fund in which the subaccounts invest. Investment income ratios are not annualized.

Note: Fee rate, unit value and total return minimum and maximum are the same where there is only one active contract level charge for the subaccount.

4. Purchases and Sales of Investments

The aggregate cost of investments purchased and the aggregate proceeds from investments sold were as follows for 2010:

<i>Subaccount</i>	<i>Aggregate Cost of Purchases</i>	<i>Aggregate Proceeds from Sales</i>
American Funds Asset Allocation Class 2	\$ 6,097,765	\$12,989,973
American Funds Blue Chip Income & Growth Class 2	10,884,598	8,440,408
American Funds Bond Class 2	20,688,784	11,479,285
American Funds Cash Management Class 2	18,793,623	27,721,544
American Funds Global Bond Class 2	14,632,531	5,633,069
American Funds Global Discovery Class 2	5,058,918	6,014,062
American Funds Global Growth Class 2	5,474,770	5,765,101
American Funds Global Growth and Income Class 2	9,138,699	7,078,517
American Funds Global Small Capitalization Class 2	8,532,227	8,871,521
American Funds Growth Class 2	18,928,924	17,421,995
American Funds Growth-Income Class 2	8,414,853	13,982,437
American Funds High-Income Bond Class 2	10,486,300	9,418,278
American Funds International Class 2	7,707,964	6,545,558
American Funds International Growth and Income Class 2	3,659,696	721,029
American Funds New World Class 2	9,325,323	7,322,465
American Funds U.S. Government/AAA-Rated Securities Class 2	44,087,792	32,794,038
LVIP American Balanced Allocation Service Class	1,410,088	93,815
LVIP American Growth Allocation Service Class	1,184,872	393
LVIP American Income Allocation Service Class	826,178	6,739

5. Investments

The following is a summary of investments owned at December 31, 2010:

<i>Subaccount</i>	<i>Shares Owned</i>	<i>Net Asset Value</i>	<i>Fair Value of Shares</i>	<i>Cost of Shares</i>
American Funds Asset Allocation Class 2	5,826,081	\$16.17	\$ 94,207,722	\$ 92,201,559
American Funds Blue Chip Income & Growth Class 2	10,111,414	9.18	92,822,779	94,973,918
American Funds Bond Class 2	9,189,115	10.56	97,037,051	97,445,007
American Funds Cash Management Class 2	2,543,680	11.28	28,692,712	28,905,872
American Funds Global Bond Class 2	2,837,766	11.78	33,428,883	32,469,674
American Funds Global Discovery Class 2	1,069,090	12.22	13,064,283	11,953,723
American Funds Global Growth Class 2	2,962,452	21.48	63,633,464	57,677,855
American Funds Global Growth and Income Class 2	5,226,287	9.94	51,949,293	50,862,617
American Funds Global Small Capitalization Class 2	2,135,676	21.35	45,596,680	40,986,129
American Funds Growth Class 2	3,512,796	54.34	190,885,316	180,081,326
American Funds Growth-Income Class 2	4,849,235	34.25	166,086,299	169,862,282

Notes to financial statements (continued)

5. Investments (continued)

<i>Subaccount</i>	<i>Net</i>		<i>Fair Value</i>	<i>Cost of Shares</i>
	<i>Shares Owned</i>	<i>Asset Value</i>		
American Funds High-Income Bond Class 2	3,283,732	\$11.08	\$ 36,383,751	\$ 35,555,766
American Funds International Class 2	4,599,009	17.98	82,690,179	83,243,022
American Funds International Growth and Income Class 2	420,511	15.21	6,395,977	5,907,665
American Funds New World Class 2	1,894,795	23.09	43,750,823	36,902,160
American Funds U.S. Government/AAA-Rated Securities Class 2	5,363,748	12.49	66,993,214	65,827,231
LVIP American Balanced Allocation Service Class	125,067	10.64	1,331,211	1,317,027
LVIP American Growth Allocation Service Class	111,273	10.75	1,196,077	1,184,482
LVIP American Income Allocation Service Class	79,141	10.43	825,126	819,428

6. Changes in Units Outstanding

The change in units outstanding for the year ended December 31, 2010, is as follows:

<i>Subaccount</i>	<i>Units Issued</i>	<i>Units Redeemed</i>	<i>Net Increase (Decrease)</i>
American Funds Asset Allocation Class 2	1,998,289	(6,297,605)	(4,299,316)
American Funds Blue Chip Income & Growth Class 2	3,785,449	(5,283,456)	(1,498,007)
American Funds Bond Class 2	5,877,498	(5,628,246)	249,252
American Funds Cash Management Class 2	5,634,079	(7,589,386)	(1,955,307)
American Funds Global Bond Class 2	1,603,613	(923,656)	679,957
American Funds Global Discovery Class 2	1,463,635	(1,907,330)	(443,695)
American Funds Global Growth Class 2	1,282,293	(2,876,047)	(1,593,754)
American Funds Global Growth and Income Class 2	1,299,079	(1,156,880)	142,199
American Funds Global Small Capitalization Class 2	2,016,282	(2,842,841)	(826,559)
American Funds Growth Class 2	5,550,198	(8,730,439)	(3,180,241)
American Funds Growth-Income Class 2	2,657,270	(8,506,314)	(5,849,044)
American Funds High-Income Bond Class 2	1,713,294	(2,312,953)	(599,659)
American Funds International Class 2	1,715,595	(3,322,706)	(1,607,111)
American Funds International Growth and Income Class 2	309,338	(126,973)	182,365
American Funds New World Class 2	1,583,163	(1,839,769)	(256,606)
American Funds U.S. Government/AAA-Rated Securities Class 2	11,125,208	(10,471,692)	653,516
LVIP American Balanced Allocation Service Class	138,752	(12,966)	125,786
LVIP American Growth Allocation Service Class	111,980	—	111,980
LVIP American Income Allocation Service Class	80,213	(584)	79,629

The change in units outstanding for the year ended December 31, 2009, is as follows:

<i>Subaccount</i>	<i>Units Issued</i>	<i>Units Redeemed</i>	<i>Net Increase (Decrease)</i>
American Funds Asset Allocation Class 2	2,484,002	(6,356,179)	(3,872,177)
American Funds Blue Chip Income & Growth Class 2	2,937,185	(5,315,776)	(2,378,591)
American Funds Bond Class 2	7,296,237	(5,182,067)	2,114,170
American Funds Cash Management Class 2	7,571,107	(13,088,370)	(5,517,263)
American Funds Global Bond Class 2	1,289,163	(558,368)	730,795
American Funds Global Discovery Class 2	1,384,426	(864,773)	519,653
American Funds Global Growth Class 2	1,667,148	(3,182,981)	(1,515,833)
American Funds Global Growth and Income Class 2	1,366,169	(978,976)	387,193
American Funds Global Small Capitalization Class 2	2,294,270	(2,664,288)	(370,018)
American Funds Growth Class 2	6,765,055	(7,794,866)	(1,029,811)
American Funds Growth-Income Class 2	4,046,505	(9,486,688)	(5,440,183)
American Funds High-Income Bond Class 2	3,319,815	(3,084,304)	235,511
American Funds International Class 2	2,031,090	(4,208,010)	(2,176,920)
American Funds International Growth and Income Class 2	285,869	(68,520)	217,349
American Funds New World Class 2	1,472,890	(1,518,142)	(45,252)
American Funds U.S. Government/AAA-Rated Securities Class 2	5,018,625	(5,736,810)	(718,185)

Report of Independent Registered Public Accounting Firm

Board of Directors of Lincoln Life & Annuity Company of New York

and

Contract Owners of Lincoln Life & Annuity Variable Annuity Account H

We have audited the accompanying statements of assets and liabilities of Lincoln Life & Annuity Variable Annuity Account H ("Variable Account"), comprised of the subaccounts described in Note 1, as of December 31, 2010, and the related statements of operations for the year then ended and changes in net assets for each of the two years in the period then ended, or for the sub-account operating for a portion of such periods as disclosed in the financial statements. These financial statements are the responsibility of the Variable Account's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Variable Account's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Variable Account's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our procedures included confirmation of investments owned as of December 31, 2010, by correspondence with the fund companies, or their transfer agents, as applicable. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of each of the respective subaccounts constituting Lincoln Life & Annuity Variable Annuity Account H at December 31, 2010, and the results of their operations and the changes in their net assets for the periods described above, in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

Philadelphia, Pennsylvania

April 6, 2011

Lincoln Life & Annuity Company of New York

Lincoln Life & Annuity Company of New York

**Financial Statements
December 31, 2010 and 2009**

Report of Independent Registered Public Accounting Firm

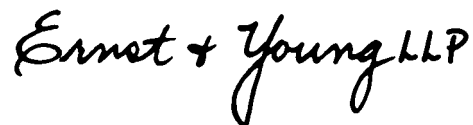
To the Board of Directors and Shareholder of
Lincoln Life & Annuity Company of New York

We have audited the accompanying balance sheets of Lincoln Life & Annuity Company of New York (the Company) as of December 31, 2010 and 2009, and the related statements of income (loss), stockholder's equity, and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lincoln Life & Annuity Company of New York at December 31, 2010 and 2009, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the financial statements, in 2009 the Company changed its method of accounting for the recognition and presentation of other-than-temporary impairments.

The logo for Ernst & Young LLP is written in a black, cursive script font. The letters are fluid and connected, with a prominent 'E' and 'Y'.

Philadelphia, Pennsylvania
April 1, 2011

Balance Sheets

(in millions, except share data)

	<i>As of December 31,</i>	
	<u>2010</u>	<u>2009</u>
ASSETS		
Investments:		
Available-for-sale securities, at fair value:		
Fixed maturity securities (amortized cost: 2010 — \$6,429; 2009 — \$6,229)	\$ 6,659	\$ 6,180
Equity securities (cost: 2010 and 2009 — \$2)	3	2
Mortgage loans on real estate	225	228
Policy loans	431	442
Other investments	1	2
Total investments	<u>7,319</u>	<u>6,854</u>
Cash and invested cash	48	65
Deferred acquisition costs and value of business acquired	731	856
Premiums and fees receivable	5	5
Accrued investment income	93	92
Reinsurance recoverables	503	502
Goodwill	162	162
Other assets	115	105
Separate account assets	<u>2,660</u>	<u>2,263</u>
Total assets	<u>\$11,636</u>	<u>\$10,904</u>
LIABILITIES AND STOCKHOLDER'S EQUITY		
Liabilities		
Future contract benefits	\$ 1,523	\$ 1,537
Other contract holder funds	5,268	5,084
Other liabilities	306	264
Separate account liabilities	<u>2,660</u>	<u>2,263</u>
Total liabilities	<u>9,757</u>	<u>9,148</u>
Contingencies and Commitments (See Note 11)		
Stockholder's Equity		
Common stock — 132,000 shares authorized, issued and outstanding	940	940
Retained earnings	879	846
Accumulated other comprehensive income (loss)	60	(30)
Total stockholder's equity	<u>1,879</u>	<u>1,756</u>
Total liabilities and stockholder's equity	<u>\$11,636</u>	<u>\$10,904</u>

See accompanying Notes to Financial Statements

Statements of Income (Loss)

(in millions)

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Revenues			
Insurance premiums	\$127	\$104	\$ 98
Insurance fees	259	255	248
Net investment income	418	408	395
Realized gain (loss):			
Total other-than-temporary impairment losses on securities	(20)	(90)	(106)
Portion of loss recognized in other comprehensive income	5	31	—
Net other-than-temporary impairment losses on securities recognized in earnings	(15)	(59)	(106)
Realized gain (loss), excluding other-than-temporary impairment losses on securities	(2)	(6)	8
Total realized gain (loss)	(17)	(65)	(98)
Other revenues and fees	—	(1)	—
Total revenues	787	701	643
Benefits and Expenses			
Interest credited	207	209	209
Benefits	254	225	228
Underwriting, acquisition, insurance and other expenses	158	159	156
Total benefits and expenses	619	593	593
Income (loss) before taxes	168	108	50
Federal income tax expense (benefit)	55	35	14
Net income (loss)	\$113	\$ 73	\$ 36

Statements of Stockholder's Equity

(in millions)

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Common Stock			
Balance as of beginning-of-year	\$ 940	\$ 940	\$ 940
Balance as of end-of-year	<u>940</u>	<u>940</u>	<u>940</u>
Retained Earnings			
Balance as of beginning-of-year	846	757	724
Cumulative effect from adoption of new accounting standards	—	16	—
Comprehensive income (loss)	203	269	(167)
Less other comprehensive income (loss), net of tax	<u>(90)</u>	<u>(196)</u>	<u>203</u>
Net income (loss)	113	73	36
Dividends declared	<u>(80)</u>	<u>—</u>	<u>(3)</u>
Balance as of end-of-year	<u>879</u>	<u>846</u>	<u>757</u>
Accumulated Other Comprehensive Income (Loss)			
Balance as of beginning-of-year	(30)	(210)	(7)
Cumulative effect from adoption of new accounting standards	—	(16)	—
Other comprehensive income (loss), net of tax	90	196	(203)
Balance as of end-of-year	<u>60</u>	<u>(30)</u>	<u>(210)</u>
Total stockholder's equity as of end-of-year	<u>\$1,879</u>	<u>\$1,756</u>	<u>\$1,487</u>

See accompanying Notes to Financial Statements

Statements of Cash Flows

(in millions)

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Cash Flows from Operating Activities			
Net income (loss)	\$ 113	\$ 73	\$ 36
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	28	27	7
Change in premiums and fees receivable	—	(2)	1
Change in accrued investment income	(1)	(6)	(3)
Change in future contract benefits and other contract holder funds	(84)	(140)	50
Change in reinsurance related assets and liabilities	25	92	(116)
Change in federal income tax accruals	40	44	(26)
Realized (gain) loss	17	65	98
Other	(18)	(5)	(15)
Net cash provided by (used in) operating activities	<u>120</u>	<u>148</u>	<u>32</u>
Cash Flows from Investing Activities			
Purchases of available-for-sale securities	(920)	(1,150)	(833)
Sales of available-for-sale securities	210	271	162
Maturities of available-for-sale securities	451	384	548
Purchases of other investments	(119)	(18)	(76)
Sales or maturities of other investments	135	70	37
Net cash provided by (used in) investing activities	<u>(243)</u>	<u>(443)</u>	<u>(162)</u>
Cash Flows from Financing Activities			
Deposits of fixed account values, including the fixed portion of variable	583	663	538
Withdrawals of fixed account values, including the fixed portion of variable	(346)	(308)	(406)
Transfers to and from separate accounts, net	(51)	(50)	(72)
Common stock issued for benefit plans and excess tax benefits	—	—	(4)
Dividends paid to stockholders	(80)	—	—
Net cash provided by (used in) financing activities	<u>106</u>	<u>305</u>	<u>56</u>
Net increase (decrease) in cash and invested cash, including discontinued operations	(17)	10	(74)
Cash and invested cash, including discontinued operations, as of beginning-of-year	65	55	129
Cash and invested cash, including discontinued operations, as of end-of-year	<u>\$ 48</u>	<u>\$ 65</u>	<u>\$ 55</u>

Notes to Financial Statements

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

Nature of Operations

Lincoln Life & Annuity Company of New York (“LLANY” or the “Company,” which also may be referred to as “we,” “our” or “us”), a wholly-owned subsidiary of The Lincoln National Life Insurance Company (“LNL”), a wholly-owned subsidiary of Lincoln National Corporation (“LNC” or the “Ultimate Parent”), and formerly referred to as Jefferson-Pilot LifeAmerica Insurance Company (“JPLA”), is domiciled in the state of New York. LLANY is principally engaged in the sale of individual life insurance products, individual annuity products and work-site and group non-medical products (primarily term life and disability). These products are marketed primarily through personal producing general agents and brokers throughout the U.S. LLANY is licensed and sells its products throughout the United States of America and several U.S. territories. See Note 20 for additional information.

