

CIGNA CORP  
Form 10-Q  
November 01, 2012  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

## FORM 10-Q

**R** QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

OR

**O** TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

for the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-08323

# Cigna Corporation

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of incorporation or  
organization)*

**900 Cottage Grove Road Bloomfield, Connecticut**

**06-1059331**

*(I.R.S. Employer Identification No.)*

**06002**

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(Address of principal executive offices)

(Zip Code)

(860) 226-6000

Registrant's telephone number, including area code

(860) 226-6741

Registrant's facsimile number, including area code

Not Applicable

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

| Indicate by check mark                                                                                                                                                                                                                                                                                                                                                                 |                     | YES                     | NO                          |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|-------------------------|-----------------------------|
| <ul style="list-style-type: none"> <li>whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.</li> </ul>    |                     | R                       | O                           |
| <ul style="list-style-type: none"> <li>whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).</li> </ul> |                     | R                       | O                           |
| <ul style="list-style-type: none"> <li>whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.</li> </ul>                                                                   |                     |                         |                             |
| Large accelerated filer R                                                                                                                                                                                                                                                                                                                                                              | Accelerated filer O | Non-accelerated filer O | Smaller Reporting Company O |
| <ul style="list-style-type: none"> <li>whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).</li> </ul>                                                                                                                                                                                                                                            |                     | O                       | R                           |

As of October 15, 2012, 285,890,413 shares of the issuer's common stock were outstanding.

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# Cigna Corporation

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As used herein, "Cigna" or the "Company" refers to one or more of Cigna Corporation and its consolidated subsidiaries.

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## Part I. FINANCIAL INFORMATION

### Item 1. FINANCIAL STATEMENTS

#### Cigna Corporation

#### Consolidated Statements of Income

| <b>Revenues</b>                                           |              |              |               |               |
|-----------------------------------------------------------|--------------|--------------|---------------|---------------|
| Premiums and fees                                         | \$ 6,637     | \$ 4,748     | \$ 19,464     | \$ 14,267     |
| Net investment income                                     | 283          | 297          | 854           | 860           |
| Mail order pharmacy revenues                              | 401          | 368          | 1,189         | 1,056         |
| Other revenues                                            | 26           | 184          | 76            | 289           |
| Realized investment gains (losses):                       |              |              |               |               |
| Other-than-temporary impairments on fixed maturities, net | -            | (23)         | (6)           | (25)          |
| Other realized investment gains                           | 11           | 36           | 26            | 81            |
| Total realized investment gains                           | 11           | 13           | 20            | 56            |
| <b>Total revenues</b>                                     | <b>7,358</b> | <b>5,610</b> | <b>21,603</b> | <b>16,528</b> |
| <b>Benefits and Expenses</b>                              |              |              |               |               |
| Health Care medical claims expense                        | 3,269        | 2,014        | 9,711         | 6,125         |
| Other benefit expenses                                    | 1,203        | 1,272        | 3,521         | 3,324         |
| Mail order pharmacy cost of goods sold                    | 324          | 309          | 975           | 874           |
| GMIB fair value (gain) loss                               | (53)         | 224          | (33)          | 245           |

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|                                                                 |               |               |                 |                |
|-----------------------------------------------------------------|---------------|---------------|-----------------|----------------|
| Other operating expenses                                        | 1,897         | 1,518         | 5,571           | 4,516          |
| <b>Total benefits and expenses</b>                              | <b>6,640</b>  | <b>5,337</b>  | <b>19,745</b>   | <b>15,084</b>  |
| <b>Income before Income Taxes</b>                               | <b>718</b>    | <b>273</b>    | <b>1,858</b>    | <b>1,444</b>   |
| Income taxes:                                                   |               |               |                 |                |
| Current                                                         | 228           | 114           | 574             | 274            |
| Deferred                                                        | 24            | (24)          | 67              | 182            |
| <b>Total income taxes</b>                                       | <b>252</b>    | <b>90</b>     | <b>641</b>      | <b>456</b>     |
| <b>Net Income</b>                                               | <b>466</b>    | <b>183</b>    | <b>1,217</b>    | <b>988</b>     |
| <b>Less: Net Income Attributable to Noncontrolling Interest</b> | <b>-</b>      | <b>-</b>      | <b>-</b>        | <b>1</b>       |
| <b>Shareholders' Net Income</b>                                 | <b>\$ 466</b> | <b>\$ 183</b> | <b>\$ 1,217</b> | <b>\$ 987</b>  |
| <b>Shareholders' Net Income Per Share:</b>                      |               |               |                 |                |
| Basic                                                           | \$ 1.64       | \$ 0.68       | \$ 4.27         | \$ 3.67        |
| Diluted                                                         | \$ 1.61       | \$ 0.67       | \$ 4.20         | \$ 3.62        |
| <b>Dividends Declared Per Share</b>                             | <b>\$ -</b>   | <b>\$ -</b>   | <b>\$ 0.04</b>  | <b>\$ 0.04</b> |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these statements.

Table of Contents**Cigna Corporation****Consolidated Statements of Comprehensive Income**

|                                                         |        |        |          |        |
|---------------------------------------------------------|--------|--------|----------|--------|
| Shareholders' net income                                | \$ 466 | \$ 183 | \$ 1,217 | \$ 987 |
| <b>Net unrealized appreciation on securities:</b>       |        |        |          |        |
| Equity securities                                       | 83     |        | 169      |        |
|                                                         | -      | (3)    | 2        | (3)    |
| Net unrealized appreciation (depreciation), derivatives | 83     |        | 171      |        |
|                                                         | (4)    | 13     | (4)      | 3      |
|                                                         | 31     |        | 23       |        |
| Postretirement benefits liability adjustment            | 8      | 4      | 44       | 13     |
|                                                         | 118    |        | 234      |        |
| Shareholders' comprehensive income                      | 584    | 196    | 1,451    | 1,168  |
| Net income attributable to noncontrolling interest      | -      | -      | -        | 1      |
|                                                         | \$ 584 |        | \$ 1,451 |        |

*The accompanying Notes to the Consolidated Financial Statements are an integral part of these statements.*

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# Cigna Corporation

## Consolidated Balance Sheets

| (In millions, except per share amounts)                                         | Unaudited<br>As of<br>September 30, 2012 | As of<br>December 31, 2011 |
|---------------------------------------------------------------------------------|------------------------------------------|----------------------------|
| <b>Assets</b>                                                                   |                                          |                            |
| Investments:                                                                    |                                          |                            |
| Fixed maturities, at fair value (amortized cost, \$15,577; \$14,257)            | \$ 17,868                                | \$ 16,217                  |
| Equity securities, at fair value (cost, \$121; \$124)                           | 109                                      | 100                        |
| Commercial mortgage loans                                                       | 2,946                                    | 3,301                      |
| Policy loans                                                                    | 1,519                                    | 1,502                      |
| Real estate                                                                     | 83                                       | 87                         |
| Other long-term investments                                                     | 1,197                                    | 1,058                      |
| Short-term investments                                                          | 151                                      | 225                        |
| Total investments                                                               | 23,873                                   | 22,490                     |
| Cash and cash equivalents                                                       | 2,236                                    | 4,690                      |
| Accrued investment income                                                       | 283                                      | 252                        |
| Premiums, accounts and notes receivable, net                                    | 1,714                                    | 1,358                      |
| Reinsurance recoverables                                                        | 6,391                                    | 6,256                      |
| Deferred policy acquisition costs                                               | 1,022                                    | 817                        |
| Property and equipment                                                          | 1,136                                    | 1,024                      |
| Deferred income taxes, net                                                      | 407                                      | 803                        |
| Goodwill                                                                        | 5,878                                    | 3,164                      |
| Other assets, including other intangibles                                       | 2,229                                    | 1,750                      |
| Separate account assets                                                         | 8,362                                    | 8,093                      |
| <b>Total assets</b>                                                             | <b>\$ 53,531</b>                         | <b>\$ 50,697</b>           |
| <b>Liabilities</b>                                                              |                                          |                            |
| Contractholder deposit funds                                                    | \$ 8,537                                 | \$ 8,553                   |
| Future policy benefits                                                          | 9,209                                    | 8,593                      |
| Unpaid claims and claim expenses                                                | 4,253                                    | 4,146                      |
| Health Care medical claims payable                                              | 1,581                                    | 1,095                      |
| Unearned premiums and fees                                                      | 474                                      | 502                        |
| Total insurance and contractholder liabilities                                  | 24,054                                   | 22,889                     |
| Accounts payable, accrued expenses and other liabilities                        | 6,373                                    | 6,627                      |
| Short-term debt                                                                 | 226                                      | 104                        |
| Long-term debt                                                                  | 4,986                                    | 4,990                      |
| Separate account liabilities                                                    | 8,362                                    | 8,093                      |
| <b>Total liabilities</b>                                                        | <b>44,001</b>                            | <b>42,703</b>              |
| <b>Contingencies Note 18</b>                                                    |                                          |                            |
| <b>Shareholders' Equity</b>                                                     |                                          |                            |
| Common stock (par value per share, \$0.25; shares issued, 366; authorized, 600) | 92                                       | 92                         |
| Additional paid-in capital                                                      | 3,282                                    | 3,188                      |
| Net unrealized appreciation, fixed maturities                                   | \$ 908                                   | \$ 739                     |
| Net unrealized appreciation, equity securities                                  | 3                                        | 1                          |
| Net unrealized depreciation, derivatives                                        | (27)                                     | (23)                       |
| Net translation of foreign currencies                                           | 26                                       | 3                          |
| Postretirement benefits liability adjustment                                    | (1,463)                                  | (1,507)                    |
| Accumulated other comprehensive loss                                            | (553)                                    | (787)                      |
| Retained earnings                                                               | 11,962                                   | 10,787                     |
| Less treasury stock, at cost                                                    | (5,253)                                  | (5,286)                    |
| Total shareholders' equity                                                      | 9,530                                    | 7,994                      |
| Total liabilities and shareholders' equity                                      | \$ 53,531                                | \$ 50,697                  |