Basis of Presentation

The accompanying financial statements are prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). Certain GAAP policies, which significantly affect the determination of financial position, results of operations and cash flows, are summarized below.

LLANY also submits financial statements to insurance industry regulatory authorities. Those financial statements are prepared on the basis of statutory accounting practices (“SAP”) and are significantly different from financial statements prepared in accordance with GAAP. See Note 18 for additional discussion on SAP.

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

Summary of Significant Accounting Policies

Accounting Estimates and Assumptions

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. Those estimates are inherently subject to change and actual results could differ from those estimates. Included among the material (or potentially material) reported amounts and disclosures that require extensive use of estimates are: fair value of certain invested assets, asset valuation allowances, deferred acquisition costs (“DAC”), value of business acquired (“VOBA”), deferred sales inducements (“DSI”), goodwill, future contract benefits, other contract holder funds which includes deferred front-end loads (“DFEL”), pension plans, income taxes and the potential effects of resolving litigated matters.

Business Combinations

For all business combination transactions occurring after January 1, 2009, we use the acquisition method of accounting, and accordingly generally, recognize the fair values of assets

acquired, liabilities assumed and any noncontrolling interests. For all business combination transactions initiated after June 30, 2001, but before January 1, 2009, the purchase method of accounting has been used, and accordingly, the assets and liabilities of the acquired company have been recorded at their estimated fair values as of the merger date. The allocation of fair values may be subject to adjustment after the initial allocation for up to a one-year period as more information relative to the fair values as of the acquisition date becomes available. The financial statements include the results of operations of any acquired company since the acquisition date.

Fair Value Measurement

Our measurement of fair value is based on assumptions used by market participants in pricing the asset or liability, which may include inherent risk, restrictions on the sale or use of an asset or non-performance risk, which would include our own credit risk. Our estimate of an exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability (“exit price”) in the principal market, or the most advantageous market in the absence of a principal market, for that asset or liability, as opposed to the price that would be paid to acquire the asset or receive a liability (“entry price”). Pursuant to the Fair Value Measurements and Disclosures Topic of the Financial Accounting Standards Board (“FASB”) *Accounting Standards Codification*[™] (“ASC”), we categorize our financial instruments carried at fair value into a three-level fair value hierarchy, based on the priority of inputs to the respective valuation technique. The three-level hierarchy for fair value measurement is defined as follows:

- Level 1 – inputs to the valuation methodology are quoted prices available in active markets for identical investments as of the reporting date, except for large holdings subject to “blockage discounts” that are excluded;
- Level 2 – inputs to the valuation methodology are other than quoted prices in active markets, that are either directly or indirectly observable as of the reporting date, and fair value can be determined through the use of models or other valuation methodologies; and
- Level 3 – inputs to the valuation methodology are unobservable inputs in situations where there is little or no market activity for the asset or liability, and we make estimates and assumptions related to the pricing of the asset or liability, including assumptions regarding risk.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment’s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the investment.

When a determination is made to classify an asset or liability within Level 3 of the fair value hierarchy, the determination is based upon the significance of the unobservable inputs to the overall fair value measurement. Because certain securities trade in less liquid or illiquid markets with limited or no pricing

Notes to Financial Statements (continued)

1. Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies (continued)

information, the determination of fair value for these securities is inherently more difficult. However, Level 3 fair value investments may include, in addition to the unobservable or Level 3 inputs, observable components, which are components that are actively quoted or can be validated to market-based sources.

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 DAC, VOBA, DSI, other contract holder funds and deferred income taxes. See Notes 3 and 12 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. 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 Engine™ 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”), mortgage pass through securities backed by residential mortgages (“MPTS”) and MBS backed by commercial mortgages (“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 and equity securities, including banking, insurance, other financial services and other securities.

AFS Securities — Evaluation for Recovery of Amortized Cost

We regularly review our AFS securities for declines in fair value that we determine to be other-than-temporary. For an equity security, if we do not have the ability and intent to hold the security for a sufficient period of time to allow for a recovery in value, we conclude that an other-than-temporary impairment (“OTTI”) has occurred and the amortized cost of the equity security is written down to the current fair value, with a corresponding charge to realized gain (loss) on our Statements of Income (Loss). When assessing our ability and intent to hold the equity security to recovery, we consider, among other things, the severity and duration of the decline in fair value of the equity security as well as the cause of the decline, a fundamental analysis of the liquidity, and business prospects and overall financial condition of the issuer.

Notes to Financial Statements (continued)

1. Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies (continued)

For our fixed maturity AFS securities, we generally consider the following to determine that our unrealized losses are not OTTI:

- The estimated range and average period until recovery;
- The estimated range and average holding period to maturity;
- Remaining payment terms of the security;
- Current delinquencies and nonperforming assets of underlying collateral;
- Expected future default rates;
- Collateral value by vintage, geographic region, industry concentration or property type;
- Subordination levels or other credit enhancements as of the balance sheet date as compared to origination; and
- Contractual and regulatory cash obligations.

For a debt security, if we intend to sell a security or it is more likely than not we will be required to sell a debt security before recovery of its amortized cost basis and the fair value of the debt security is below amortized cost, we conclude that an OTTI has occurred and the amortized cost is written down to current fair value, with a corresponding charge to realized gain (loss) on our Statements of Income (Loss). If we do not intend to sell a debt security or it is not more likely than not we will be required to sell a debt security before recovery of its amortized cost basis but the present value of the cash flows expected to be collected is less than the amortized cost of the debt security (referred to as the credit loss), we conclude that an OTTI has occurred and the amortized cost is written down to the estimated recovery value with a corresponding charge to realized gain (loss) on our Statements of Income (Loss), as this amount is deemed the credit portion of the OTTI. The remainder of the decline to fair value is recorded in OCI to unrealized OTTI on AFS securities on our Statements of Stockholder's Equity, as this amount is considered a noncredit (i.e., recoverable) impairment.

When assessing our intent to sell a debt security or if it is more likely than not we will be required to sell a debt security before recovery of its cost basis, we evaluate facts and circumstances such as, but not limited to, decisions to reposition our security portfolio, sale of securities to meet cash flow needs and sales of securities to capitalize on favorable pricing. In order to determine the amount of the credit loss for a debt security, we calculate the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows we expect to recover. The discount rate is the effective interest rate implicit in the underlying debt security. The effective interest rate is the original yield or the coupon if the debt security was previously impaired. See the discussion below for additional information on the methodology and significant inputs, by security type, which we use to determine the amount of a credit loss.

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

securities for a period of time sufficient for recovery is based upon our asset-liability management process. Management considers the following as part of the evaluation:

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

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

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

In periods subsequent to the recognition of an OTTI, the AFS security is accounted for as if it had been purchased on the measurement date of the OTTI. Therefore, for the fixed maturity AFS security, the original discount or reduced premium is reflected in net investment income over the contractual term of the investment in a manner that produces a constant effective yield.

To determine recovery value of a corporate bond or ABS CDOs, we perform additional analysis related to the underlying issuer including, but not limited to, the following:

- Fundamentals of the issuer to determine what we would recover if they were to file bankruptcy versus the price at which the market is trading;
- Fundamentals of the industry in which the issuer operates;
- Earnings multiples for the given industry or sector of an industry that the underlying issuer operates within, divided by the outstanding debt to determine an expected recovery value of the security in the case of a liquidation;
- Expected cash flows of the issuer (e.g., whether the issuer has cash flows in excess of what is required to fund its operations);
- Expectations regarding defaults and recovery rates;
- Changes to the rating of the security by a rating agency; and
- Additional market information (e.g., if there has been a replacement of the corporate debt security).

Notes to Financial Statements (continued)

1. Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies (continued)

Each quarter we review the cash flows for the MBS to determine whether or not they are sufficient to provide for the recovery of our amortized cost. We revise our cash flow projections only for those securities that are at most risk for impairment based on current credit enhancement and trends in the underlying collateral performance. To determine recovery value of a MBS, we perform additional analysis related to the underlying issuer including, but not limited to, the following:

- Discounted cash flow analysis based on the current cash flows and future cash flows we expect to recover;
- Level of creditworthiness of the home equity loans that back a CMO, residential mortgages that back a MPTS or commercial mortgages that back a CMBS;
- Susceptibility to fair value fluctuations for changes in the interest rate environment;
- Susceptibility to reinvestment risks, in cases where market yields are lower than the securities' book yield earned;
- Susceptibility to reinvestment risks, in cases where market yields are higher than the book yields earned on a security;
- Expectations of sale of such a security where market yields are higher than the book yields earned on a security; and
- Susceptibility to variability of prepayments.

When evaluating MBS and mortgage-related ABS, we consider a number of pool-specific factors as well as market level factors when determining whether or not the impairment on the security is temporary or other-than-temporary. The most important factor is the performance of the underlying collateral in the security and the trends of that performance in the prior periods. We use this information about the collateral to forecast the timing and rate of mortgage loan defaults, including making projections for loans that are already delinquent and for those loans that are currently performing but may become delinquent in the future. Other factors used in this analysis include type of underlying collateral (e.g., prime, Alt-A or subprime), geographic distribution of underlying loans and timing of liquidations by state. Once default rates and timing assumptions are determined, we then make assumptions regarding the severity of a default if it were to occur. Factors that impact the severity assumption include expectations for future home price appreciation or depreciation, loan size, first lien versus second lien, existence of loan level private mortgage insurance, type of occupancy and geographic distribution of loans. Once default and severity assumptions are determined for the security in question, cash flows for the underlying collateral are projected including expected defaults and prepayments. These cash flows on the collateral are then translated to cash flows on our tranche based on the cash flow waterfall of the entire capital security structure. If this analysis indicates the entire principal on a particular security will not be returned, the security is reviewed for OTTI by comparing the expected cash flows to amortized cost. To the extent that the security has already been impaired or was purchased at a discount, such that the amortized cost of the security is less than or equal to the present value of cash flows expected to be collected, no impairment is required.

Otherwise, if the amortized cost of the security is greater than the present value of the cash flows expected to be collected, and the security was not purchased at a discount greater than the expected principal loss, then impairment is recognized.

We further monitor the cash flows of all of our AFS securities backed by pools on an ongoing basis. We also perform detailed analysis on all of our subprime, Alt-A, non-agency residential MBS and on a significant percentage of our AFS securities backed by pools of commercial mortgages. The detailed analysis includes revising projected cash flows by updating the cash flows for actual cash received and applying assumptions with respect to expected defaults, foreclosures and recoveries in the future. These revised projected cash flows are then compared to the amount of credit enhancement (subordination) in the structure to determine whether the amortized cost of the security is recoverable. If it is not recoverable, we record an impairment of the security.

Mortgage Loans on Real Estate

Mortgage loans on real estate are carried at unpaid principal balances adjusted for amortization of premiums and accretion of discounts and are net of valuation allowances. Interest income is accrued on the principal balance of the loan based on the loan's contractual interest rate. Premiums and discounts are amortized using the effective yield method over the life of the loan. Interest income and amortization of premiums and discounts are reported in net investment income on our Statements of Income (Loss) along with mortgage loan fees, which are recorded as they are incurred.