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|              |                  |          |          |
|--------------|------------------|----------|----------|
| Shareholders | Equity Per Share | \$ 33.24 | \$ 28.00 |
|--------------|------------------|----------|----------|

*The accompanying Notes to the Consolidated Financial Statements are an integral part of these statements.*

[Table of Contents](#)**Cigna Corporation****Consolidated Statements of Changes in Total Equity**

| <b>Unaudited</b><br><b>For the three months ended September 30, 2012</b><br><i>(In millions, except per share amounts)</i> | <b>Common<br/>Stock</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> | <b>Retained<br/>Earnings</b> | <b>Treasury<br/>Stock</b> | <b>Shareholder<br/>Equity</b> | <b>Noncontrolling<br/>Interest</b> | <b>Total<br/>Equity</b> |
|----------------------------------------------------------------------------------------------------------------------------|-------------------------|-------------------------------------------|---------------------------------------------------------|------------------------------|---------------------------|-------------------------------|------------------------------------|-------------------------|
| Balance at July 1, 2012, as retrospectively adjusted                                                                       | \$ 92                   | \$ 3,276                                  | \$ (671)                                                | \$ 11,501                    | \$ (5,176)                | \$ 9,022                      | \$ -                               | \$ 9,022                |
| Effect of issuing stock for employee benefit plans                                                                         |                         | 6                                         |                                                         | (5)                          | 8                         | 9                             |                                    | 9                       |
| Other comprehensive income                                                                                                 |                         |                                           | 118                                                     |                              |                           | 118                           |                                    | 118                     |
| Net income                                                                                                                 |                         |                                           |                                                         | 466                          |                           | 466                           | -                                  | 466                     |
| Repurchase of common stock                                                                                                 |                         |                                           |                                                         |                              | (85)                      | (85)                          |                                    | (85)                    |
| <b>Balance at September 30, 2012</b>                                                                                       | <b>\$ 92</b>            | <b>\$ 3,282</b>                           | <b>\$ (553)</b>                                         | <b>\$ 11,962</b>             | <b>\$ (5,253)</b>         | <b>\$ 9,530</b>               | <b>\$ -</b>                        | <b>\$ 9,530</b>         |

| <b>For the three months ended September 30, 2011</b><br><i>(In millions, except per share amounts)</i> | <b>Common<br/>Stock</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> | <b>Retained<br/>Earnings</b> | <b>Treasury<br/>Stock</b> | <b>Shareholder<br/>Equity</b> | <b>Noncontrolling<br/>Interest</b> | <b>Total<br/>Equity</b> |
|--------------------------------------------------------------------------------------------------------|-------------------------|-------------------------------------------|---------------------------------------------------------|------------------------------|---------------------------|-------------------------------|------------------------------------|-------------------------|
| Balance at July 1, 2011, as retrospectively adjusted                                                   | \$ 88                   | \$ 2,556                                  | \$ (446)                                                | \$ 10,336                    | \$ (5,318)                | \$ 7,216                      | \$ -                               | \$ 7,216                |
| Effect of issuing stock for employee benefit plans                                                     |                         | 5                                         |                                                         | (3)                          | 16                        | 18                            |                                    | 18                      |
| Other comprehensive income                                                                             |                         |                                           | 13                                                      |                              |                           | 13                            |                                    | 13                      |
| Net income                                                                                             |                         |                                           |                                                         | 183                          |                           | 183                           | -                                  | 183                     |
| <b>Balance at September 30, 2011</b>                                                                   | <b>\$ 88</b>            | <b>\$ 2,561</b>                           | <b>\$ (433)</b>                                         | <b>\$ 10,516</b>             | <b>\$ (5,302)</b>         | <b>\$ 7,430</b>               | <b>\$ -</b>                        | <b>\$ 7,430</b>         |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these statements.

Table of Contents**Cigna Corporation****Consolidated Statements of Changes in Total Equity****Unaudited**

| <b>For the nine months ended September 30, 2012</b><br><i>(In millions, except per share amounts)</i> | <b>Common<br/>Stock</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> | <b>Retained<br/>Earnings</b> | <b>Treasury<br/>Stock</b> | <b>Shareholder<br/>Equity</b> | <b>Noncontrolling<br/>Interest</b> | <b>Total<br/>Equity</b> |
|-------------------------------------------------------------------------------------------------------|-------------------------|-------------------------------------------|---------------------------------------------------------|------------------------------|---------------------------|-------------------------------|------------------------------------|-------------------------|
| Balance at January 1, 2012, as retrospectively adjusted                                               | \$ 92                   | \$ 3,188                                  | \$ (787)                                                | \$ 10,787                    | \$ (5,286)                | \$ 7,994                      | \$ -                               | \$ 7,994                |
| Effect of issuing stock for employee benefit plans                                                    |                         | 94                                        |                                                         | (31)                         | 118                       | 181                           |                                    | 181                     |
| Other comprehensive income                                                                            |                         |                                           | 234                                                     |                              |                           | 234                           |                                    | 234                     |
| Net income                                                                                            |                         |                                           |                                                         | 1,217                        |                           | 1,217                         | -                                  | 1,217                   |
| Common dividends declared (per share: \$0.04)                                                         |                         |                                           |                                                         | (11)                         |                           | (11)                          |                                    | (11)                    |
| Repurchase of common stock                                                                            |                         |                                           |                                                         | -                            | (85)                      | (85)                          |                                    | (85)                    |
| <b>Balance at September 30, 2012</b>                                                                  | <b>\$ 92</b>            | <b>\$ 3,282</b>                           | <b>\$ (553)</b>                                         | <b>\$ 11,962</b>             | <b>\$ (5,253)</b>         | <b>\$ 9,530</b>               | <b>\$ -</b>                        | <b>\$ 9,530</b>         |

| <b>For the nine months ended September 30, 2011</b><br><i>(In millions, except per share amounts)</i> | <b>Common<br/>Stock</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> | <b>Retained<br/>Earnings</b> | <b>Treasury<br/>Stock</b> | <b>Shareholder<br/>Equity</b> | <b>Noncontrolling<br/>Interest</b> | <b>Total<br/>Equity</b> |
|-------------------------------------------------------------------------------------------------------|-------------------------|-------------------------------------------|---------------------------------------------------------|------------------------------|---------------------------|-------------------------------|------------------------------------|-------------------------|
| Balance at January 1, 2011, as previously reported                                                    | \$ 88                   | \$ 2,534                                  | \$ (614)                                                | \$ 9,879                     | \$ (5,242)                | \$ 6,645                      | \$ 18                              | \$ 6,663                |
| Cumulative effect of amended accounting guidance for deferred policy acquisition costs                |                         |                                           |                                                         | (289)                        |                           | (289)                         |                                    | (289)                   |
| Balance at January 1, 2011, as retrospectively adjusted                                               | 88                      | 2,534                                     | (614)                                                   | 9,590                        | (5,242)                   | 6,356                         | 18                                 | 6,374                   |
| Effect of issuing stock for employee benefit plans                                                    |                         | 23                                        |                                                         | (50)                         | 165                       | 138                           |                                    | 138                     |
| Effect of acquiring noncontrolling interest                                                           |                         | 4                                         |                                                         |                              |                           | 4                             | (19)                               | (15)                    |
| Other comprehensive income                                                                            |                         |                                           | 181                                                     |                              |                           | 181                           |                                    | 181                     |
| Net income                                                                                            |                         |                                           |                                                         | 987                          |                           | 987                           | 1                                  | 988                     |
| Common dividends declared (per share: \$0.04)                                                         |                         |                                           |                                                         | (11)                         |                           | (11)                          |                                    | (11)                    |
| Repurchase of common stock                                                                            |                         |                                           |                                                         |                              | (225)                     | (225)                         |                                    | (225)                   |
| <b>Balance at September 30, 2011</b>                                                                  | <b>\$ 88</b>            | <b>\$ 2,561</b>                           | <b>\$ (433)</b>                                         | <b>\$ 10,516</b>             | <b>\$ (5,302)</b>         | <b>\$ 7,430</b>               | <b>\$ -</b>                        | <b>\$ 7,430</b>         |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these statements.