Our commercial loan portfolio is comprised of long-term loans secured by existing commercial real estate. As such, it does not exhibit risk characteristics unique to mezzanine, construction, residential, agricultural, land or other types of real estate loans. We believe all of the loans in our portfolio share three primary risks: borrower creditworthiness; sustainability of the cash flow of the property; and market risk; therefore, our methods for monitoring and assessing credit risk are consistent for our entire portfolio. Loans are considered impaired when it is probable that, based upon current information and events, we will be unable to collect all amounts due under the contractual terms of the loan agreement. When we determine that a loan is impaired, a valuation allowance is established for the excess carrying value of the loan over its estimated value. The loan's estimated value is based on: the present value of expected future cash flows discounted at the loan's effective interest rate; the loan's observable market price; or the fair value of the loan's collateral. Valuation allowances are maintained at a level we believe is adequate to absorb estimated probable credit losses of each specific loan. Our periodic evaluation of the adequacy of the allowance for losses is based on our past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of the underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. Trends in market vacancy and rental rates are

Notes to Financial Statements (continued)

1. Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies (continued)

incorporated into the analysis that we perform for monitored loans and may contribute to the establishment of (or an increase or decrease in) an allowance for credit losses. In addition, we review each loan individually in our commercial mortgage loan portfolio on an annual basis to identify emerging risks. We focus on properties that experienced a reduction in debt-service coverage or that have significant exposure to tenants with deteriorating credit profiles. Where warranted, we establish or increase loss reserves for a specific loan based upon this analysis. Our process for determining past due or delinquency status begins when a payment date is missed, at which time the borrower is contacted. After the grace period expiration that may last up to 10 days, we send a default notice. The default notice generally provides a short time period to cure the default. Our policy is to report loans that are 60 or more days past due, which equates to two or more payments missed, as delinquent. We do not accrue interest on loans 90 days past due, and any interest received on these loans is either applied to the principal or recorded in net investment income on our Statements of Income (Loss) when received, depending on the assessment of the collectibility of the loan. We resume accruing interest once a loan complies with all of its original terms or restructured terms. Mortgage loans deemed uncollectible are charged against the allowance for losses, and subsequent recoveries, if any, are credited to the allowance for losses. All mortgage loans that are impaired have an established allowance for credit losses. Changes in valuation allowances are reported in realized gain (loss) on our Statements of Income (Loss).

We measure and assess the credit quality of our mortgage loans by using loan-to-value and debt-service coverage ratios. The loan-to-value ratio compares the principal amount of the loan to the fair value at origination of the underlying property collateralizing the loan and is commonly expressed as a percentage. Loan-to-value ratios greater than 100% indicate that the principal amount is greater than the collateral value. Therefore, all else being equal, a lower loan-to-value ratio generally indicates a higher quality loan. The debt-service coverage ratio compares a property's net operating income to its debt-service payments. Debt-service coverage ratios of less than 1.0 indicate that property operations do not generate enough income to cover its current debt payments. Therefore, all else being equal, a higher debt-service coverage ratio generally indicates a higher quality loan.

Policy Loans

Policy loans represent loans we issue to contract holders that use the cash surrender value of their life insurance policy as collateral. Policy loans are carried at unpaid principal balances.

Derivative Instruments

We have certain variable annuity products with guaranteed withdrawal benefits ("GWB") and guaranteed income benefits ("GIB") features that are embedded derivatives. These derivative instruments are recognized as either assets or liabilities on our Balance Sheets at estimated fair value. The change in fair

value of the embedded derivatives flows through net income as realized gain (loss) on our Statements of Income (Loss).

Cash and Cash Equivalents

Cash and invested cash is carried at cost and includes all highly liquid debt instruments purchased with a maturity of three months or less.

DAC, VOBA, DSI and DFEL

Commissions and other costs of acquiring universal life ("UL") insurance, variable universal life ("VUL") insurance, traditional life insurance, annuities and other investment contracts, which vary with and are related primarily to the production of new business, have been deferred (i.e., DAC) to the extent recoverable. VOBA is an intangible asset that reflects the estimated fair value of in-force contracts in a life insurance company acquisition and represents the portion of the purchase price that is allocated to the value of the right to receive future cash flows from the business in force at the acquisition date. Bonus credits and excess interest for dollar cost averaging contracts are considered DSI, and the unamortized balance is reported in other assets on our Balance Sheets. Contract sales charges that are collected in the early years of an insurance contract are deferred (referred to as "DFEL"), and the unamortized balance is reported in other contract holder funds on our Balance Sheets.

Both DAC and VOBA amortization is reported within underwriting, acquisition, insurance and other expenses on our Statements of Income (Loss). DSI amortization is reported in interest credited on our Statements of Income (Loss). The amortization of DFEL is reported within insurance fees on our Statements of Income (Loss). The methodology for determining the amortization of DAC, VOBA, DSI and DFEL varies by product type. For all insurance contracts, amortization is based on assumptions consistent with those used in the development of the underlying contract adjusted for emerging experience and expected trends.

Acquisition costs for UL and VUL insurance and investment-type products, which include fixed and variable deferred annuities, are generally amortized over the lives of the policies in relation to the incidence of estimated gross profits ("EGPs") from surrender charges, investment, mortality net of reinsurance ceded and expense margins and actual realized gain (loss) on investments. Contract lives for UL and VUL policies are estimated to be 40 years and 30 years, respectively, based on the expected lives of the contracts. Contract lives for fixed and variable deferred annuities are generally between 12 and 30 years, while some of our fixed multi-year guarantee products have amortization periods equal to the guarantee period. The front-end load annuity product has an assumed life of 25 years. Longer lives are assigned to those blocks that have demonstrated favorable lapse experience.

Acquisition costs for all traditional contracts, including traditional life insurance, which include individual whole life, group business and term life insurance contracts, are amortized over periods of 7 to 30 years on either a straight-line

Notes to Financial Statements (continued)

1. Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies (continued)

basis or as a level percent of premium of the related policies depending on the block of business. There is currently no DAC, VOBA, DSI or DFEL balance or related amortization for fixed and variable payout annuities.

The carrying amounts of DAC, VOBA, DSI and DFEL are adjusted for the effects of realized and unrealized gains and losses on securities classified as AFS and certain embedded derivatives. Amortization expense of DAC, VOBA, DSI and DFEL reflects an assumption for an expected level of credit-related investment losses. When actual credit-related investment losses are realized, we recognize a true-up to our DAC, VOBA, DSI and DFEL amortization within realized gain (loss) on our Statements of Income (Loss) reflecting the incremental effect of actual versus expected credit-related investment losses. These actual to expected amortization adjustments can create volatility from period to period in realized gain (loss).

On a quarterly basis, we may record an adjustment to the amounts included within our Balance Sheets for DAC, VOBA, DSI and DFEL with an offsetting benefit or charge to revenue or expense for the effect of the difference between future 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 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 prospective assumptions 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 expectations of future EGPs.

DAC, VOBA, DSI and DFEL are reviewed periodically to ensure that the unamortized portion does not exceed the expected recoverable amounts.

Reinsurance

We enter into reinsurance agreements with other companies in the normal course of business. Assets and liabilities and premiums and benefits from certain reinsurance contracts that grant statutory surplus relief to other insurance companies are netted on our Balance Sheets and Statements of Income (Loss), respectively, because there is a right of offset. All other reinsurance agreements are reported on a gross basis on our Balance Sheets as an asset for amounts recoverable from reinsurers or as a component of other liabilities for amounts, such as premiums, owed to the reinsurers, with the exception of modified coinsurance (“Modco”) agreements for which the right of offset also exists. Reinsurance premiums and benefits paid or provided are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums, benefits and DAC are reported net of insurance ceded.

Goodwill

We recognize the excess of the purchase price, plus the fair value of any noncontrolling interest in the acquiree, over the fair value of identifiable net assets acquired as goodwill. Goodwill is not amortized, but is reviewed at least annually for indications of value impairment, with consideration given to financial performance and other relevant factors. In addition, certain events, including a significant adverse change in legal factors or the business climate, an adverse action or assessment by a regulator or unanticipated competition, would cause us to review the carrying amounts of goodwill for impairment. We are required to perform a two-step test in our evaluation of the carrying value of goodwill for impairment. 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 is deemed to be sufficient 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 to be performed. In Step 2, the implied fair value of the reporting unit’s goodwill is determined by assigning the reporting unit’s fair value as determined in Step 1 to all of its net assets (recognized and unrecognized) as if the reporting unit had been acquired in a business combination at 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, and a charge is reported in impairment of intangibles on our Statements of Income (Loss).

Specifically Identifiable Intangible Assets

Specifically identifiable intangible assets, net of accumulated amortization, are reported in other assets on our Balance Sheets. The carrying values of specifically identifiable intangible assets are reviewed at least annually for indicators of impairment in value that are other-than-temporary, including unexpected or adverse changes in the following: the economic or competitive environments in which the Company operates; profitability analyses; cash flow analyses; and the fair value of the relevant business operation. If there was an indication of

Notes to Financial Statements (continued)

1. Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies (continued)

impairment, then the cash flow method would be used to measure the impairment, and the carrying value would be adjusted as necessary and reported in impairment of intangibles on our Statements of Income (Loss).

Sales force intangibles are attributable to the value of the new business distribution system for certain life insurance products within the Insurance Solutions – Life Insurance segment acquired through business combinations. These assets are amortized on a straight-line basis over their useful life of 25 years.

Other Long-Lived Assets

Property and equipment owned for company use is included in other assets on our Balance Sheets and is carried at cost less allowances for depreciation. Provisions for depreciation of investment real estate and property and equipment owned for company use are computed principally on the straight-line method over the estimated useful lives of the assets, which include buildings, computer hardware and software and other property and equipment.

We periodically review the carrying value of our long-lived assets, including property and equipment, for impairment whenever events or circumstances indicate that the carrying amount of such assets may not be fully recoverable. For long-lived assets to be held and used, impairments are recognized when the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. An impairment loss is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

Long-lived assets to be disposed of by abandonment or in an exchange for a similar productive long-lived asset are classified as held-for-use until they are disposed.

Long-lived assets to be sold are classified as held-for-sale and are no longer depreciated. Certain criteria have to be met in order for the long-lived asset to be classified as held-for-sale, including that a sale is probable and expected to occur within one year. Long-lived assets classified as held-for-sale are recorded at the lower of their carrying amount or fair value less cost to sell.

Separate Account Assets and Liabilities

We maintain separate account assets, which are reported at fair value. The related liabilities are reported at an amount equivalent to the separate account assets. Investment risks associated with market value changes are borne by the contract holders, except to the extent of minimum guarantees made by the Company with respect to certain accounts. See Note 9 for additional information regarding arrangements with contractual guarantees.

We issue variable annuity contracts through our separate accounts for which investment income and investment gains and losses accrue directly to, and investment risk is borne by, the contract holder (traditional variable annuities). We also

issue variable annuity and life contracts through separate accounts that include various types of guaranteed death benefit (“GDB”), GWB and GIB features. The GDB features include those where we contractually guarantee to the contract holder either: return of no less than total deposits made to the contract less any partial withdrawals (“return of net deposits”); total deposits made to the contract less any partial withdrawals plus a minimum return (“minimum return”); or the highest contract value on any contract anniversary date through age 80 minus any payments or withdrawals following the contract anniversary (“anniversary contract value”).

As discussed in Note 4, certain features of these guarantees are accounted for as embedded derivative reserves, whereas other guarantees are accounted for as benefit reserves. Other guarantees contain characteristics of both and are accounted for under an approach that calculates the value of the embedded derivative reserve and the benefit reserve based on the specific characteristics of each guaranteed living benefit (“GLB”) feature. The net impact of these changes is reported as a component of realized gain (loss) on our Statements of Income (Loss) in a category referred to as GLBs.

The “market consistent scenarios” used in the determination of the fair value of the GWB liability are similar to those used by an investment bank to value derivatives for which the pricing is not transparent and the aftermarket is nonexistent or illiquid. In our calculation, risk-neutral Monte-Carlo simulations resulting in over 10 million scenarios are utilized to value the entire block of guarantees. The market consistent scenario assumptions, as of each valuation date, are those we view to be appropriate for a hypothetical market participant. The market consistent inputs include assumptions for the capital markets (e.g., implied volatilities, correlation among indices, risk-free swap curve, etc.), policyholder behavior (e.g., policy lapse, benefit utilization, mortality, etc.), risk margins, administrative expenses and a margin for profit. We believe these assumptions are consistent with those that would be used by a market participant; however, as the related markets develop we will continue to reassess our assumptions. It is possible that different valuation techniques and assumptions could produce a materially different estimate of fair value.

Future Contract Benefits and Other Contract Holder Funds

Future contract benefits represent liability reserves that we have established and carry based on estimates of how much we will need to pay for future benefits and claims. Other contract holder funds represent liabilities for account values, dividends payable, premium deposit funds, undistributed earnings on participating business and other contract holder funds as well the carrying value of DFEL discussed above.

The liabilities for future contract benefits and claim reserves for UL and VUL insurance policies consist of contract account balances that accrue to the benefit of the contract holders, excluding surrender charges. The liabilities for future insurance contract benefits and claim reserves for traditional life policies are computed using assumptions for investment yields, mortality and withdrawals based principally on generally accepted

Notes to Financial Statements (continued)

1. Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies (continued)

actuarial methods and assumptions at the time of contract issue. Investment yield assumptions for traditional direct individual life reserves for all contracts range from 2.25% to 7.75% depending on the time of contract issue. The investment yield assumptions for immediate and deferred paid-up annuities range from 1.50% to 10.00%. These investment yield assumptions are intended to represent an estimation of the interest rate experience for the period that these contract benefits are payable.

The liabilities for future claim reserves for variable annuity products containing GDB features are calculated by estimating the present value of total expected benefit payments over the life of the contract divided by the present value of total expected assessments over the life of the contract ("benefit ratio") multiplied by the cumulative assessments recorded from the contract inception through the balance sheet date less the cumulative GDB payments plus interest on the reserves. The change in the reserve for a period is the benefit ratio multiplied by the assessments recorded for the period less GDB claims paid in the period plus interest. If experience or assumption changes result in a new benefit ratio, the reserves are adjusted to reflect the changes in a manner similar to the unlocking of DAC, VOBA, DFEL and DSI.

With respect to our future contract benefits and other contract holder funds, we continually review: overall reserve position, reserving techniques and reinsurance arrangements. As experience develops and new information becomes known, liabilities are adjusted as deemed necessary. The effects of changes in estimates are included in the operating results for the period in which such changes occur.

The business written or assumed by us includes participating life insurance contracts, under which the contract holder is entitled to share in the earnings of such contracts via receipt of dividends. The dividend scale for participating policies is reviewed annually and may be adjusted to reflect recent experience and future expectations.

UL and VUL products with secondary guarantees represented approximately 11% of permanent life insurance in force as of December 31, 2010, and approximately 65% of sales for these products in 2010. Liabilities for the secondary guarantees on UL-type products are calculated by multiplying the benefit ratio by the cumulative assessments recorded from contract inception through the balance sheet date less the cumulative secondary guarantee benefit payments plus interest. If experience or assumption changes result in a new benefit ratio, the reserves are adjusted to reflect the changes in a manner similar to the unlocking of DAC, VOBA, DFEL and DSI. The accounting for secondary guarantee benefits impacts, and is impacted by, EGPs used to calculate amortization of DAC, VOBA, DFEL and DSI.

Future contract benefits on our Balance Sheets include GLB features and remaining guaranteed interest and similar contracts that are carried at fair value, which represents approximate

surrender value including an estimate for our nonperformance risk. Our *Lincoln SmartSecurity*[®] Advantage GWB feature, GIB and 4LATER[®] features have elements of both insurance benefits and embedded derivatives. We weight these features and their associated reserves accordingly based on their hybrid nature. We classify these items in Level 3 within the hierarchy levels described above in "Fair Value Measurement."

The fair value of our indexed annuity contracts is based on their approximate surrender values.

Commitments and Contingencies

Contingencies arising from environmental remediation costs, regulatory judgments, claims, assessments, guarantees, litigation, recourse reserves, fines, penalties and other sources are recorded when deemed probable and reasonably estimable.

Insurance Fees

Insurance fees for investment and interest-sensitive life insurance contracts consist of asset-based fees, cost of insurance charges, percent of premium charges, contract administration charges and surrender charges that are assessed against contract holder account balances. Investment products consist primarily of individual and group variable and fixed deferred annuities. Interest-sensitive life insurance products include UL insurance, VUL insurance and other interest-sensitive life insurance policies. These products include life insurance sold to individuals, corporate-owned life insurance and bank-owned life insurance.

In bifurcating the embedded derivative of our GLB features on our variable annuity products, we attribute to the embedded derivative the portion of total fees collected from the contract holder that relate to the GLB riders (the "attributed fees"), which are not reported within insurance fees on our Statements of Income (Loss). These attributed fees represent the present value of future claims expected to be paid for the GLB at the inception of the contract plus a margin that a theoretical market participant would include for risk/profit and are reported within realized gain (loss) on our Statements of Income (Loss).

The timing of revenue recognition as it relates to fees assessed on investment contracts is determined based on the nature of such fees. Asset-based fees, cost of insurance and contract administration charges are assessed on a daily or monthly basis and recognized as revenue when assessed and earned. Percent of premium charges are assessed at the time of premium payment and recognized as revenue when assessed and earned. Certain amounts assessed that represent compensation for services to be provided in future periods are reported as unearned revenue and recognized in income over the periods benefited. Surrender charges are recognized upon surrender of a contract by the contract holder in accordance with contractual terms.

For investment and interest-sensitive life insurance contracts, the amounts collected from contract holders are considered deposits and are not included in revenue.

Notes to Financial Statements (continued)

1. Nature of Operations, Basis of Presentation and Summary of Significant Accounting Policies (continued)

Insurance Premiums

Our insurance premiums for traditional life insurance and group insurance products are recognized as revenue when due from the contract holder. Our traditional life insurance products include those products with fixed and guaranteed premiums and benefits and consist primarily of whole life insurance, limited-payment life insurance, term life insurance and certain annuities with life contingencies. Our group non-medical insurance products consist primarily of term life, disability and dental.

Net Investment Income

Dividends and interest income, recorded in net investment income, are recognized when earned. Amortization of premiums and accretion of discounts on investments in debt securities are reflected in net investment income over the contractual terms of the investments in a manner that produces a constant effective yield.

For ABS and MBS, included in the AFS fixed maturity securities portfolios, we recognize income using a constant effective yield based on anticipated prepayments and the estimated economic life of the securities. When actual prepayments differ significantly from originally anticipated prepayments, the retrospective effective yield is recalculated to reflect actual payments to date and a catch up adjustment is recorded in the current period. In addition, the new effective yield, which reflects anticipated future payments, is used prospectively. Any adjustments resulting from changes in effective yield are reflected in net investment income on our Statements of Income (Loss).

Realized Gain (Loss)

Realized gain (loss) on our Statements of Income (Loss) includes realized gains and losses from the sale of investments, write-downs for other-than-temporary impairments of investments, embedded derivative gains and losses, gains and losses on the sale of subsidiaries and businesses and net gains and losses on reinsurance embedded derivatives. Realized gains and losses on the sale of investments are determined using the specific identification method. Realized gain (loss) is recognized in net income, net of associated amortization of DAC, VOBA, DSI and DFEL. Realized gain (loss) is also net of allocations of investment gains and losses to certain contract holders and certain funds withheld on reinsurance arrangements for which we have a contractual obligation.

Interest Credited

Interest credited includes interest credited to contract holder account balances. Interest crediting rates associated with funds invested in our general account during 2008 through 2010 ranged from 3.00% to 9.00%.

Benefits

Benefits for UL and other interest-sensitive life insurance products include benefit claims incurred during the period in excess of contract account balances. Benefits also include the change in reserves for life insurance products with secondary guarantee benefits and annuity products with guaranteed death benefits. For traditional life, group health and disability income

products, benefits are recognized when incurred in a manner consistent with the related premium recognition policies.

Pension and Other Postretirement Benefit Plans

Our employees participate in the pension and postretirement benefit plans which are sponsored by LNC and LNL. Pursuant to the accounting rules for our obligations to employees and agents under our various pension and other postretirement benefit plans, we are required to make a number of assumptions to estimate related liabilities and expenses. We use assumptions for the weighted-average discount rate and expected return on plan assets to estimate pension expense. The discount rate assumptions are determined using an analysis of current market information and the projected benefit flows associated with these plans. The expected long-term rate of return on plan assets is based on historical and projected future rates of return on the funds invested in the plan. The calculation of our accumulated postretirement benefit obligation also uses an assumption of weighted-average annual rate of increase in the per capita cost of covered benefits, which reflects a health care cost trend rate. See Note 15 for additional information.

Stock-Based Compensation

In general, we expense the fair value of stock awards included in our incentive compensation plans. As of the date LNC's Board of Directors approves stock awards, the fair value of stock options is determined using a Black-Scholes options valuation methodology, and the fair value of other stock awards is based upon the market value of the stock. The fair value of the awards is expensed over the performance or service period, which generally corresponds to the vesting period, and is recognized as an increase to common stock in stockholder's equity. We classify certain stock awards as liabilities. For these awards, the settlement value is classified as a liability on our balance sheet and the liability is marked-to-market through net income at the end of each reporting period. Stock-based compensation expense is reflected in underwriting, acquisition, insurance and other expenses on our Statements of Income (Loss). See Note 17 for additional information.

Income Taxes

We have elected to file consolidated federal income tax returns with LNC and its subsidiaries. Pursuant to an intercompany tax sharing agreement with LNC, we provide for income taxes on a separate return filing basis. The tax sharing agreement also provides that we will receive benefit for net operating losses, capital losses and tax credits which are not usable on a separate return basis to the extent such items may be utilized in the consolidated income tax returns of LNC. Deferred income taxes are recognized, based on enacted rates, when assets and liabilities have different values for financial statement and tax reporting purposes. A valuation allowance is recorded to the extent required to reduce the deferred tax asset to an amount that we expect, more likely than not, will be realized. See Note 5 for additional information.

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

2. New Accounting Standards

Adoption of New Accounting Standards

Derivatives and Hedging Topic

In March 2010, the FASB issued Accounting Standards Update (“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. Embedded credit derivatives, which no longer qualify for the scope exception, are subject to a bifurcation analysis. 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 are within the scope of ASU 2010-11. We adopted ASU 2010-11 at the beginning of the interim reporting period ended September 30, 2010. The adoption did not have a material impact on our financial condition and results of operations.

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 additional disclosure related to the three-level fair value hierarchy. Entities are required to disclose significant transfers in and out of Levels 1 and 2 of the fair value hierarchy, and separately present information related to purchases, sales, issuances and settlements in the reconciliation of fair value measurements classified as Level 3. We adopted the amendments in ASU 2010-06 effective January 1, 2010, and have prospectively included the required disclosures in Note 19 related to Levels 1 and 2 of the fair value hierarchy. 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 Financial Statements effective January 1, 2011.

Investments — Debt and Equity Securities Topic

In April 2009, the FASB replaced the guidance in the Investments – Debt and Equity Securities Topic of the FASB ASC related to OTTI. Under this new accounting guidance, management’s assertion that it has the intent and ability to hold an impaired debt security until recovery was replaced by the requirement for management to assert if it either has the intent to sell the debt security or if it is more likely than not the entity will be required to sell the debt security before recovery of its amortized cost basis. Our accounting policy for OTTI, included in Note 1, reflects these changes to the accounting guidance adopted by FASB.

As permitted by the transition guidance, we early adopted these amendments to the Investments – Debt and Equity Securities Topic effective January 1, 2009, by recording an increase of \$16 million to the opening balance of retained

earnings with a corresponding decrease to accumulated OCI on our Statements of Stockholder’s Equity to reclassify the noncredit portion of previously other-than-temporarily impaired debt securities held as of January 1, 2009. The following summarizes the components (in millions) for this cumulative effect adjustment:

	<i>Unrealized OTTI on AFS Securities</i>	<i>Net Unrealized Loss on AFS Securities</i>	<i>Total</i>
Increase in amortized cost of fixed maturity AFS securities . . .	\$11	\$ 29	\$ 40
Change in DAC, VOBA, DSI, and DFEL	(4)	(11)	(15)
Income tax	(2)	(7)	(9)
Net cumulative effect adjustment	<u>\$ 5</u>	<u>\$ 11</u>	<u>\$ 16</u>

The cumulative effect adjustment was calculated for all debt securities held as of January 1, 2009, for which an OTTI was previously recognized, and for which we did not intend to sell the security and it was not more likely than not that we would be required to sell the security before recovery of its amortized cost, by comparing the present value of cash flows expected to be received as of January 1, 2009, to the amortized cost basis of the debt securities. The discount rate used to calculate the present value of the cash flows expected to be collected was the rate for each respective debt security in effect before recognizing any OTTI. In addition, because the carrying amounts of DAC, VOBA, DSI and DFEL are adjusted for the effects of realized and unrealized gains and losses on fixed maturity AFS securities, we recognized a true-up to our DAC, VOBA, DSI and DFEL balances for this cumulative effect adjustment.

The following summarizes the increase to the amortized cost of our fixed maturity AFS securities (in millions) as of January 1, 2009, resulting from the recognition of the cumulative effect adjustment:

Corporate bonds	\$25
CMOs	15
Total fixed maturity AFS securities	<u>\$40</u>

In addition, we include on the face of our Statements of Income (Loss) the total OTTI recognized in realized gain (loss), with an offset for the amount of noncredit impairments recognized in accumulated OCI. We disclose the amount of OTTI recognized in accumulated OCI in Note 12, and the enhanced disclosures related to OTTI are included in Note 3.

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”), in order to enhance and expand the financial statement disclosures. These amendments are intended to provide more information regarding the nature of the risk associated with financing receivables and how the assessment of the risk is used to estimate

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

2. New Accounting Standards (continued)

the allowance for credit losses. In addition, expanded disclosures provide more information regarding changes recognized during the reporting period to the allowance for credit losses. Comparative disclosures are not required for earlier reporting periods ending prior to the initial adoption date, and the amendments in ASU 2010-20 are effective in phases over two reporting periods. We adopted the amendments related to information required as of the end of the reporting period for the reporting period ending December 31, 2010, and have included the required disclosures in Notes 1 and 3. Disclosures that provide information about the activity during a reporting period, primarily 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, and will be included in the Notes to Financial Statements beginning with the reporting period ending March 31, 2011.

Future Adoption of New Accounting Standards

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 accounts. 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 will adopt ASU 2010-15 as of the beginning of the reporting period ending March 31, 2011, and do not expect the adoption will have a material impact on our financial condition and results of operations.

In October 2010, the FASB issued ASU No. 2010-26, "Accounting for Costs Associated with Acquiring or Renewing

Insurance Contracts" ("ASU 2010-26"), which clarifies the types of costs incurred by an insurance entity that can be capitalized in the acquisition of insurance contracts. Only those costs incurred which result directly from and are essential to the successful acquisition of new or renewal insurance contracts may be capitalized. Incremental costs related to unsuccessful attempts to acquire insurance contracts must be expensed as incurred. Under ASU 2010-26, the capitalization criteria in the direct-response advertising guidance of the Other Assets and Deferred Costs Topic of the FASB ASC must be met in order to capitalize advertising costs. The amendments are effective for fiscal years and interim periods beginning after December 15, 2011. Early adoption is permitted, and an entity may elect to apply the guidance prospectively or retrospectively. We will adopt the provisions of ASU 2010-26 effective January 1, 2012, and are currently evaluating the impact of the adoption on our financial condition and results of operations.

Intangibles — Goodwill and Other Topic

In December 2010, the FASB issued ASU No. 2010-28, "When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts" ("ASU 2010-28"). Generally, reporting units with zero or negative carrying amounts will pass Step 1 of the goodwill impairment test as the fair value will exceed carrying value; therefore, goodwill impairment is not assessed under Step 2. ASU 2010-28 modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts, and requires these reporting units to perform Step 2 of the impairment test to determine if it is more likely than not that goodwill impairment exists. The amendments are effective for fiscal years and interim periods beginning after December 15, 2010, and early adoption is not permitted. Upon adoption of this ASU, all reporting units within scope must be evaluated under the new accounting guidance, and any resulting impairment will be recognized as a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Impairments identified after the period of adoption must be recognized in earnings. We will adopt the amendments in ASU 2010-28 effective as of the beginning of the reporting period ending March 31, 2011, and do not expect the adoption will have a material impact on our financial condition and result of operations.