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# Cigna Corporation

## Consolidated Statements of Cash Flows

|                                                                                   | Unaudited<br>Nine Months Ended<br>September 30, |                |
|-----------------------------------------------------------------------------------|-------------------------------------------------|----------------|
|                                                                                   | 2012                                            | 2011           |
| <i>(In millions)</i>                                                              |                                                 |                |
| <b>Cash Flows from Operating Activities</b>                                       |                                                 |                |
| Net income                                                                        | \$ 1,217                                        | \$ 988         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                                 |                |
| Depreciation and amortization                                                     | 406                                             | 252            |
| Realized investment gains                                                         | (20)                                            | (56)           |
| Deferred income taxes                                                             | 67                                              | 182            |
| Gains on sale of businesses (excluding discontinued operations)                   | (14)                                            | (20)           |
| Net changes in assets and liabilities, net of non-operating effects:              |                                                 |                |
| Premiums, accounts and notes receivable                                           | (20)                                            | (133)          |
| Reinsurance recoverables                                                          | 50                                              | 8              |
| Deferred policy acquisition costs                                                 | (106)                                           | (106)          |
| Other assets                                                                      | 166                                             | (292)          |
| Insurance liabilities                                                             | 75                                              | 380            |
| Accounts payable, accrued expenses and other liabilities                          | (394)                                           | 293            |
| Current income taxes                                                              | 141                                             | (202)          |
| Other, net                                                                        | (11)                                            | (51)           |
| <b>Net cash provided by operating activities</b>                                  | <b>1,557</b>                                    | <b>1,243</b>   |
| <b>Cash Flows from Investing Activities</b>                                       |                                                 |                |
| Proceeds from investments sold:                                                   |                                                 |                |
| Fixed maturities                                                                  | 439                                             | 452            |
| Equity securities                                                                 | 8                                               | 5              |
| Commercial mortgage loans                                                         | 325                                             | 166            |
| Other (primarily short-term and other long-term investments)                      | 649                                             | 999            |
| Investment maturities and repayments:                                             |                                                 |                |
| Fixed maturities                                                                  | 1,030                                           | 943            |
| Commercial mortgage loans                                                         | 311                                             | 274            |
| Investments purchased:                                                            |                                                 |                |
| Fixed maturities                                                                  | (1,907)                                         | (2,309)        |
| Equity securities                                                                 | (8)                                             | (18)           |
| Commercial mortgage loans                                                         | (314)                                           | (279)          |
| Other (primarily short-term and other long-term investments)                      | (600)                                           | (1,169)        |
| Property and equipment purchases                                                  | (329)                                           | (291)          |
| Acquisitions and dispositions, net of cash acquired                               | (3,468)                                         | 1              |
| <b>Net cash used in investing activities</b>                                      | <b>(3,864)</b>                                  | <b>(1,226)</b> |
| <b>Cash Flows from Financing Activities</b>                                       |                                                 |                |
| Deposits and interest credited to contractholder deposit funds                    | 999                                             | 1,002          |
| Withdrawals and benefit payments from contractholder deposit funds                | (927)                                           | (895)          |
| Change in cash overdraft position                                                 | 19                                              | (57)           |
| Net change in short-term debt                                                     | 123                                             | (222)          |
| Issuance of long-term debt                                                        | -                                               | 587            |
| Repayment of long-term debt                                                       | (326)                                           | (2)            |
| Repurchase of common stock                                                        | (85)                                            | (225)          |
| Issuance of common stock                                                          | 58                                              | 100            |
| Common dividends paid                                                             | (11)                                            | (11)           |
| <b>Net cash (used in) / provided by financing activities</b>                      | <b>(150)</b>                                    | <b>277</b>     |
| Effect of foreign currency rate changes on cash and cash equivalents              | 3                                               | 3              |
| <b>Net (decrease) / increase in cash and cash equivalents</b>                     | <b>(2,454)</b>                                  | <b>297</b>     |

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|                                                     |          |          |
|-----------------------------------------------------|----------|----------|
| Cash and cash equivalents, January 1,               | 4,690    | 1,605    |
| Cash and cash equivalents, September 30,            | \$ 2,236 | \$ 1,902 |
| <b>Supplemental Disclosure of Cash Information:</b> |          |          |
| Income taxes paid, net of refunds                   | \$ 414   | \$ 466   |
| Interest paid                                       | \$ 186   | \$ 124   |

*The accompanying Notes to the Consolidated Financial Statements are an integral part of these statements.*

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# CIGNA CORPORATION

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

### **Note 1**    **Basis of Presentation**

Cigna Corporation is a holding company and is not an insurance company. Its subsidiaries conduct various businesses that are described in its Annual Report on Form 10-K for the year ended December 31, 2011 ( 2011 Form 10-K ). As used in this document, Cigna or the Company may refer to Cigna Corporation itself, one or more of its subsidiaries, or Cigna Corporation and its consolidated subsidiaries. The Consolidated Financial Statements include the accounts of Cigna Corporation and its significant subsidiaries. Intercompany transactions and accounts have been eliminated in consolidation. These Consolidated Financial Statements were prepared in conformity with accounting principles generally accepted in the United States of America ( GAAP ).

The Company is a global health services organization dedicated to helping its customers improve their health, well-being and sense of security. Its insurance subsidiaries are major providers of medical, dental, disability, life and accident insurance and related products and services, the majority of which are offered through employers and other groups (e.g. governmental and non-governmental organizations, unions and associations). Cigna also offers Medicare and Medicaid products and health, life and accident insurance coverages primarily to individuals in the U.S. and selected international markets. In addition to its ongoing operations described above, the Company also has certain run-off operations, including a Run-off Reinsurance segment.

The interim consolidated financial statements are unaudited but include all adjustments (including normal recurring adjustments) necessary, in the opinion of management, for a fair statement of financial position and results of operations for the periods reported. The interim consolidated financial statements and notes should be read in conjunction with the Consolidated Financial Statements and Notes in the Company's 2011 Form 10-K filed on February 27, 2012 and as updated by Cigna's Current Report on Form 8-K filed on August 8, 2012 (collectively, the 2011 Annual Report ).

The preparation of interim consolidated financial statements necessarily relies heavily on estimates. This and certain other factors, such as the seasonal nature of portions of the health care and related benefits business as well as competitive and other market conditions, call for caution in estimating full year results based on interim results of operations. Certain reclassifications have been made to prior period amounts to conform to the current presentation.

As explained further in Note 3, on August 31, 2012, the Company acquired Great American Supplemental Benefits Group for approximately \$310 million, and on January 31, 2012, the Company acquired HealthSpring, Inc. for approximately \$3.8 billion.

## Note 2 Recent Accounting Pronouncements

***Fees Paid to the Federal Government by Health Insurers (Accounting Standards Update ( ASU ) 2011-06)*** In 2011, the Financial Accounting Standards Board ( FASB ) issued accounting guidance for the health insurance industry assessment (the fee ) mandated by the Patient Protection and Affordable Care Act of 2010 ( Health Care Reform ). The fee will be levied on health insurers beginning in 2014 based on a ratio of an insurer's net health insurance premiums written for the previous calendar year compared to the U.S. health insurance industry total. In addition, because these fees will generally not be tax deductible, the Company's effective tax rate is expected to be adversely impacted in future periods. Under the guidance, the liability for the fee will be estimated and recorded in full each year beginning in 2014 when health insurance is first provided. A corresponding deferred cost will be recorded and amortized over the calendar year. The amount of the fees is expected to be material, although the Company is unable to estimate the impact of these fees on shareholders' net income and the effective tax rate because guidance for these calculations has not been finalized.

***Deferred policy acquisition costs.*** Effective January 1, 2012, the Company adopted the FASB's amended guidance (ASU 2010-26) on accounting for costs to acquire or renew insurance contracts. This guidance requires certain sales compensation and telemarketing costs related to unsuccessful efforts and any indirect costs to be expensed as incurred. The Company's deferred acquisition costs arise from sales and renewal activities primarily in its supplemental health, life and accident business reported in the International segment. This amended guidance was implemented through retrospective adjustment of comparative prior periods. As reported in the Consolidated Statement of Equity, the cumulative effect of adopting the amended accounting guidance as of January 1, 2011 was a reduction in Total Shareholders' Equity of \$289 million. Full-year 2011 shareholders' net income on a retrospectively adjusted basis was reduced by \$67 million, partially offset by increased foreign currency translation of \$6 million, resulting in a cumulative impact on Total Shareholders' Equity as of December 31, 2011 of \$350 million. Summarized below are the effects of the amended guidance on previously reported amounts for the three months and nine months ended September 30, 2011. This implementation had no impact on the underlying economic value or cash flows of the Company's businesses, nor did it impact the Company's liquidity or the statutory surplus of its insurance subsidiaries.