3. 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, which also includes additional disclosures regarding our fair value measurements.

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

3. Investments (continued)

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

	<i>As of December 31, 2010</i>				
	<i>Amortized Cost</i>	<i>Gross Unrealized</i>			<i>Fair Value</i>
		<i>Gains</i>	<i>Losses</i>	<i>OTTI</i>	
Fixed Maturity Securities					
Corporate bonds	\$4,898	\$348	\$ 93	\$13	\$5,140
U.S. Government bonds	29	4	—	—	33
Foreign government bonds	28	2	—	—	30
MBS:					
CMOs	639	38	23	12	642
MPTS	250	7	—	—	257
CMBS	200	8	25	—	183
ABS CDOs	3	—	—	—	3
State and municipal bonds	257	1	8	—	250
Hybrid and redeemable preferred securities	125	6	10	—	121
Total fixed maturity securities	<u>6,429</u>	<u>414</u>	<u>159</u>	<u>25</u>	<u>6,659</u>
Equity Securities					
Other securities	2	1	—	—	3
Total equity securities	<u>2</u>	<u>1</u>	<u>—</u>	<u>—</u>	<u>3</u>
Total AFS securities	<u>\$6,431</u>	<u>\$415</u>	<u>\$159</u>	<u>\$25</u>	<u>\$6,662</u>

	<i>As of December 31, 2009</i>				
	<i>Amortized Cost</i>	<i>Gross Unrealized</i>			<i>Fair Value</i>
		<i>Gains</i>	<i>Losses</i>	<i>OTTI</i>	
Fixed Maturity Securities					
Corporate bonds	\$4,723	\$219	\$183	\$15	\$4,744
U.S. Government bonds	29	3	—	—	32
Foreign government bonds	23	1	—	—	24
MBS:					
CMOs	674	31	40	16	649
MPTS	245	4	2	—	247
CMBS	255	6	43	—	218
ABS CDOs	4	—	1	—	3
State and municipal bonds	176	1	7	—	170
Hybrid and redeemable preferred securities	100	8	15	—	93
Total fixed maturity securities	<u>6,229</u>	<u>273</u>	<u>291</u>	<u>31</u>	<u>6,180</u>
Equity Securities					
Other securities	2	—	—	—	2
Total equity securities	<u>2</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>2</u>
Total AFS securities	<u>\$6,231</u>	<u>\$273</u>	<u>\$291</u>	<u>\$31</u>	<u>\$6,182</u>

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

	<i>As of December 31, 2010</i>	
	<i>Amortized Cost</i>	<i>Fair Value</i>
Due in one year or less	\$ 254	\$ 260
Due after one year through five years	999	1,059
Due after five years through ten years	2,001	2,169
Due after ten years	2,083	2,086
Subtotal	<u>5,337</u>	<u>5,574</u>
MBS	1,089	1,082
CDOs	3	3
Total fixed maturity AFS securities	<u>\$6,429</u>	<u>\$6,659</u>

Lincoln Life & Annuity Company of New York
Notes to Financial Statements (continued)

3. Investments (continued)

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 OCI, of AFS securities (dollars in millions), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows:

	<i>As of December 31, 2010</i>					
	<i>Less Than or Equal to Twelve Months</i>		<i>Greater Than Twelve Months</i>		<i>Total</i>	
	<i>Fair Value</i>	<i>Gross Unrealized Losses and OTTI</i>	<i>Fair Value</i>	<i>Gross Unrealized Losses and OTTI</i>	<i>Fair Value</i>	<i>Gross Unrealized Losses and OTTI</i>
Fixed Maturity Securities						
Corporate bonds	\$505	\$26	\$371	\$ 80	\$ 876	\$106
MBS:						
CMOs	42	14	94	21	136	35
CMBS	4	—	39	25	43	25
State and municipal bonds	179	7	8	1	187	8
Hybrid and redeemable preferred securities	21	2	43	8	64	10
Total fixed maturity AFS securities	<u>\$751</u>	<u>\$49</u>	<u>\$555</u>	<u>\$135</u>	<u>\$1,306</u>	<u>\$184</u>
Total number of AFS securities in an unrealized loss position						<u>401</u>

	<i>As of December 31, 2009</i>					
	<i>Less Than or Equal to Twelve Months</i>		<i>Greater Than Twelve Months</i>		<i>Total</i>	
	<i>Fair Value</i>	<i>Gross Unrealized Losses and OTTI</i>	<i>Fair Value</i>	<i>Gross Unrealized Losses and OTTI</i>	<i>Fair Value</i>	<i>Gross Unrealized Losses and OTTI</i>
Fixed Maturity Securities						
Corporate bonds	\$479	\$42	\$ 850	\$156	\$1,329	\$198
MBS:						
CMOs	34	16	117	40	151	56
MPTS	122	1	4	1	126	2
CMBS	24	2	61	41	85	43
ABS CDOs	—	—	3	1	3	1
State and municipal bonds	116	5	17	2	133	7
Hybrid and redeemable preferred securities	3	—	70	15	73	15
Total fixed maturity AFS securities	<u>\$778</u>	<u>\$66</u>	<u>\$1,122</u>	<u>\$256</u>	<u>\$1,900</u>	<u>\$322</u>
Total number of AFS securities in an unrealized loss position						<u>580</u>

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

3. Investments (continued)

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:

	<i>As of December 31, 2010</i>			<i>Number of Securities⁽¹⁾</i>
	<i>Fair Value</i>	<i>Gross Unrealized Losses</i>		
		<i>OTTI</i>		
Less than six months	\$ 25	\$ 12	\$—	17
Six months or greater, but less than nine months	9	3	—	2
Nine months or greater, but less than twelve months	6	2	—	3
Twelve months or greater	<u>126</u>	<u>84</u>	<u>22</u>	<u>76</u>
Total	<u>\$166</u>	<u>\$101</u>	<u>\$22</u>	<u>98</u>

	<i>As of December 31, 2009</i>			<i>Number of Securities⁽¹⁾</i>
	<i>Fair Value</i>	<i>Gross Unrealized Losses</i>		
		<i>OTTI</i>		
Less than six months	\$ 47	\$ 14	\$ 1	23
Six months or greater, but less than nine months	39	26	—	13
Nine months or greater, but less than twelve months	55	23	17	35
Twelve months or greater	<u>191</u>	<u>135</u>	<u>12</u>	<u>104</u>
Total	<u>\$332</u>	<u>\$198</u>	<u>\$30</u>	<u>175</u>

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

We regularly review our investment holdings for OTTI. Our gross unrealized losses on AFS securities as of December 31, 2010, decreased \$138 million in comparison to December 31, 2009. This change 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 December 31, 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 December 31, 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 December 31, 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 December 31, 2010, the unrealized losses associated with our MBS 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 December 31, 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

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

3. Investments (continued)

recognized in OCI (in millions) on fixed maturity AFS securities were as follows:

	<i>For the Years Ended December 31,</i>	
	<u>2010</u>	<u>2009</u>
Balance as of beginning-of-year	\$46	\$—
Cumulative effect from adoption of new accounting standard	—	5
Increases attributable to:		
Credit losses on securities for which an OTTI was not previously recognized	1	46
Credit losses on securities for which an OTTI was previously recognized	9	—
Decreases attributable to:		
Securities sold	(9)	(5)
Balance as of end-of-year	<u>\$47</u>	<u>\$46</u>

During the years ended December 31, 2010 and 2009, we recorded credit losses on securities for which an OTTI was not previously recognized as we determined the cash flows expected to be collected would not be sufficient to recover the entire amortized cost basis of the debt security. The credit losses we recorded on securities for which an OTTI was not previously recognized were attributable primarily to one or a combination of the following reasons:

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

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 New York and Texas, which accounted for 38% of mortgage loans as of December 31, 2010, and New York, Illinois and Texas, which accounted for 36% of mortgage loans as of December 31, 2009.

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

	<i>As of December 31,</i>	
	<u>2010</u>	<u>2009</u>
Current	\$226	\$230
Valuation allowance associated with impaired mortgage loans on real estate	—	(1)
Unamortized premium (discount)	(1)	(1)
Total carrying value	<u>\$225</u>	<u>\$228</u>

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

	<i>As of December 31,</i>	
	<u>2010</u>	<u>2009</u>
Number of impaired mortgage loans on real estate	—	1
Principal balance of impaired mortgage loans on real estate	\$—	\$ 3
Valuation allowance associated with impaired mortgage loans on real estate	—	(1)
Carrying value of impaired mortgage loans on real estate	<u>\$—</u>	<u>\$ 2</u>

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

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Average carrying value for impaired mortgage loans on real estate	\$—	\$ 1	\$—
Interest income recognized on impaired mortgage loans on real estate	—	—	—
Amount of interest income collected on impaired mortgage loans on real estate	—	—	—

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

3. Investments (continued)

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

	As of December 31, 2010		
	Principal Amount	%	Debt-Service Coverage Ratio
Loan-to-Value			
Less than 65%	\$187	82.8%	1.58
65% to 74%	34	15.0%	1.50
75% to 100%	5	2.2%	0.41
Total mortgage loans on real estate	<u>\$226</u>	<u>100.0%</u>	

Net Investment Income

The major categories of net investment income (in millions) on our Statements of Income (Loss) were as follows:

	For the Years Ended December 31,		
	2010	2009	2008
Fixed maturity AFS securities ..	<u>\$384</u>	<u>\$372</u>	<u>\$355</u>
Mortgage loans on real estate ..	<u>15</u>	<u>15</u>	<u>17</u>
Policy loans	<u>25</u>	<u>25</u>	<u>24</u>
Invested cash	<u>—</u>	<u>—</u>	<u>3</u>
Consent fees	<u>1</u>	<u>—</u>	<u>—</u>
Investment income	<u>425</u>	<u>412</u>	<u>399</u>
Investment expense	<u>(7)</u>	<u>(4)</u>	<u>(4)</u>
Net investment income ...	<u>\$418</u>	<u>\$408</u>	<u>\$395</u>

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 Years Ended December 31,		
	2010	2009	2008
Fixed maturity AFS securities:			
Gross gains	<u>\$ 7</u>	<u>\$ 13</u>	<u>\$ 4</u>
Gross losses	<u>(29)</u>	<u>(103)</u>	<u>(151)</u>
Gain (loss) on other investments	<u>1</u>	<u>(1)</u>	<u>—</u>
Associated amortization of DAC, VOBA, DSI and DFEL and changes in other contract holder funds	<u>6</u>	<u>25</u>	<u>51</u>
Total realized gain (loss) related to certain investments	<u>\$ (15)</u>	<u>\$ (66)</u>	<u>\$ (96)</u>

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 Years Ended December 31,		
	2010	2009	2008
OTTI Recognized in Net Income (Loss)			
Fixed maturity securities:			
Corporate bonds	<u>\$ (8)</u>	<u>\$(37)</u>	<u>\$ (65)</u>
MBS:			
CMOs	<u>(12)</u>	<u>(49)</u>	<u>(68)</u>
CMBS	<u>(5)</u>	<u>—</u>	<u>—</u>
Total fixed maturity securities	<u>(25)</u>	<u>(86)</u>	<u>(133)</u>
Equity securities:			
Other securities	<u>—</u>	<u>(1)</u>	<u>—</u>
Total equity securities	<u>—</u>	<u>(1)</u>	<u>—</u>
Gross OTTI recognized in net income (loss) ..	<u>(25)</u>	<u>(87)</u>	<u>(133)</u>
Associated amortization of DAC, VOBA, DSI and DFEL	<u>10</u>	<u>28</u>	<u>27</u>
Net OTTI recognized in net income (loss), pre-tax	<u>\$(15)</u>	<u>\$(59)</u>	<u>\$(106)</u>
Portion of OTTI Recognized in OCI			
Gross OTTI recognized in OCI ..	<u>\$ 6</u>	<u>\$ 46</u>	<u>\$ —</u>
Change in DAC, VOBA, DSI and DFEL	<u>(1)</u>	<u>(15)</u>	<u>—</u>
Net portion of OTTI recognized in OCI, pre-tax	<u>\$ 5</u>	<u>\$ 31</u>	<u>\$ —</u>

Determination of Credit Losses on Corporate Bonds

As of December 31, 2010 and 2009, we reviewed our corporate bond 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.

Determination of Credit Losses on MBS

As of December 31, 2010 and 2009, 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

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

3. Investments (continued)

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% severity with higher severity assumed for investor properties and further housing price depreciation.

Investment Commitments

As of December 31, 2010, our investment commitments were \$1 million, which included private placements and mortgage loans.

Concentrations of Financial Instruments

As of December 31, 2010 and 2009, our most significant investment in one issuer was our investments in securities

issued by the Federal Home Loan Mortgage Corporation with a fair value of \$507 million and \$472 million, or 7% of our invested assets portfolio, respectively. These investments are included in corporate bonds in the tables above.

As of December 31, 2010 and 2009, our most significant investments in one industry were our investment securities in the electric industry with a fair value of \$713 million and \$623 million, or 10% and 9% of our invested assets portfolio, respectively, and our investment securities in the CMO industry with a fair value of \$647 million and \$676 million, or 9% and 10% of our invested assets portfolio, respectively. We utilized the industry classifications to obtain the concentration of financial instruments amounts; as such, these amounts will not agree to the AFS securities table above.

Assets on Deposit

The Company had investment assets on deposit with regulatory agencies with a fair market value of \$14 million and \$13 million as of December 31, 2010 and 2009, respectively.

4. Derivative Instruments

Types of Derivative Instruments and Derivative Strategies

Through LNL, 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 GWB feature, the 4LATER[®] Advantage GIB feature and the *i4LIFE*[®] Advantage GIB feature. See below for further details.

See Note 19 for additional disclosures related to the fair value of our financial instruments.