Table of Contents**Condensed Consolidated Statement of Income****Three Months Ended September 30, 2011**

| <i>(in millions)</i>                                      | As previously<br>reported | Effect of amended<br>accounting guidance | As retrospectively<br>adjusted |
|-----------------------------------------------------------|---------------------------|------------------------------------------|--------------------------------|
| Revenues, excluding other revenues                        | \$ 5,426                  | \$                                       | \$ 5,426                       |
| Other revenues                                            | 187                       | (3)                                      | 184                            |
| Total revenues                                            | 5,613                     | (3)                                      | 5,610                          |
| Benefits and expenses, excluding other operating expenses | 3,819                     |                                          | 3,819                          |
| Other operating expenses                                  | 1,497                     | 21                                       | 1,518                          |
| Total benefits and expenses                               | 5,316                     | 21                                       | 5,337                          |
| Income before income taxes                                | 297                       | (24)                                     | 273                            |
| Current income taxes                                      | 114                       |                                          | 114                            |
| Deferred income taxes                                     | (17)                      | (7)                                      | (24)                           |
| Total taxes                                               | 97                        | (7)                                      | 90                             |
| Net income                                                | 200                       | (17)                                     | 183                            |
| Less: net income attributable to noncontrolling interest  | -                         |                                          | -                              |
| <b>Shareholders' Net Income</b>                           | <b>\$ 200</b>             | <b>\$ (17)</b>                           | <b>\$ 183</b>                  |
| Earnings per share:                                       |                           |                                          |                                |
| Basic                                                     | \$ 0.74                   | \$ (0.06)                                | \$ 0.68                        |
| Diluted                                                   | \$ 0.74                   | \$ (0.07)                                | \$ 0.67                        |

**Condensed Consolidated Statement of Income****Nine Months Ended September 30, 2011**

| <i>(in millions)</i>                                      | As previously<br>reported | Effect of amended<br>accounting guidance | As retrospectively<br>adjusted |
|-----------------------------------------------------------|---------------------------|------------------------------------------|--------------------------------|
| Revenues, excluding other revenues                        | \$ 16,239                 | \$                                       | \$ 16,239                      |
| Other revenues                                            | 296                       | (7)                                      | 289                            |
| Total revenues                                            | 16,535                    | (7)                                      | 16,528                         |
| Benefits and expenses, excluding other operating expenses | 10,568                    |                                          | 10,568                         |
| Other operating expenses                                  | 4,454                     | 62                                       | 4,516                          |
| Total benefits and expenses                               | 15,022                    | 62                                       | 15,084                         |
| Income before income taxes                                | 1,513                     | (69)                                     | 1,444                          |
| Current income taxes                                      | 274                       |                                          | 274                            |
| Deferred income taxes                                     | 201                       | (19)                                     | 182                            |
| Total taxes                                               | 475                       | (19)                                     | 456                            |
| Net income                                                | 1,038                     | (50)                                     | 988                            |
| Less: net income attributable to noncontrolling interest  | 1                         |                                          | 1                              |
| <b>Shareholders' Net Income</b>                           | <b>\$ 1,037</b>           | <b>\$ (50)</b>                           | <b>\$ 987</b>                  |
| Earnings per share:                                       |                           |                                          |                                |
| Basic                                                     | \$ 3.85                   | \$ (0.18)                                | \$ 3.67                        |
| Diluted                                                   | \$ 3.80                   | \$ (0.18)                                | \$ 3.62                        |

Table of Contents**Condensed Consolidated Balance sheet****As of December 31, 2011**

| <i>(in millions)</i>                      | As previously reported | Effect of amended accounting guidance | As retrospectively adjusted |
|-------------------------------------------|------------------------|---------------------------------------|-----------------------------|
| Deferred policy acquisition costs         | \$ 1,312               | \$ (495)                              | \$ 817                      |
| Deferred income taxes, net                | 632                    | 171                                   | 803                         |
| Other assets, including other intangibles | 1,776                  | (26)                                  | 1,750                       |
| All other assets                          | 47,327                 |                                       | 47,327                      |
| <b>Total assets</b>                       | <b>\$ 51,047</b>       | <b>\$ (350)</b>                       | <b>\$ 50,697</b>            |
| Net translation of foreign currencies     | \$ (3)                 | \$ 6                                  | \$ 3                        |
| Retained earnings                         | 11,143                 | (356)                                 | 10,787                      |
| Other shareholders' equity                | (2,796)                |                                       | (2,796)                     |
| <b>Total shareholders' equity</b>         | <b>\$ 8,344</b>        | <b>\$ (350)</b>                       | <b>\$ 7,994</b>             |

**Condensed Consolidated Statement of Cash Flows****Nine Months Ended September 30, 2011**

| <i>(in millions)</i>                 | As previously reported | Effect of amended accounting guidance | As retrospectively adjusted |
|--------------------------------------|------------------------|---------------------------------------|-----------------------------|
| Net income                           | \$ 1,038               | \$ (50)                               | \$ 988                      |
| Deferred income taxes                | 201                    | (19)                                  | 182                         |
| Deferred policy acquisition expenses | (168)                  | 62                                    | (106)                       |
| Other assets                         | (299)                  | 7                                     | (292)                       |

**Note 16****Segment information: International**

| <i>(in millions)</i>                 | Three Months Ended September 30, 2011 |                                       |                             | Nine Months Ended September 30, 2011 |                                       |                             |
|--------------------------------------|---------------------------------------|---------------------------------------|-----------------------------|--------------------------------------|---------------------------------------|-----------------------------|
|                                      | As previously reported                | Effect of amended accounting guidance | As retrospectively adjusted | As previously reported               | Effect of amended accounting guidance | As retrospectively adjusted |
| Premiums and fees and other revenues | \$ 771                                | \$ (3)                                | \$ 768                      | \$ 2,219                             | \$ (7)                                | \$ 2,212                    |
| Segment earnings                     | 79                                    | (17)                                  | 62                          | 230                                  | (50)                                  | 180                         |

**Presentation of Comprehensive Income.** Effective January 1, 2012, the Company adopted the FASB's amended guidance (ASU 2011-05) that requires presenting net income and other comprehensive income in either a single continuous statement or in two separate, but consecutive statements. Neither measurement of comprehensive income nor disclosure requirements for reclassification adjustments between other comprehensive income and net income were affected by this amended guidance. The Company has elected to present a separate statement of comprehensive income following the statement of income and has retrospectively adjusted prior periods to conform to the new presentation, as

required.

***Amendments to Fair Value Measurement and Disclosure.*** Effective January 1, 2012, the Company adopted the FASB's amended guidance on fair value measurement and disclosure (ASU 2011-04) on a prospective basis. A key objective was to achieve common fair value measurement and disclosure requirements between U.S. GAAP and IFRS. The amended guidance changes certain fair value measurement principles and expands required disclosures to include quantitative and qualitative information about unobservable inputs in Level 3 measurements and leveling for financial instruments not carried at fair value in the financial statements. Upon adoption, there were no effects on the Company's fair value measurements. See Note 8 for expanded fair value disclosures.

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## Note 3 Acquisitions

The Company may from time to time acquire or dispose of assets, subsidiaries or lines of business. Significant transactions are described below.

### A. Joint Venture Agreement with Finansbank

During the fourth quarter of 2012, subject to regulatory approval, the Company expects to acquire 51% of the total issued and outstanding shares of Finans Emeklilik ve Hayat A.S. (Finans Emeklilik) from Finansbank A.S. (Finansbank), a Turkish retail bank, for a purchase price of 85 million, or approximately \$110 million. Finansbank would continue to hold 49% of the total issued and outstanding shares. Finans Emeklilik operates in life insurance, accident insurance and pension product markets. The transaction is expected to be financed with internal cash resources. The acquisition will provide Cigna opportunities to reach and serve the growing middle class market in Turkey through Finansbank's network of retail banking branches.

### B. Acquisition of Great American Supplemental Benefits Group

On August 31, 2012, the Company acquired Great American Supplemental Benefits Group, one of the largest providers of supplemental health insurance products in the U.S., for approximately \$310 million in cash from internal resources. The acquisition provides the Company with an increased presence in the Medicare supplemental benefits market. It also extends the Company's global direct-to-consumer retail channel as well as further enhances its distribution network of agents and brokers. Results of this business are reported in the supplemental health, life and accident business included in the International segment.

In accordance with GAAP, the total purchase price has been allocated to the tangible and intangible net assets acquired based on management's preliminary estimates of their fair value and may change as additional information becomes available over the next several months. Accordingly, approximately \$95 million was allocated to intangible assets, primarily the value of business acquired (VOBA) that represents the present value of the estimated net cash flows from the long duration contracts in force. The VOBA asset will be amortized in proportion to premium recognized over the life of the contracts that is estimated to be 30 years. Amortization of the VOBA asset is expected to be higher in early years and decline as policies lapse. Goodwill has been provisionally allocated to the International segment; it has not yet been allocated to a reporting unit as of September 30, 2012. Substantially all of the goodwill is tax deductible and will be amortized over the next 15 years for federal income tax purposes.

The condensed balance sheet at the acquisition date was as follows:

*(In millions)*

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|                                                                                                          |    |            |
|----------------------------------------------------------------------------------------------------------|----|------------|
| Investments                                                                                              | \$ | 211        |
| Cash and cash equivalents                                                                                |    | 36         |
| Reinsurance recoverables                                                                                 |    | 448        |
| Goodwill                                                                                                 |    | 161        |
| Value of business acquired (reported in Deferred policy acquisition costs in Consolidated Balance Sheet) |    | 71         |
| Other assets, including other intangibles                                                                |    | 36         |
| <b>Total assets acquired</b>                                                                             |    | <b>963</b> |
| Insurance liabilities                                                                                    |    | 634        |
| Accounts payable, accrued expenses and other liabilities                                                 |    | 22         |
| <b>Total liabilities acquired</b>                                                                        |    | <b>656</b> |
| Net assets acquired                                                                                      | \$ | 307        |

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The results of Great American Supplemental Benefits have been included in the Company's Consolidated Financial Statements from the date of acquisition and were not considered material to the Company's consolidated results of operations. The pro forma effect on total revenues and net income assuming the acquisition had occurred as of January 1, 2011 is not presented as they were not material to the Company's total revenues or shareholders' net income for the three months and nine months ended September 30, 2012 and 2011.

## C. Acquisition of HealthSpring, Inc.

On January 31, 2012 the Company acquired the outstanding shares of HealthSpring, Inc. ( "HealthSpring" ) for \$55 per share in cash and Cigna stock awards, representing a cost of approximately \$3.8 billion. HealthSpring provides Medicare Advantage coverage in 11 states and the District of Columbia, as well as a large, national stand-alone Medicare prescription drug business. The acquisition of HealthSpring strengthens the Company's ability to serve individuals across their life stages as well as deepens its presence in a number of geographic markets. The addition of HealthSpring brings industry leading physician partnership capabilities and creates the opportunity to deepen the Company's existing client and customer relationships, as well as facilitates a broader deployment of its range of health and wellness capabilities and product offerings. The Company funded the acquisition with internal cash resources.

*Merger consideration:* The estimated merger consideration of \$3.8 billion was calculated as follows:

*(In millions, except per share amounts)*

|                                                                  |           |              |
|------------------------------------------------------------------|-----------|--------------|
| HealthSpring, Inc. common shares outstanding at January 30, 2012 |           | 67.8         |
| Less: common shares outstanding not settled in cash              |           | (0.1)        |
| Common shares settled in cash                                    |           | 67.7         |
| Price per share                                                  | \$        | 55           |
| Cash consideration for outstanding shares                        | \$        | 3,725        |
| Fair value of share-based compensation awards                    |           | 65           |
| Additional cash and equity consideration                         |           | 21           |
| <b>Total merger consideration</b>                                | <b>\$</b> | <b>3,811</b> |

**Fair value of share-based compensation awards.** On the date of the acquisition, HealthSpring employees' awards of options and restricted shares of HealthSpring stock were rolled over to Cigna stock options and restricted stock. Each holder of a HealthSpring stock option or restricted stock award received 1.24 Cigna stock options or restricted stock awards. The conversion ratio of 1.24 at the date of acquisition was determined by dividing the acquisition price of HealthSpring shares of \$55 per share by the price of Cigna stock on January 31, 2012 of \$44.43. The Cigna stock option exercise price was determined by using this same conversion ratio. Vesting periods and the remaining life of the options rolled over with the original HealthSpring awards.

Using fair value as of the acquisition date, the Company valued the restricted stock at Cigna's stock price and stock options using a Black-Scholes pricing model. The assumptions used were generally consistent with those disclosed in Note 20 to the Company's 2011 Consolidated Financial Statements included in the 2011 Annual Report, except the expected life assumption of these options ranged from 1.8 to 4.8 years and the exercise price did not equal the market value at the grant date. Because the exercise price at the acquisition date for substantially all of the options was significantly below Cigna's stock price, fair value of the new stock options approximated intrinsic value.

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The fair value of these options and restricted stock was included in the purchase price to the extent that services had been provided prior to the acquisition based on the grant date of the original HealthSpring awards and vesting periods. The remaining fair value not included in the purchase price will be recorded as compensation expense in future periods over the remaining vesting periods. Most of the expense is expected to be recognized in 2012 and 2013.

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The following table summarizes the effect of these rollover awards for former HealthSpring employees.

|                                                                             | Number of    | Average exercise/ | Fair value   | Included in    | Compensation expense |
|-----------------------------------------------------------------------------|--------------|-------------------|--------------|----------------|----------------------|
| <i>(Awards in thousands, dollars in millions, except per share amounts)</i> | awards       | award price       | of awards    | purchase price | post-acquisition     |
| Vested options                                                              | 589          | \$ 14.04          | \$ 18        | \$ 18          | \$ -                 |
| Unvested options                                                            | 1,336        | \$ 16.21          | 37           | 28             | 9                    |
| Restricted stock                                                            | 786          | \$ 44.43          | 35           | 19             | 16                   |
| <b>Total</b>                                                                | <b>2,711</b> |                   | <b>\$ 90</b> | <b>\$ 65</b>   | <b>\$ 25</b>         |

**Purchase price allocation.** In accordance with GAAP, the total purchase price has been allocated to the tangible and intangible net assets acquired based on management's preliminary estimates of their fair values and may change as additional information becomes available over the next several months. Goodwill has been allocated to the Medicare operating segment as of September 30, 2012 and is not deductible for federal income tax purposes. During the nine months ended September 30, 2012, the Company recorded \$53 million pre-tax (\$40 million after-tax) of acquisition-related costs in other operating expenses. The condensed balance sheet of HealthSpring at the acquisition date was as follows:

|                                         |                 |
|-----------------------------------------|-----------------|
| <i>(In millions)</i>                    |                 |
| Investments                             | \$ 612          |
| Cash and cash equivalents               | 492             |
| Premiums, accounts and notes receivable | 320             |
| Goodwill                                | 2,545           |
| Intangible assets                       | 795             |
| Other                                   | 91              |
| <b>Total assets acquired</b>            | <b>4,855</b>    |
| Insurance liabilities                   | 505             |
| Deferred income taxes                   | 213             |
| Debt                                    | 326             |
| <b>Total liabilities acquired</b>       | <b>1,044</b>    |
| <b>Net assets acquired</b>              | <b>\$ 3,811</b> |

In accordance with debt covenants, HealthSpring's debt obligation was paid immediately following the acquisition. This repayment is reported as a financing activity in the statement of cash flows for the nine months ended September 30, 2012.

The estimated fair values and useful lives for all intangible assets are as follows:

|                                      | Estimated Fair Value | Estimated Useful Life (In Years) |
|--------------------------------------|----------------------|----------------------------------|
| <i>(Dollars in millions)</i>         |                      |                                  |
| Customer relationships               | \$ 711               | 8                                |
| Other                                | 84                   | 3-10                             |
| <b>Total other intangible assets</b> | <b>\$ 795</b>        |                                  |

The fair value of the customer relationship and the amortization method were determined using an income approach that relies on projected future net cash flows including key assumptions for the customer attrition rate and discount rate. The estimated weighted average useful life reflects the time period and pattern of use that Cigna expects for over 90% of the projected benefits. Accordingly, amortization will be recorded on an accelerated basis in 2012 and decline in subsequent years.

The results of HealthSpring have been included in the Company's Consolidated Financial Statements from the date of the acquisition. Revenues of HealthSpring included in the Company's results for the nine months ended September 30, 2012 were approximately \$4.0 billion.

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**Pro forma information.** The following table presents selected unaudited pro forma information for the Company assuming the acquisition of HealthSpring had occurred as of January 1, 2011. This pro forma information does not purport to represent what the Company's actual results would have been if the acquisition had occurred as of the date indicated or what such results would be for any future periods.

| (In millions, except per share amounts) | Three Months Ended | Nine Months Ended September 30, |           |
|-----------------------------------------|--------------------|---------------------------------|-----------|
|                                         | September 30, 2011 | 2012                            | 2011      |
| Total revenues                          | \$ 6,940           | \$ 22,092                       | \$ 20,639 |
| Shareholders' net income                | \$ 229             | \$ 1,227                        | \$ 1,096  |
| Earnings per share:                     |                    |                                 |           |
| Basic                                   | \$ 0.80            | \$ 4.30                         | \$ 3.84   |
| Diluted                                 | \$ 0.79            | \$ 4.23                         | \$ 3.78   |

## D. Acquisition of FirstAssist

In November 2011, the Company acquired FirstAssist Group Holdings Limited (FirstAssist) for approximately \$115 million, which was financed with cash. FirstAssist is based in the United Kingdom and provides travel and protection insurance services that the Company expects will enhance its individual business in the U.K. and around the world.

In accordance with GAAP, the total purchase price has been allocated to the tangible and intangible net assets acquired based on management's estimates of their fair values. During 2012, the Company updated its allocation of the purchase price based on additional information. Accordingly, the allocation to intangible assets was decreased by \$18 million from \$58 million reported at December 31, 2011 to \$40 million. The allocation to goodwill was increased by \$8 million from \$56 million reported at December 31, 2011 to \$64 million. Goodwill is reported in the International segment.

The results of FirstAssist are included in the Company's Consolidated Financial Statements from the date of acquisition. The pro forma effects assuming the acquisition had occurred as of January 1, 2010 were not material to the Company's total revenues, shareholders' net income and earnings per share for the three months and nine months ended September 30, 2011.