We have embedded derivatives with off-balance-sheet risks whose contract amounts exceed the credit exposure. Outstanding embedded derivatives not designated and not qualifying as hedging instruments, with off-balance-sheet risks (in millions) were as follows:

	As of December 31, 2010					
	Number of Instruments	Notional Amounts	Asset Carrying or Fair Value		(Liability) Carrying or Fair Value	
			Gain	Loss	Gain	Loss
GLB reserves ⁽¹⁾	<u>10,646</u>	<u>\$—</u>	<u>\$—</u>	<u>\$—</u>	<u>\$18</u>	<u>\$(42)</u>
	As of December 31, 2009					
	Number of Instruments	Notional Amounts	Asset Carrying or Fair Value		(Liability) Carrying or Fair Value	
			Gain	Loss	Gain	Loss
GLB reserves ⁽¹⁾	<u>9,748</u>	<u>\$—</u>	<u>\$—</u>	<u>\$—</u>	<u>\$11</u>	<u>\$(43)</u>

⁽¹⁾ Reported in future contract benefits on our Balance Sheets.

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

4. Derivative Instruments (continued)

The gains (losses) on embedded derivatives not designated and not qualifying as hedging instruments (in millions), recorded within net income (loss) on our Statements of Income (Loss) were as follows:

	For the Years Ended December 31,		
	2010	2009	2008
GLB reserves ⁽¹⁾	<u>\$8</u>	<u>\$92</u>	<u>\$(107)</u>

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

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 IncomeSM Advantage* 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 December 31, 2010, we had \$1.3 billion of account values that were attributable to variable annuities with a

GWB feature and \$383 million of account values that were attributable to variable annuities with a GIB feature.

We transfer the liability for our GWB and GIB features to LNL, who along with an affiliate, 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 these 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 the current hedging program, equity markets, interest rates and volatility in market conditions are monitored on a daily basis. The hedge positions are re-balanced based upon changes in these factors as needed. While the hedge positions are actively managed, 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 the ability to purchase hedging instruments at prices consistent with the desired risk and return trade off.

5. Federal Income Taxes

The federal income tax expense (benefit) on continuing operations (in millions) was as follows:

	For the Years Ended December 31,		
	2010	2009	2008
Current	<u>\$30</u>	<u>\$ (9)</u>	<u>\$13</u>
Deferred	<u>25</u>	<u>44</u>	<u>1</u>
Federal income tax expense (benefit)	<u>\$55</u>	<u>\$35</u>	<u>\$14</u>

A reconciliation of the effective tax rate differences (in millions) was as follows:

	For the Years Ended December 31,		
	2010	2009	2008
Tax rate times pre-tax income	<u>\$59</u>	<u>\$38</u>	<u>\$18</u>
Effect of:			
Separate account dividend received deduction	<u>(3)</u>	<u>(2)</u>	<u>(3)</u>
Other items	<u>(1)</u>	<u>(1)</u>	<u>(1)</u>
Federal income tax expense (benefit)	<u>\$55</u>	<u>\$35</u>	<u>\$14</u>
Effective tax rate	<u>33%</u>	<u>32%</u>	<u>28%</u>

The separate account dividend received deduction included in the table above is exclusive of any prior years’ tax return resolution.

The federal income tax asset (liability) (in millions), which is included in other liabilities on our Balance Sheets, was as follows:

	As of December 31,	
	2010	2009
Current	<u>\$ (24)</u>	<u>\$ (6)</u>
Deferred	<u>(259)</u>	<u>(178)</u>
Total federal income tax asset (liability)	<u>\$(283)</u>	<u>\$(184)</u>

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

5. Federal Income Taxes (continued)

Significant components of our deferred tax assets and liabilities (in millions) were as follows:

	<i>As of December 31,</i>	
	<u>2010</u>	<u>2009</u>
Deferred Tax Assets		
Future contract benefits and other contract holder funds	\$ 66	\$ 83
Investments	11	14
Net unrealized loss on AFS Securities . .	—	15
Net capital loss carryforward	9	11
Other	4	6
Total deferred tax assets	<u>90</u>	<u>129</u>
Deferred Tax Liabilities		
DAC	140	150
VOBA	112	146
Net unrealized gain on AFS securities . .	82	—
Other	15	11
Total deferred tax liabilities	<u>349</u>	<u>307</u>
Net deferred tax asset (liability)	<u>\$(259)</u>	<u>\$(178)</u>

As of December 31, 2010, LLANY had net capital loss carryforwards of \$26 million which will expire in 2014. We believe that it is more likely than not that the capital losses will be fully utilized within the allowable carryforward period.

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.

As of December 31, 2010 and 2009, \$6 million and \$5 million of our unrecognized tax benefits presented below, if recognized, would have impacted our income tax expense (benefit) and our effective tax rate. We anticipate a change to our unrecognized tax benefits during 2011 in the range of none to \$3 million.

A reconciliation of the unrecognized tax benefits (in millions) was as follows:

	<i>For the Years Ended December 31,</i>	
	<u>2010</u>	<u>2009</u>
Balance as of beginning-of-year	\$24	\$23
Increases for prior year tax positions . .	—	1
Decreases for current year tax positions	(2)	—
Balance as of end-of-year	<u>\$22</u>	<u>\$24</u>

We recognize interest and penalties accrued, if any, related to unrecognized tax benefits as a component of tax expense. During the years ended December 31, 2010, 2009, and 2008, we recognized interest and penalty expense related to uncertain tax positions of \$1 million, in each year. We had accrued interest and penalty expense related to the unrecognized tax benefits of \$4 million and \$3 million as of December 31, 2010 and 2009, respectively.

We are subject to annual tax examinations from the Internal Revenue Service ("IRS"). During the third quarter of 2008, the IRS completed its examination for tax years 2003 and 2004 resulting in a proposed assessment. During the second quarter of 2010, the IRS completed its examination for tax years 2005 and 2006 resulting in a proposed assessment. Also, during the second quarter of 2010, the IRS completed its examination of tax year 2006 for the former Jefferson-Pilot Corporation ("JP") and its subsidiaries. We believe a portion of the assessments is inconsistent with existing law and are protesting it through the established IRS appeals process. We do not anticipate that any adjustments that might result from such audits would be material to our results of operations or financial condition. We are currently under audit by the IRS for years 2007 and 2008. The JP subsidiaries acquired in the April 2006 merger are subject to a separate IRS examination cycle. For the former JP LifeAmerica Insurance Company, the IRS is examining the tax year ended April 1, 2007.

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

6. DAC, VOBA, DSI and DFEL

During the fourth quarter of 2008, we recorded a decrease to income (loss) totaling \$7 million, for a reversion to the mean prospective unlocking of DAC, VOBA, DSI and DFEL as a result of significant and sustained declines in the equity markets during 2008. During 2010 and 2009, we did not have a reversion to the mean prospective unlocking of DAC, VOBA, DSI and DFEL. The pre-tax impact for these items is included within the prospective unlocking line items in the changes in DAC, VOBA, DSI and DFEL tables below.

Changes in DAC (in millions) were as follows:

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Balance as of beginning-of-year . . .	\$439	\$460	\$306
Deferrals	72	76	95
Amortization, net of interest:			
Prospective unlocking — assumption changes	(6)	—	(12)
Prospective unlocking — model refinements	(4)	—	9
Retrospective unlocking	9	3	(10)
Other amortization, net of interest	(50)	(40)	(36)
Adjustment related to realized (gains) losses	2	20	36
Adjustment related to unrealized (gains) losses	(50)	(80)	72
Balance as of end-of-year	<u>\$412</u>	<u>\$439</u>	<u>\$460</u>

Changes in VOBA (in millions) were as follows:

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Balance as of beginning-of-year . . .	\$417	\$655	\$493
Deferrals	1	2	3
Amortization:			
Prospective unlocking — assumption changes	21	3	4
Prospective unlocking — model refinements	(2)	—	—
Retrospective unlocking	(2)	(2)	3
Other amortization	(68)	(73)	(72)
Accretion of interest ⁽¹⁾	22	24	26
Adjustment related to realized (gains) losses	—	6	7
Adjustment related to unrealized (gains) losses	(70)	(198)	191
Balance as of end-of-year	<u>\$319</u>	<u>\$417</u>	<u>\$655</u>

⁽¹⁾ The interest accrual rates utilized to calculate the accretion of interest ranged from 3.50% to 7.25%.

Estimated future amortization of VOBA, net of interest (in millions), as of December 31, 2010, was as follows:

2011	\$37
2012	32
2013	30
2014	28
2015	27

Changes in DSI (in millions) were as follows:

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Balance as of beginning-of-year	\$16	\$14	\$14
Deferrals	3	3	4
Amortization, net of interest:			
Prospective unlocking — assumption changes	—	—	(2)
Other amortization, net of interest	(2)	(1)	(2)
Adjustment related to unrealized (gains) losses	(4)	—	—
Balance as of end-of-year	<u>\$13</u>	<u>\$16</u>	<u>\$14</u>

Changes in DFEL (in millions) were as follows:

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Balance as of beginning-of-year . . .	\$ 87	\$65	\$48
Deferrals	35	34	27
Amortization, net of interest:			
Prospective unlocking — assumption changes	(2)	(1)	—
Prospective unlocking — model refinements	1	—	4
Retrospective unlocking	1	(1)	(4)
Other amortization, net of interest	(13)	(10)	(10)
Adjustment related to unrealized (gains) losses	(8)	—	—
Balance as of end-of-year	<u>\$101</u>	<u>\$87</u>	<u>\$65</u>

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

7. Reinsurance

The following summarizes reinsurance amounts (in millions) recorded on our Statements of Income (Loss):

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Direct insurance premiums and fees	\$ 529	\$ 502	\$ 480
Reinsurance ceded	(143)	(143)	(134)
Total insurance premiums and fees, net	<u>\$ 386</u>	<u>\$ 359</u>	<u>\$ 346</u>
Direct insurance benefits	\$ 425	\$ 365	\$ 395
Reinsurance recoveries netted against benefits	(171)	(140)	(167)
Total benefits, net	<u>\$ 254</u>	<u>\$ 225</u>	<u>\$ 228</u>

We cede insurance to other companies. The portion of risks exceeding our retention limit is reinsured with other insurers. We seek reinsurance coverage within the businesses that sell life insurance and annuities in order to limit our exposure to mortality losses and enhance our capital management. As discussed in Note 22, a portion of this reinsurance activity is with affiliated companies.

Under our reinsurance program, we reinsure approximately 40% to 45% of the mortality risk on newly issued non-term life insurance contracts and approximately 35% of total mortality risk including term insurance contracts. Our policy for this program is to retain no more than \$10 million on a single insured life issued on fixed, VUL and term life insurance contracts. The retention per single insured life for corporate-owned life insurance is \$2 million. Portions of our deferred annuity business have been reinsured on a Modco basis with other companies to limit our exposure to interest rate risks. As of December 31, 2010, the reserves associated with these reinsurance arrangements totaled \$5 million. To cover products other than life insurance, we acquire other reinsurance coverages with retentions and limits.

Reinsurance contracts do not relieve an insurer from its primary obligation to policyholders. Therefore, the failure of a reinsurer to discharge its reinsurance obligations could result in a loss to us. We regularly evaluate the financial condition of our reinsurers and monitor concentrations of credit risk related to reinsurance activities.

8. Goodwill and Specifically Identifiable Intangible Assets

The carrying amount of our goodwill (in millions) for the years ended December 31, 2010 and 2009, was as follows:

	<i>Gross Carrying Amount</i>
Retirement Solutions — Annuities	\$ 26
Insurance Solutions — Life Insurance	136
Total	<u>\$162</u>

There were no changes in the carrying amount of goodwill during the years ended December 31, 2010, or December 31, 2009.

We perform a Step 1 goodwill impairment analysis on all of our reporting units at least annually on October 1. The Step 1 analysis for the reporting units within our Insurance Solutions and Retirement Solutions businesses utilizes primarily a discounted cash flow valuation technique (“income approach”), although limited available market data is also considered. In determining the estimated fair value, we consider discounted cash flow calculations, the level of LNC’s share price and assumptions that

market participants would make in valuing the reporting unit. This analysis requires us to make judgments about revenues, earnings projections, capital market assumptions and discount rates.

As of October 1, 2010, all of our reporting units passed the Step 1 analysis, and although Insurance Solutions – Life Insurance carrying value of the net assets was within the estimated fair value range, we deemed it necessary to validate the carrying value of goodwill through a Step 2 analysis. In our Step 2 analysis of Insurance Solutions – Life Insurance, we estimated the implied fair value of the reporting unit’s goodwill, including assigning the reporting unit’s fair value determined in Step 1 to all of its net assets (recognized and unrecognized) as if the reporting unit were acquired in a business combination as of October 1, 2010, and determined there was no impairment due to the implied fair value of goodwill being in excess of the carrying value of goodwill.

As of October 1, 2009, all of our reporting units passed the Step 1 analysis.

The gross carrying amount and accumulated amortization (in millions) for the major specifically identifiable intangible asset class by reportable segment was as follows:

	<i>As of December 31,</i>			
	<u>2010</u>		<u>2009</u>	
	<i>Gross Carrying Amount</i>	<i>Accumulated Amortization</i>	<i>Gross Carrying Amount</i>	<i>Accumulated Amortization</i>
Insurance Solutions — Life Insurance:				
Sales force	\$7	\$1	\$7	\$1

Future estimated amortization of the specifically identifiable intangible asset was immaterial as of December 31, 2010.