Table of Contents**Note 4 Earnings Per Share ( EPS )**

Basic and diluted earnings per share were computed as follows:

| <i>(Dollars in millions, except per share amounts)</i> | <b>Basic</b> |         | <b>Effect of Dilution</b> |        | <b>Diluted</b> |
|--------------------------------------------------------|--------------|---------|---------------------------|--------|----------------|
| Three Months Ended September 30,                       |              |         |                           |        |                |
| <b>2012</b>                                            |              |         |                           |        |                |
| Shareholders' net income                               | \$           | 466     |                           | \$     | 466            |
| Shares <i>(in thousands)</i> :                         |              |         |                           |        |                |
| Weighted average                                       |              | 284,891 |                           |        | 284,891        |
| Common stock equivalents                               |              |         | 4,984                     |        | 4,984          |
| Total shares                                           |              | 284,891 | 4,984                     |        | 289,875        |
| EPS                                                    | \$           | 1.64    | \$                        | (0.03) | \$ 1.61        |
| <b>2011</b>                                            |              |         |                           |        |                |
| Shareholders' net income                               | \$           | 183     |                           | \$     | 183            |
| Shares <i>(in thousands)</i> :                         |              |         |                           |        |                |
| Weighted average                                       |              | 268,569 |                           |        | 268,569        |
| Common stock equivalents                               |              |         | 3,491                     |        | 3,491          |
| Total shares                                           |              | 268,569 | 3,491                     |        | 272,060        |
| EPS                                                    | \$           | 0.68    | \$                        | (0.01) | \$ 0.67        |

  

| <i>(Dollars in millions, except per share amounts)</i> | <b>Basic</b> |         | <b>Effect of Dilution</b> |        | <b>Diluted</b> |
|--------------------------------------------------------|--------------|---------|---------------------------|--------|----------------|
| Nine Months Ended September 30,                        |              |         |                           |        |                |
| <b>2012</b>                                            |              |         |                           |        |                |
| Shareholders' net income                               | \$           | 1,217   |                           | \$     | 1,217          |
| Shares <i>(in thousands)</i> :                         |              |         |                           |        |                |
| Weighted average                                       |              | 285,247 |                           |        | 285,247        |
| Common stock equivalents                               |              |         | 4,560                     |        | 4,560          |
| Total shares                                           |              | 285,247 | 4,560                     |        | 289,807        |
| EPS                                                    | \$           | 4.27    | \$                        | (0.07) | \$ 4.20        |
| <b>2011</b>                                            |              |         |                           |        |                |
| Shareholders' net income                               | \$           | 987     |                           | \$     | 987            |
| Shares <i>(in thousands)</i> :                         |              |         |                           |        |                |
| Weighted average                                       |              | 269,163 |                           |        | 269,163        |
| Common stock equivalents                               |              |         | 3,721                     |        | 3,721          |
| Total shares                                           |              | 269,163 | 3,721                     |        | 272,884        |
| EPS                                                    | \$           | 3.67    | \$                        | (0.05) | \$ 3.62        |

In 2012, the Company adopted, as required, amended accounting guidance for deferred acquisition costs by selecting retrospective adjustment of prior periods. See Note 2 for the effect of this new guidance on previously reported EPS amounts.

The following outstanding employee stock options were not included in the computation of diluted earnings per share because their effect would have increased diluted earnings per share (antidilutive) as their exercise price was greater than the average share price of the Company's common stock for the period.

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| (In millions)        | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |      |
|----------------------|-------------------------------------|------|------------------------------------|------|
|                      | 2012                                | 2011 | 2012                               | 2011 |
| Antidilutive options | 3.9                                 | 3.9  | 3.4                                | 3.6  |

The Company held 79,439,106 shares of common stock in Treasury as of September 30, 2012, and 80,697,257 shares as of September 30, 2011.

Table of Contents**Note 5 Health Care Medical Claims Payable**

Medical claims payable for the Health Care segment reflects estimates of the ultimate cost of claims that have been incurred but not yet reported, those that have been reported but not yet paid (reported claims in process) and other medical expense payable, that primarily comprises accruals for incentives and other amounts payable to health care professionals and facilities. Incurred but not yet reported is the majority of the reserve balance as follows:

| <i>(In millions)</i>                                   | September 30,<br>2012 | December 31,<br>2011 |
|--------------------------------------------------------|-----------------------|----------------------|
| Incurred but not yet reported                          | \$ 1,372              | \$ 952               |
| Reported claims in process                             | 132                   | 129                  |
| Physician incentives and other medical expense payable | 77                    | 14                   |
| <b>Medical claims payable</b>                          | <b>\$ 1,581</b>       | <b>\$ 1,095</b>      |

Activity in medical claims payable was as follows:

| <i>(In millions)</i>                            | For the period ended<br>September 30,<br>2012 | December 31,<br>2011 |
|-------------------------------------------------|-----------------------------------------------|----------------------|
| Balance at January 1,                           | \$ 1,095                                      | \$ 1,246             |
| Less: Reinsurance and other amounts recoverable | 194                                           | 236                  |
| Balance at January 1, net                       | 901                                           | 1,010                |
| Acquired HealthSpring balances, net             | 504                                           | -                    |
| Incurred claims related to:                     |                                               |                      |
| Current year                                    | 9,875                                         | 8,308                |
| Prior years                                     | (164)                                         | (126)                |
| Total incurred                                  | 9,711                                         | 8,182                |
| Paid claims related to:                         |                                               |                      |
| Current year                                    | 8,555                                         | 7,450                |
| Prior years                                     | 1,166                                         | 841                  |
| Total paid                                      | 9,721                                         | 8,291                |
| Ending Balance, net                             | 1,395                                         | 901                  |
| Add: Reinsurance and other amounts recoverable  | 186                                           | 194                  |
| <b>Ending Balance</b>                           | <b>\$ 1,581</b>                               | <b>\$ 1,095</b>      |

Reinsurance and other amounts recoverable reflect amounts due from reinsurers and policyholders to cover incurred but not reported and pending claims for minimum premium products and certain administrative services only business where the right of offset does not exist. See Note 12 for additional information on reinsurance. For the nine months ended September 30, 2012, actual experience differed from the Company's key assumptions resulting in favorable incurred claims related to prior years' medical claims payable of \$164 million, or 2.0% of the current year incurred claims as reported for the year ended December 31, 2011. Actual completion factors accounted for \$76 million, or 0.9% of the favorability while actual medical cost trend resulted in the remaining \$88 million, or 1.1%.

For the year ended December 31, 2011, actual experience differed from the Company's key assumptions, resulting in favorable incurred claims related to prior years' medical claims payable of \$126 million, or 1.5% of the current year incurred claims as reported for the year ended

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December 31, 2010. Actual completion factors accounted for \$87 million favorability while actual medical cost trend resulted in the remaining \$39 million.

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The corresponding impact of prior year development on shareholders' net income, including HealthSpring, was \$61 million for the nine months ended September 30, 2012 compared with \$52 million for the nine months ended September 30, 2011. The favorable effect of prior year development on net income in 2012 and 2011 primarily reflects low utilization of medical services. The change in the amount of the incurred claims related to prior years in the medical claims payable liability does not directly correspond to an increase or decrease in the Company's shareholders' net income recognized for the following reasons:

First, the Company consistently recognizes the actuarial best estimate of the ultimate liability within a level of confidence, as required by actuarial standards of practice, that require the liabilities be adequate under moderately adverse conditions. As the Company establishes the liability for each incurral year, the Company ensures that its assumptions appropriately consider moderately adverse conditions. When a portion of the development related to the prior year incurred claims is offset by an increase determined appropriate to address moderately adverse conditions for the current year incurred claims, the Company does not consider that offset amount as having any impact on shareholders' net income.

Second, as a result of the adoption of the commercial minimum medical loss ratio (MLR) provisions of the Patient Protection and Affordable Care Act in 2011, changes in medical claim estimates due to prior year development may be offset by a change in the MLR rebate accrual.

Third, changes in reserves for the Company's retrospectively experience-rated business do not always impact shareholders' net income. For the Company's retrospectively experience-rated business only adjustments to medical claims payable on accounts in deficit affect shareholders' net income. An increase or decrease to medical claims payable on accounts in deficit, in effect, accrues to the Company and directly impacts shareholders' net income. An account is in deficit when the accumulated medical costs and administrative charges, including profit charges, exceed the accumulated premium received. Adjustments to medical claims payable on accounts in surplus accrue directly to the policyholder with no impact on the Company's shareholders' net income. An account is in surplus when the accumulated premium received exceeds the accumulated medical costs and administrative charges, including profit charges.

The determination of liabilities for Health Care medical claims payable requires the Company to make critical accounting estimates. See Note 2(N) to the Consolidated Financial Statements in the Company's 2011 Annual Report.

## **Note 6 Realignment and Efficiency Plan**

During the third quarter of 2012, the Company, in connection with the execution of its strategy, committed to a series of actions to further improve its organizational alignment, operational effectiveness, and efficiency. As a result, the Company recognized charges in other operating expenses of \$77 million pre-tax (\$50 million after-tax) in the third quarter of 2012 consisting primarily of severance costs. The Health Care segment reported \$60 million pre-tax (\$39 million after-tax) of the charge. The remainder was reported as follows: \$14 million pre-tax (\$9 million after-tax) in International and \$3 million pre-tax (\$2 million after-tax) in Disability and Life. The severance costs are expected to be substantially paid in 2013.



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## **Note 7 Guaranteed Minimum Death Benefit Contracts**

The Company had future policy benefit reserves for guaranteed minimum death benefit ( GMDB ) contracts of \$1.1 billion as of September 30, 2012 and \$1.2 billion as of December 31, 2011. The determination of liabilities for GMDB requires the Company to make critical accounting estimates. The Company estimates its liabilities for GMDB exposures using an internal model using many scenarios and based on assumptions regarding lapse, future partial surrenders, claim mortality (deaths that result in claims), interest rates (mean investment performance and discount rate) and volatility. These assumptions are based on the Company's experience and future expectations over an extended period, consistent with the long-term nature of this product. The Company regularly evaluates these assumptions and changes its estimates if actual experience or other evidence suggests that assumptions should be revised. If actual experience differs from the assumptions used in estimating these liabilities, the result could have a material adverse effect on the Company's consolidated results of operations, and in certain situations, could have a material adverse effect on the Company's financial condition.

In 2000, the Company determined that the GMDB reinsurance business was premium deficient because the recorded future policy benefit reserve was less than the expected present value of future claims and expenses less the expected present value of future premiums and investment income using revised assumptions based on actual and expected experience. The Company tests for premium deficiency by reviewing its reserve each quarter using current market conditions and its long-term assumptions. Under premium deficiency accounting, if the recorded reserve is determined insufficient, an increase to the reserve is reflected as a charge to current period income. Consistent with GAAP, the Company does not recognize gains on premium deficient long duration products.

See Note 10 for further information on the Company's dynamic hedge programs that are used to reduce certain equity and interest rate exposures associated with this business.

The Company's normal reviews of reserves resulted in charges to strengthen GMDB reserves of \$10 million (\$6 million after-tax) for the three months and \$43 million (\$27 million after-tax) for the nine months ended September 30, 2012. These charges were reported in other benefit expenses. The third quarter charge primarily reflects adverse interest rate impacts reflecting management's consideration of the anticipated impact of continued low short-term interest rates. This evaluation also led management to lower the mean investment performance for equity funds from 4.75% to 4.00% for those funds not subject to the growth interest rate hedge program. This impact was partially offset by favorable equity market conditions. For the nine months ended September 30, 2012 the charges were also due to the update of long-term assumptions described below, including a decrease in assumed lapses and, to a lesser extent, an increase in the volatility assumption.

Since December 31, 2011, the Company has updated the following long-term assumptions for GMDB based on a review of experience:

- The mean investment performance for equity funds not subject to the growth interest rate hedge program was updated from 4.75% at December 31, 2011 to 4.00% at September 30, 2012. This change was a result of a review of interest rates completed in the third quarter of 2012. The effect of this update was an increase to the reserve.

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- The lapse assumptions for the entire block were updated during the course of the first three quarters. The lapse rate varies depending on contract type, policy duration, and the ratio of the net amount at risk to account value. As a result of this update, the overall range of lapses for the entire block of business changed from 0% to 24% at December 31, 2011 to 0% to 12% at September 30, 2012. The effect of this update was an increase in the reserve.
- The reserves include an estimate for partial surrenders, that essentially lock in the death benefit for a particular policy based on annual election rates, depending on the net amount at risk for each policy and whether surrender charges apply. The election rates were updated from 0% - 15% at December 31, 2011 to 0% - 13% at September 30, 2012. The effect of this update was a decrease in the reserve.
- The volatility assumption was updated to use a review of historical weekly returns for each index (e.g. S&P 500) for a 20-year period. Volatility represents the dispersion of historical returns compared to the average historical return (standard deviation) for each index. The volatility assumption for equity fund types has been updated from 16% - 25% at December 31, 2011 to 18% - 24% at September 30, 2012; for bond funds from 4% - 10% at December 31, 2011 to 5% - 7% at September 30, 2012; and for money market funds from 2% at December 31, 2011 to 0% - 1% at September 30, 2012. The degree of correlation between asset classes was also updated. The effect of these updates was an increase in the reserve.

During 2011, the Company completed its normal review of reserves (including assumptions) and recorded additional other benefit expenses of \$70 million (\$45 million after-tax) to strengthen GMDB reserves. The reserve strengthening was driven primarily by an adverse impact of \$34 million (\$22 million after-tax) due to volatile equity market conditions, adverse interest rate impacts of \$23 million (\$15 million after-tax) reflecting management's consideration of the anticipated impact of continued low short-term interest rates and adverse impacts of overall market declines in the third quarter of \$13 million (\$8 million after-tax), that included an increase in the provision for expected future partial surrenders and declines in the value of contractholders' non-equity investments.

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Activity in future policy benefit reserves for the GMDB business was as follows:

|                                                 | For the period ended  |                      |
|-------------------------------------------------|-----------------------|----------------------|
|                                                 | September 30,<br>2012 | December 31,<br>2011 |
| <i>(In millions)</i>                            |                       |                      |
| Balance at January 1                            | \$ 1,170              | \$ 1,138             |
| Add: Unpaid Claims                              | 40                    | 37                   |
| Less: Reinsurance and other amounts recoverable | 53                    | 51                   |
| Balance at January 1, net                       | 1,157                 | 1,124                |
| Add: Incurred benefits                          | 9                     | 138                  |
| Less: Paid benefits                             | 79                    | 105                  |
| Ending balance, net                             | 1,087                 | 1,157                |
| Less: unpaid claims                             | 28                    | 40                   |
| Add: Reinsurance and other amounts recoverable  | 46                    | 53                   |
| <b>Ending balance</b>                           | <b>\$ 1,105</b>       | <b>\$ 1,170</b>      |

Benefits paid and incurred are net of ceded amounts. Incurred benefits reflect the favorable or unfavorable impact of a rising or falling equity market on the liability, and include the charges discussed above.

The aggregate value of the underlying mutual fund investments was \$13.7 billion as of September 30, 2012 and \$13.8 billion as of December 31, 2011. The death benefit coverage in force was \$4.2 billion as of September 30, 2012 and \$5.4 billion as of December 31, 2011. The death benefit coverage in force represents the excess of the guaranteed benefit amount over the value of the underlying mutual fund investments for all contractholders (approximately 445,000 as of September 30, 2012 and 480,000 as of December 31, 2011).

The Company has also written reinsurance contracts with issuers of variable annuity contracts that provide annuitants with certain guarantees related to minimum income benefits ( GMIB ). All reinsured GMIB policies also have a GMDB benefit reinsured by the Company. See Note 8 for further information.

## Note 8 Fair Value Measurements

The Company carries certain financial instruments at fair value in the financial statements including fixed maturities, equity securities, short-term investments and derivatives. Other financial instruments are measured at fair value under certain conditions, such as when impaired.

Fair value is defined as the price at which an asset could be exchanged in an orderly transaction between market participants at the balance sheet date. A liability's fair value is defined as the amount that would be paid to transfer the liability to a market participant, not the amount that would

be paid to settle the liability with the creditor.

Fair values are based on quoted market prices when available. When market prices are not available, fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality. In instances where there is little or no market activity for the same or similar instruments, the Company estimates fair value using methods, models and assumptions that the Company believes a hypothetical market participant would use to determine a current transaction price. These valuation techniques involve some level of estimation and judgment by the Company which becomes significant with increasingly complex instruments or pricing models.

The Company's financial assets and liabilities carried at fair value have been classified based upon a hierarchy defined by GAAP. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest ranking to fair values determined using methodologies and models with significant unobservable inputs (Level 3). An asset's or a liability's classification is based on the lowest level of input that is significant to its measurement. For example, a financial asset or liability carried at fair value would be classified in Level 3 if unobservable inputs were significant to the instrument's fair value, even though the measurement may be derived using inputs that are both observable (Levels 1 and 2) and unobservable (Level 3).

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The prices the Company uses to value its investment assets are representative of prices that would be received to sell the assets at the measurement date (exit prices) and are classified appropriately in the fair value hierarchy. The Company performs ongoing analyses of prices used to value the Company's invested assets to determine that they represent appropriate estimates of fair value. This process involves quantitative and qualitative analysis that is overseen by the Company's investment professionals, including reviews of pricing methodologies, judgments of valuation inputs, the significance of any unobservable inputs, pricing statistics and trends. These reviews are also designed to ensure prices do not become stale, have reasonable explanations as to why they have changed from prior valuations, or require additional review for other anomalies. The Company also performs sample testing of sales values to confirm the accuracy of prior fair value estimates. Exceptions identified during these processes indicate that adjustments to prices are infrequent and do not significantly impact valuations.