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

9. Guaranteed Benefit Features

Information on the 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):

	<i>As of December 31,</i>	
	<u>2010</u>	<u>2009</u>
Return of Net Deposits		
Total account value	\$1,834	\$1,558
Net amount at risk ⁽¹⁾	25	63
Average attained age of contract holders	54 years	53 years
Minimum Return		
Average attained age of contract holders	79 years	78 years
Guaranteed minimum return	5%	5%
Anniversary Contract Value		
Total account value	\$ 995	\$ 915
Net amount at risk ⁽¹⁾	78	162
Average attained age of contract holders	66 years	65 years

⁽¹⁾ Represents the amount of death benefit in excess of the account balance. The decrease in net amount at risk when comparing December 31, 2010, to December 31, 2009, was attributable primarily to the rise in equity markets and associated increase 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 Balance Sheets:

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Balance as of beginning-of-year	\$ 2	\$ 8	\$ 1
Changes in reserves	—	—	9
Benefits paid	(1)	(6)	(2)
Balance as of end-of-year	<u>\$ 1</u>	<u>\$ 2</u>	<u>\$ 8</u>

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

Asset Type	<i>As of December 31,</i>	
	<u>2010</u>	<u>2009</u>
Domestic equity	\$ 990	\$ 890
International equity	454	392
Bonds	479	300
Money market	184	231
Total	<u>\$2,107</u>	<u>\$1,813</u>

Percent of total variable annuity separate account values

	89%	89%
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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 11% of permanent life insurance in force as of December 31, 2010, and approximately 65% of total sales for these products for the year ended December 31, 2010.

10. Other Contract Holder Funds

Details of other contract holder funds (in millions) were as follows:

	<i>As of December 31,</i>	
	<u>2010</u>	<u>2009</u>
Fixed account values, including the fixed portion of variable and other contract holder funds	\$4,965	\$4,808
DFEL	101	87
Contract holder dividends payable	161	164
Premium deposit funds	11	10
Undistributed earnings on participating business	30	15
Total other contract holder funds	<u>\$5,268</u>	<u>\$5,084</u>

As of December 31, 2010 and 2009, participating policies comprised approximately 3% and 4%, respectively, of the face amount of insurance in force, and dividend expenses were \$27 million, \$29 million and \$29 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Notes to Financial Statements (continued)

11. Contingencies and Commitments

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 and securities laws.

In the ordinary course of our business, we 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 our financial position. 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, it is possible that an adverse outcome in certain matters could be material to our operating results for any particular reporting period.

Vulnerability from Concentrations

As of December 31, 2010, we did not have a concentration of business transactions with a particular customer or lender or sources of supply of labor or services used in the business. However, we do have a concentration in market and geographic area in which business is conducted. For the year ended December 31, 2010, approximately 88% of the premiums, on the basis of SAP, were generated in New York.

Other Contingency Matters

State guaranty funds assess insurance companies to cover losses to contract holders of insolvent or rehabilitated companies. Mandatory assessments may be partially recovered through a reduction in future premium taxes in some states. The accrual for expected assessments was immaterial as of December 31, 2010 and 2009.

12. Shares and Stockholder's Equity

All authorized and issued shares of LLANY are owned by LNL.

Accumulated OCI

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

	For the Years Ended December 31,		
	2010	2009	2008
Unrealized Gain (Loss) on AFS Securities			
Balance as of beginning-of-year	\$ (19)	\$ (211)	\$ (8)
Cumulative effect from adoption of new accounting standards	—	(11)	—
Unrealized holding gains (losses) arising during the year	252	541	(758)
Change in DAC, VOBA, DSI and other contract holder funds	(123)	(282)	337
Income tax benefit (expense)	(51)	(98)	156
Less:			
Reclassification adjustment for gains (losses) included in net income (loss)	(22)	(90)	(147)
Associated amortization of DAC, VOBA, DSI and DFEL	6	25	51
Income tax benefit (expense)	6	23	34
Balance as of end-of-year	<u>\$ 69</u>	<u>\$ (19)</u>	<u>\$ (211)</u>

For the Years Ended
December 31,

2010 2009 2008

Unrealized OTTI on
AFS Securities

Balance as of beginning-of-year	\$ (12)	\$ —	\$ —
(Increases) attributable to:			
Cumulative effect from adoption of new accounting standards	—	(5)	—
Gross OTTI recognized in OCI during the year	(6)	(46)	—
Change in DAC, VOBA, DSI and DFEL	1	15	—
Income tax benefit (expense)	2	11	—
Decreases attributable to:			
Sales, maturities or other settlements of AFS securities	12	26	—
Change in DAC, VOBA, DSI and DFEL	(4)	(6)	—
Income tax benefit (expense)	(3)	(7)	—
Balance as of end-of-year	<u>\$ (10)</u>	<u>\$ (12)</u>	<u>\$ —</u>

Unrealized Gain (Loss) on
Derivative Instruments

Balance as of beginning-of-year	\$ 1	\$ 1	\$ 1
Balance as of end-of-year	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 1</u>

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

13. Realized (Gain) Loss

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

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Total realized gain (loss) on investments ⁽¹⁾ . . .	\$(15)	\$(66)	\$(96)
Realized gain (loss) on certain reinsurance derivatives ⁽²⁾	—	—	(1)
Guaranteed living benefits ⁽³⁾ :			
Gross gain (loss)	—	1	—
Associated amortization of DAC, VOBA, DSI and DFEL	<u>(2)</u>	<u>—</u>	<u>(1)</u>
Total realized gain (loss)	<u>\$(17)</u>	<u>\$(65)</u>	<u>\$(98)</u>

⁽¹⁾ See “Realized Gain (Loss) Related to Certain Investments” section in Note 3.

⁽²⁾ Represents changes in the fair value of 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).

⁽³⁾ Represents the change in embedded derivative reserves of our GLB products.

14. Underwriting, Acquisition, Insurance, Restructuring and Other Expenses

Details underlying underwriting, acquisition, insurance and other expenses (in millions) were as follows:

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Commissions	\$ 74	\$ 71	\$ 84
General and administrative expenses	61	65	66
DAC and VOBA deferrals and interest, net of amortization	7	7	(10)
Taxes, licenses and fees	<u>16</u>	<u>16</u>	<u>16</u>
Total	<u>\$158</u>	<u>\$159</u>	<u>\$156</u>

15. Pension, Postretirement Health Care and Life Insurance Benefit Plans

LNC and LNL maintain qualified funded defined benefit pension plans for our employees and agents, respectively, including those of LLANY. LNC and LNL also maintain non-qualified, unfunded defined benefit pension plans for certain employees, including certain former employees of acquired companies, and agents, respectively. In addition, for certain former employees, LNC has supplemental retirement plans that provide defined benefit pension benefits in excess of limits imposed by federal tax law. All of LNC’s and LNL’s defined benefit pension plans were “frozen” as of December 31, 2007, or earlier. For their frozen plans, there are no new participants and no future accruals of benefits from the date of the freeze.

The eligibility requirements for each plan are described in each plan document and vary for each plan based on completion of a specified period of continuous service and date of hire, subject to age limitations. The frozen pension plan benefits are calculated either on a traditional or cash balance formula. Those formulas are based upon years of credited service and eligible earnings as defined in each plan document. The traditional formula provides benefits stated in terms of a single life annuity payable at age 65. The cash balance formula provides benefits stated as a lump sum hypothetical account balance. That account balance equals the sum of the employee’s accumulated annual benefit credits plus interest credits. Benefit credits, which are

based on years of service and base salary plus bonus, ceased as of the date the plan was frozen. Interest credits continue until the participant’s benefit is paid.

LNC and LNL also sponsor a voluntary employees’ beneficiary association (“VEBA”) trust that provides postretirement medical, dental and life insurance benefits to retired full-time employees and agents who, depending on the plan, have worked for us for 10 years and attained age 55 (age 60 for agents). VEBAs are a special type of tax-exempt trust used to provide benefits that are subject to preferential tax treatment under the Internal Revenue Code. Medical and dental benefits are available to spouses and other eligible dependents of retired employees and agents. Retirees may be required to contribute toward the cost of these benefits. Eligibility and the amount of required contribution for these benefits varies based upon a variety of factors including years of service and year of retirement. Effective January 1, 2008, the postretirement plan providing benefits to former employees of JP was amended such that only employees who had attained age 55 with a minimum of 10 years of service by December 31, 2007, and who later retire on or after age 60 with 15 years of service will be eligible to receive life insurance benefits when they retire.

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

16. Defined Contribution and Deferred Compensation Plans

Defined Contribution Plans

LNC and LNL sponsor contributory defined contribution plans for eligible employees and agents, respectively, including those of LLANY, which includes money purchase plans. LNC and LNL make contributions and matching contributions to each of the active plans in accordance with the plan document and various limitations under Section 401(a) of the Internal Revenue Code of 1986, as amended. The expenses related to these plans was \$2 million for the years ended December 31, 2010, 2009 and 2008, which are recorded in the underwriting, acquisition, insurance and other expenses on our Statements of Income (Loss).

Deferred Compensation Plans

LNC sponsors six separate non-qualified unfunded, deferred compensation plans for various groups: employees; agents and non-employee directors. LLANY participants in five of these deferred compensation plans. The liability for these five plans was \$1 million and \$2 million as of December 31, 2010 and 2009, respectively, which is recorded in other liabilities in our Balance Sheets.

The Deferred Compensation Plan for Employees

Eligible participants in this plan may elect to defer payment of a portion of their compensation as defined by the plan. Plan participants may select from a menu of “phantom” investment options (identical to those offered under LNC and LNL qualified defined contribution plans) used as investment measures for calculating the investment return notionally credited to their deferrals. Under the terms of the plan, LNC agrees to pay

out amounts based upon the aggregate performance of the investment measures selected by the participant. LNC makes matching contributions to these plans based upon amounts placed into the deferred compensation plans by individuals after participants have exceeded applicable limits of the Internal Revenue Code. The amount of LNC contribution is calculated in accordance with the plan document, which is similar to LNC and LNL qualified defined contribution plans. Our expense for this plan was not significant for the years December 31, 2010, 2009 and 2008.

Deferred Compensation Plan for Agents

LNC sponsors three deferred compensation plans for certain eligible agents. Eligible participants in these plans may elect to defer payment of a portion of their compensation as defined by the various plans. The plans’ participants may select from a menu of “phantom” investment options (identical to those offered under LNC and LNL qualified defined contribution plans) used as investment measures for calculating the investment return notionally credited to their deferrals. Under the terms of this plan, LNC agrees to pay out amounts based upon the aggregate performance of the investment measures selected by the participant. LNC makes matching contributions to these plans based upon amounts placed into the deferred compensation plans by individuals after participants have exceeded applicable limits of the Internal Revenue Code. The amount of LNC contribution is calculated in accordance with the plan document, which is similar to LNC and LNL qualified defined contribution plans. Our expenses for these plans were not significant for the years December 31, 2010, 2009 and 2008.

17. Stock-Based Incentive Compensation Plans

Our employees and agents are included in LNC’s various incentive plans that provide for the issuance of stock options, performance shares (performance-vested shares as opposed to time-vested shares), SARS, restricted stock units, and restricted stock awards. LNC has a policy of issuing new shares to satisfy option exercises. Total compensation expense for stock-based awards to our employees and agents was not material for the years ended December 31, 2010, 2009 and 2008.

18. Statutory Information and Restrictions

We prepare financial statements in accordance with SAP prescribed or permitted by the New York Department of Insurance, which may vary materially from GAAP. Prescribed SAP includes the Accounting Practices and Procedures Manual of the National Association of Insurance Commissioners (“NAIC”) as well as state laws, regulations and administrative rules. Permitted SAP encompasses all accounting practices not so prescribed. The principal differences between statutory financial statements and financial statements prepared in accordance

with GAAP are that statutory financial statements do not reflect DAC, some bond portfolios may be carried at amortized cost, assets and liabilities are presented net of reinsurance, contract holder liabilities are generally valued using more conservative assumptions and certain assets are non-admitted.

We are subject to the applicable laws and regulations of our state of domicile. Changes in these laws and regulations could change capital levels or capital requirements for the Company.

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

18. Statutory Information and Restrictions (continued)

Specified statutory information (in millions) was as follows:

	<i>As of December 31,</i>		
	<i>2010</i>	<i>2009</i>	
Capital and surplus	\$794	\$819	
	<i>For the Years Ended December 31,</i>		
	<i>2010</i>	<i>2009</i>	<i>2008</i>
Net gain (loss) from operations, after-tax . .	\$73	\$107	\$ 13
Net income (loss)	55	13	(95)
Dividends to LNC	80	—	—

The increase in statutory net income (loss) for the year ended December 31, 2010, from that of 2009 was primarily due to a significant decrease in realized losses on investments due to improving market conditions throughout 2010.

The increase in statutory net income (loss) for the year ended December 31, 2009, from that of 2008 was primarily due to the improved market conditions in 2009. The new statutory reserving standard (commonly called "VACARVM") that was developed by the NAIC replaced current statutory reserve practices for variable annuities with guaranteed benefits, such as GWBs, and was effective December 31, 2009. The actual effect of adoption was relatively neutral to our RBC ratios and future dividend capacity with a slight decrease in statutory reserves offset by a higher capital requirement. LNC utilizes captive reinsurance structures, as well as third-party reinsurance arrangements, to lessen the negative effect on statutory capital and dividend capacity in its life insurance subsidiaries.

Our state of domicile, New York, has adopted a certain prescribed accounting practice that differs from those found in

NAIC SAP. This prescribed practice is the use of continuous Commissioners Annuity Reserve Valuation Method ("CARVM") in the calculation of reserves as prescribed by the state of New York. We also have an accounting practice permitted by our state of domicile that differs from that found in NAIC SAP. Specifically, the use of a more conservative valuation interest rate on certain annuities as of December 31, 2010 and 2009.

The effects on statutory surplus compared to NAIC statutory surplus from the use of these prescribed practices (in millions) were as follows:

	<i>As of December 31,</i>	
	<i>2010</i>	<i>2009</i>
Calculation of reserves using continuous CARVM	\$(5)	\$(6)
Conservative valuation rate on certain variable annuities	(1)	—

We are subject to certain insurance department regulatory restrictions as to the transfer of funds and payment of dividends to LNL. Under New York laws and regulations, we may pay dividends to LNL without prior approval from the Superintendent of the New York Department of Insurance, provided such dividend, along with all other dividends paid within the preceding twelve consecutive months, would not exceed the statutory limitation. The current statutory limitation is the lesser of 10% of surplus to contract holders as of the immediately preceding calendar year-end or net gain from operations for the immediately preceding calendar year, not including realized capital gains. We expect we could pay dividends of approximately \$73 million in 2011 without prior approval from the Superintendent.

19. Fair Value of Financial Instruments

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

	<i>As of December 31,</i>			
	<i>2010</i>		<i>2009</i>	
	<i>Carrying Value</i>	<i>Fair Value</i>	<i>Carrying Value</i>	<i>Fair Value</i>
Assets				
AFS securities:				
Fixed maturity securities	\$ 6,659	\$ 6,659	\$ 6,180	\$ 6,180
Equity securities	3	3	2	2
Mortgage loans on real estate	225	243	228	234
Other investments	1	1	2	2
Cash and invested cash	48	48	65	65
Separate account assets	2,660	2,660	2,263	2,263
Liabilities				
Future contract benefits:				
GLB reserves embedded derivatives	(24)	(24)	(32)	(32)
Other contract holder funds:				
Remaining guaranteed interest and similar contracts	(98)	(98)	(81)	(81)
Account values of certain investment contracts	(1,396)	(1,442)	(1,356)	(1,364)
Other liabilities:				
Deferred compensation plans embedded derivatives	(1)	(1)	(2)	(2)

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

19. Fair Value of Financial Instruments (continued)

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 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 our assets classified as other investments approximates their fair value. Other investments include

The following summarizes our financial instruments carried at fair value (in millions) on a recurring basis by the fair value hierarchy levels described above:

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 December 31, 2010 and 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.

Financial Instruments Carried at Fair Value

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

	As of December 31, 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	\$ 5	\$4,996	\$139	\$5,140
U.S. Government bonds	32	—	1	33
Foreign government bonds	—	29	1	30
MBS:				
CMOs	—	640	2	642
MPTS	—	257	—	257
CMBS	—	168	15	183
ABS CDOs	—	—	3	3
State and municipal bonds	—	250	—	250
Hybrid and redeemable preferred securities	—	117	4	121
Equity AFS securities:				
Other securities	3	—	—	3
Cash and invested cash	—	48	—	48
Separate account assets	—	2,660	—	2,660
Total assets	<u>\$40</u>	<u>\$9,165</u>	<u>\$165</u>	<u>\$9,370</u>
Liabilities				
Future contract benefits:				
GLB reserves embedded derivatives	\$—	\$ —	\$(24)	\$ (24)
Other liabilities:				
Deferred compensation plans embedded derivatives	—	—	(1)	(1)
Total liabilities	<u>\$—</u>	<u>\$ —</u>	<u>\$(25)</u>	<u>\$ (25)</u>

Lincoln Life & Annuity Company of New York
Notes to Financial Statements (continued)

19. Fair Value of Financial Instruments (continued)

	<i>As of December 31, 2009</i>			
	<i>Quoted Prices in Active Markets for Identical Assets (Level 1)</i>	<i>Significant Observable Inputs (Level 2)</i>	<i>Significant Unobservable Inputs (Level 3)</i>	<i>Total Fair Value</i>
Assets				
Investments:				
Fixed maturity AFS securities:				
Corporate bonds	\$ 5	\$4,579	\$160	\$4,744
U.S. Government bonds	31	1	—	32
Foreign government bonds	—	24	—	24
MBS:				
CMOs	—	646	3	649
MPTS	—	247	—	247
CMBS	—	167	51	218
ABS:				
CDOs	—	—	3	3
State and municipal bonds	—	170	—	170
Hybrid and redeemable preferred securities	—	79	14	93
Equity AFS securities:				
Other securities	2	—	—	2
Cash and invested cash	—	65	—	65
Separate account assets	—	2,263	—	2,263
Total assets	<u>\$38</u>	<u>\$8,241</u>	<u>\$231</u>	<u>\$8,510</u>
Liabilities				
Future contract benefits:				
GLB reserves embedded derivatives	\$—	\$ —	\$ (32)	\$ (32)
Other liabilities:				
Deferred compensation plans embedded derivatives	—	—	(2)	(2)
Total liabilities	<u>\$—</u>	<u>\$ —</u>	<u>\$ (34)</u>	<u>\$ (34)</u>

Lincoln Life & Annuity Company of New York
Notes to Financial Statements (continued)

19. Fair Value of Financial Instruments (continued)

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.

	<i>For the Year Ended December 31, 2010</i>					<i>Ending Fair Value</i>
	<i>Beginning Fair Value</i>	<i>Items Included in Net Income</i>	<i>Gains (Losses) in OCI</i>	<i>Sales, Issuances, Maturities, Settlements, Calls, Net</i>	<i>Transfers In or Out of Level 3, Net⁽¹⁾</i>	
Investments ⁽²⁾ :						
Fixed maturity AFS securities:						
Corporate bonds	\$ 160	\$ 1	\$ 6	\$ (10)	\$ (18)	\$139
U.S. Government bonds	—	—	—	—	1	1
Foreign government bonds	—	—	—	—	1	1
MBS:						
CMOs	3	—	—	(1)	—	2
CMBS	51	(5)	12	(14)	(29)	15
ABS:						
CDOs	3	—	—	—	—	3
Hybrid and redeemable preferred securities	14	—	(10)	—	—	4
Future contract benefits ⁽³⁾ :						
GLB reserves embedded derivatives	(32)	8	—	—	—	(24)
Other liabilities:						
Deferred compensation plans embedded derivatives ⁽⁴⁾	(2)	(2)	—	3	—	(1)
Total, net	<u>\$ 197</u>	<u>\$ 2</u>	<u>\$ 8</u>	<u>\$ (22)</u>	<u>\$ (45)</u>	<u>\$140</u>

	<i>For the Year Ended December 31, 2009</i>					<i>Ending Fair Value</i>
	<i>Beginning Fair Value</i>	<i>Items Included in Net Income</i>	<i>Gains (Losses) in OCI</i>	<i>Sales, Issuances, Maturities, Settlements, Calls, Net</i>	<i>Transfers In or Out of Level 3, Net⁽¹⁾</i>	
Investments ⁽²⁾ :						
Fixed maturity AFS securities:						
Corporate bonds	\$ 176	\$ (2)	\$ 3	\$ 6	\$ (23)	\$160
MBS:						
CMOs	22	—	—	(1)	(18)	3
CMBS	42	—	12	(3)	—	51
ABS:						
CDOs	4	—	2	(3)	—	3
State and municipal bonds	37	—	—	(5)	(32)	—
Hybrid and redeemable preferred securities	6	—	8	—	—	14
Future contract benefits ⁽³⁾ :						
GLB reserves embedded derivatives	(124)	92	—	—	—	(32)
Other liabilities:						
Deferred compensation plans embedded derivatives ⁽⁴⁾	(2)	(5)	—	5	—	(2)
Total, net	<u>\$ 161</u>	<u>\$85</u>	<u>\$25</u>	<u>\$ (1)</u>	<u>\$ (73)</u>	<u>\$197</u>

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

19. Fair Value of Financial Instruments (continued)

For the Year Ended December 31, 2008

	<i>Beginning Fair Value</i>	<i>Items Included in Net Income</i>	<i>Gains (Losses) in OCI</i>	<i>Sales, Issuances, Maturities, Settlements, Calls, Net</i>	<i>Transfers In or Out of Level 3, Net⁽¹⁾</i>	<i>Ending Fair Value</i>
Investments ⁽²⁾ :						
Fixed maturity AFS securities:						
Corporate bonds	\$220	\$ (16)	\$ (18)	\$ (17)	\$ 7	\$ 176
Foreign government bonds	5	—	—	(5)	—	—
MBS:						
CMOs	42	(4)	1	(3)	(14)	22
CMBS	60	—	(30)	7	5	42
ABS:						
CDOs	7	—	(3)	—	—	4
State and municipal bonds	38	—	(1)	—	—	37
Hybrid and redeemable preferred securities	—	—	—	6	—	6
Future contract benefits ⁽³⁾ :						
GLB reserves embedded derivatives	(17)	(107)	—	—	—	(124)
Other liabilities:						
Deferred compensation plans embedded derivatives ⁽⁴⁾	(1)	(8)	—	7	—	(2)
Total, net	<u>\$354</u>	<u>\$(135)</u>	<u>\$(51)</u>	<u>\$ (5)</u>	<u>\$ (2)</u>	<u>\$ 161</u>

⁽¹⁾ Transfers in or out of Level 3 for AFS are displayed at amortized cost as of the beginning-of-period. For AFS, the difference between beginning-of-year amortized cost and beginning-of-year fair value was included in OCI and earnings, respectively, in prior years.

⁽²⁾ Amortization and accretion of premiums and discounts are included in net investment income on our Statements of Income (Loss). Gains (losses) from sales, maturities, settlements and calls and OTTI are included in realized gain (loss) on our Statements of Income (Loss).

⁽³⁾ Gains (losses) from sales, maturities, settlements and calls are included in realized gain (loss) on our Statements of Income (Loss).

⁽⁴⁾ Deferrals and subsequent changes in fair value for the participants' investment options are reported in underwriting, acquisition, insurance and other expenses on our 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):

	<i>For the Years Ended December 31,</i>		
	<i>2010</i>	<i>2009</i>	<i>2008</i>
Investments ⁽¹⁾ :			
GLB reserves embedded derivatives . . .	\$16	\$99	\$(100)
Other liabilities:			
Deferred compensation plans embedded derivatives ⁽²⁾	<u>(2)</u>	<u>(5)</u>	<u>(8)</u>
Total, net	<u>\$14</u>	<u>\$94</u>	<u>\$(108)</u>

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

⁽²⁾ Included in underwriting, acquisition, insurance and other expenses on our Statements of Income (Loss).

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

	<i>For the Year Ended December 31, 2010</i>		
	<i>Transfers In to Level 3</i>	<i>Transfers Out of Level 3</i>	<i>Total</i>
Investments:			
Fixed maturity AFS securities:			
Corporate bonds	\$5	\$(23)	\$(18)
U.S. Government bonds	1	—	1
Foreign government bonds . . .	1	—	1
MBS CMBS	<u>1</u>	<u>(30)</u>	<u>(29)</u>
Total, net	<u>\$8</u>	<u>\$(53)</u>	<u>\$(45)</u>

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 year ended December 31, 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 year ended December 31, 2010, there were no significant transfers between Level 1 and 2 of the fair value hierarchy.

Notes to Financial Statements (continued)

20. Segment Information

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

<u>Business</u>	<u>Corresponding Segments</u>
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, defined benefit, individual retirement accounts and mutual-fund based programs in the retirement plan 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 excess capital, other corporate investments and benefit plan net liability.

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

- Realized gains and losses associated with the following (“excluded realized gain (loss)”):
 - Sale or disposal of securities;
 - Impairments of securities;
 - Change in the fair value of embedded derivatives within certain reinsurance arrangements; and
 - Change in the GLB embedded derivative reserves.

- 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 gain (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 results of operations.

Segment information (in millions) was as follows:

	<i>For the Years Ended December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Revenues			
Operating revenues:			
Retirement Solutions:			
Annuities	\$111	\$ 99	\$ 96
Defined Contribution	53	52	52
Total Retirement Solutions	164	151	148
Insurance Solutions:			
Life Insurance	563	550	531
Group Protection	62	48	39
Total Insurance Solutions	625	598	570
Other Operations	18	20	25
Excluded realized gain (loss), pre-tax	(20)	(68)	(100)
Total revenues	<u>\$787</u>	<u>\$701</u>	<u>\$ 643</u>

Lincoln Life & Annuity Company of New York

Notes to Financial Statements (continued)

21. Supplemental Disclosures of Cash Flow Data

The following summarizes our supplemental cash flow data (in millions):

	<i>For the Years Ended</i>		
	<i>December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Income taxes paid (received)	<u>\$15</u>	<u>\$ (9)</u>	<u>\$40</u>

22. Transactions with Affiliates

Transactions with affiliates (in millions) recorded on our financial statements were as follows:

	<i>As of December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Assets with affiliates:			
Service agreement receivable ⁽¹⁾	\$16	\$16	
Reinsurance on ceded reinsurance contracts ⁽²⁾	64	57	
	<i>For the Years Ended</i>		
	<i>December 31,</i>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Revenues with affiliates:			
Premiums paid on ceded reinsurance contracts ⁽³⁾	\$(10)	\$(17)	\$(15)
Fees for management of general account ⁽⁴⁾	—	(4)	(4)
Benefits and expenses with affiliates:			
Service agreement payments ⁽⁵⁾	57	59	59

⁽¹⁾ Reported in other assets on our Balance Sheets.

⁽²⁾ Reported in reinsurance recoverables on our Balance Sheets.

⁽³⁾ Reported in insurance premiums on our Statements of Income (Loss).

⁽⁴⁾ Reported in net investment income on our Statements of Income (Loss).

⁽⁵⁾ Reported in underwriting, acquisition, insurance and other expenses on our Statements of Income (Loss).

Service Agreement

In accordance with service agreements with LNL and certain of its affiliates for personnel and facilities usage, general management services and investment management services, we

receive services from and provide services to affiliated companies and also receive an allocation of corporate overhead from LNC. Corporate overhead expenses are assigned based on specific methodologies for each function. The majority of the expenses are assigned based on the following methodologies: assets by product, assets under management, weighted number of policy applications, weighted policies in force and sales.

Fees for Management of General Account

On January 4, 2010, LNC closed on a purchase and sale agreement pursuant to which all of the outstanding capital stock of Delaware Management Holdings, Inc. ("Delaware") was sold. In addition, we entered into investment advisory agreements with Delaware, pursuant to which Delaware will continue to manage the majority of our general account insurance assets.

Ceded Reinsurance Contracts

We cede business to two affiliated companies, LNL and Lincoln National Reinsurance Company (Barbados) Ltd.