## Financial Assets and Financial Liabilities Carried at Fair Value

The following tables provide information as of September 30, 2012 and December 31, 2011 about the Company's financial assets and liabilities carried at fair value. Similar disclosures for separate account assets, that are also recorded at fair value on the Company's Consolidated Balance Sheets, are provided separately as gains and losses related to these assets generally accrue directly to policyholders.

| <b>September 30, 2012</b><br><i>(In millions)</i>                            | <b>Quoted Prices in<br/>Active Markets for<br/>Identical Assets<br/>(Level 1)</b> | <b>Significant Other<br/>Observable Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> | <b>Total</b>     |
|------------------------------------------------------------------------------|-----------------------------------------------------------------------------------|--------------------------------------------------------------|--------------------------------------------------------------|------------------|
| Financial assets at fair value:                                              |                                                                                   |                                                              |                                                              |                  |
| Fixed maturities:                                                            |                                                                                   |                                                              |                                                              |                  |
| Federal government and agency                                                | \$ 156                                                                            | \$ 761                                                       | \$ -                                                         | \$ 917           |
| State and local government                                                   | -                                                                                 | 2,486                                                        | -                                                            | 2,486            |
| Foreign government                                                           | -                                                                                 | 1,314                                                        | 25                                                           | 1,339            |
| Corporate                                                                    | -                                                                                 | 11,434                                                       | 557                                                          | 11,991           |
| Federal agency mortgage-backed                                               | -                                                                                 | 137                                                          | -                                                            | 137              |
| Other mortgage-backed                                                        | -                                                                                 | 90                                                           | 1                                                            | 91               |
| Other asset-backed                                                           | -                                                                                 | 346                                                          | 561                                                          | 907              |
| Total fixed maturities (1)                                                   | 156                                                                               | 16,568                                                       | 1,144                                                        | 17,868           |
| Equity securities                                                            | 4                                                                                 | 68                                                           | 37                                                           | 109              |
| Subtotal                                                                     | 160                                                                               | 16,636                                                       | 1,181                                                        | 17,977           |
| Short-term investments                                                       | -                                                                                 | 151                                                          | -                                                            | 151              |
| GMIB assets (2)                                                              | -                                                                                 | -                                                            | 625                                                          | 625              |
| Other derivative assets (3)                                                  | -                                                                                 | 46                                                           | -                                                            | 46               |
| <b>Total financial assets at fair value,<br/>excluding separate accounts</b> | <b>\$ 160</b>                                                                     | <b>\$ 16,833</b>                                             | <b>\$ 1,806</b>                                              | <b>\$ 18,799</b> |
| Financial liabilities at fair value:                                         |                                                                                   |                                                              |                                                              |                  |
| GMIB liabilities                                                             | \$ -                                                                              | \$ -                                                         | \$ 1,184                                                     | \$ 1,184         |
| Other derivative liabilities (3)                                             | -                                                                                 | 32                                                           | -                                                            | 32               |
| Total financial liabilities at fair value                                    | \$ -                                                                              | \$ 32                                                        | \$ 1,184                                                     | \$ 1,216         |

(1) Fixed maturities included \$907 million of net appreciation required to adjust future policy benefits for the run-off settlement annuity business including \$93 million of appreciation for securities classified in Level 3.

(2) The GMIB assets represent retrocessional contracts in place from two external reinsurers that cover 55% of the exposures on these contracts.

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(3) *Other derivative assets included \$7 million of interest rate and foreign currency swaps qualifying as cash flow hedges and \$39 million of interest rate swaps not designated as accounting hedges. Other derivative liabilities reflected foreign currency and interest rate swaps qualifying as cash flow hedges. See Note 10 for additional information.*

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| <b>December 31, 2011</b><br><i>(In millions)</i>                             | <b>Quoted Prices in<br/>Active Markets for<br/>Identical Assets<br/>(Level 1)</b> | <b>Significant Other<br/>Observable Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> | <b>Total</b>     |
|------------------------------------------------------------------------------|-----------------------------------------------------------------------------------|--------------------------------------------------------------|--------------------------------------------------------------|------------------|
| Financial assets at fair value:                                              |                                                                                   |                                                              |                                                              |                  |
| Fixed maturities:                                                            |                                                                                   |                                                              |                                                              |                  |
| Federal government and agency                                                | \$ 217                                                                            | \$ 738                                                       | \$ 3                                                         | \$ 958           |
| State and local government                                                   | -                                                                                 | 2,456                                                        | -                                                            | 2,456            |
| Foreign government                                                           | -                                                                                 | 1,251                                                        | 23                                                           | 1,274            |
| Corporate                                                                    | -                                                                                 | 10,132                                                       | 381                                                          | 10,513           |
| Federal agency mortgage-backed                                               | -                                                                                 | 9                                                            | -                                                            | 9                |
| Other mortgage-backed                                                        | -                                                                                 | 79                                                           | 1                                                            | 80               |
| Other asset-backed                                                           | -                                                                                 | 363                                                          | 564                                                          | 927              |
| Total fixed maturities (1)                                                   | 217                                                                               | 15,028                                                       | 972                                                          | 16,217           |
| Equity securities                                                            | 3                                                                                 | 67                                                           | 30                                                           | 100              |
| Subtotal                                                                     | 220                                                                               | 15,095                                                       | 1,002                                                        | 16,317           |
| Short-term investments                                                       | -                                                                                 | 225                                                          | -                                                            | 225              |
| GMIB assets (2)                                                              | -                                                                                 | -                                                            | 712                                                          | 712              |
| Other derivative assets (3)                                                  | -                                                                                 | 45                                                           | -                                                            | 45               |
| <b>Total financial assets at fair value,<br/>excluding separate accounts</b> | <b>\$ 220</b>                                                                     | <b>\$ 15,365</b>                                             | <b>\$ 1,714</b>                                              | <b>\$ 17,299</b> |
| Financial liabilities at fair value:                                         |                                                                                   |                                                              |                                                              |                  |
| GMIB liabilities                                                             | \$ -                                                                              | \$ -                                                         | \$ 1,333                                                     | \$ 1,333         |
| Other derivative liabilities (3)                                             | -                                                                                 | 30                                                           | -                                                            | 30               |
| Total financial liabilities at fair value                                    | \$ -                                                                              | \$ 30                                                        | \$ 1,333                                                     | \$ 1,363         |

(1) Fixed maturities included \$826 million of net appreciation required to adjust future policy benefits for the run-off settlement annuity business including \$115 million of appreciation for securities classified in Level 3.

(2) The GMIB assets represent retrocessional contracts in place from two external reinsurers that cover 55% of the exposures on these contracts.

(3) Other derivative assets included \$10 million of interest rate and foreign currency swaps qualifying as cash flow hedges and \$35 million of interest rate swaps not designated as accounting hedges. Other derivative liabilities reflected foreign currency and interest rate swaps qualifying as cash flow hedges. See Note 10 for additional information.

**Level 1 Financial Assets**

Inputs for instruments classified in Level 1 include unadjusted quoted prices for identical assets in active markets accessible at the measurement date. Active markets provide pricing data for trades occurring at least weekly and include exchanges and dealer markets.

Assets in Level 1 include actively-traded U.S. government bonds and exchange-listed equity securities. Given the narrow definition of Level 1 and the Company's investment asset strategy to maximize investment returns, a relatively small portion of the Company's investment assets are classified in this category.

## Level 2 Financial Assets and Financial Liabilities

Inputs for instruments classified in Level 2 include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are market observable or can be corroborated by market data for the term of the instrument. Such other inputs include market interest rates and volatilities, spreads and yield curves. An instrument is classified in Level 2 if the Company determines that unobservable inputs are insignificant.

***Fixed maturities and equity securities.*** Approximately 93% of the Company's investments in fixed maturities and equity securities are classified in Level 2 including most public and private corporate debt and equity securities, federal agency and municipal bonds, non-government mortgage-backed securities and preferred stocks. Because many fixed maturities and preferred stocks do not trade daily, fair values are often derived using recent trades of securities with similar features and characteristics. When recent trades are not available, pricing models are used to determine these prices. These models calculate fair values by discounting future cash flows at estimated market interest rates. Such market rates are derived by calculating the appropriate spreads over comparable U.S. Treasury securities, based on the credit quality, industry and structure of the asset. Typical inputs and assumptions to pricing models include, but are not limited to, a combination of benchmark yields, reported trades, issuer spreads, liquidity, benchmark securities, bids, offers, reference data, and industry and economic events. For mortgage-backed securities, inputs and assumptions may also include characteristics of the issuer, collateral attributes, prepayment speeds and credit rating.

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Nearly all of these instruments are valued using recent trades or pricing models. Less than 1% of the fair value of investments classified in Level 2 represents foreign bonds that are valued, consistent with local market practice, using a single unadjusted market-observable input derived by averaging multiple broker-dealer quotes.

**Short-term investments** are carried at fair value, which approximates cost. On a regular basis the Company compares market prices for these securities to recorded amounts to validate that current carrying amounts approximate exit prices. The short-term nature of the investments and corroboration of the reported amounts over the holding period support their classification in Level 2.

**Other derivatives** classified in Level 2 represent over-the-counter instruments such as interest rate and foreign currency swap contracts. Fair values for these instruments are determined using market observable inputs including forward currency and interest rate curves and widely published market observable indices. Credit risk related to the counterparty and the Company is considered when estimating the fair values of these derivatives. However, the Company is largely protected by collateral arrangements with counterparties, and determined that no adjustment for credit risk was required as of September 30, 2012 or December 31, 2011. The nature and use of these other derivatives are described in Note 10.

### Level 3 Financial Assets and Financial Liabilities

Certain inputs for instruments classified in Level 3 are unobservable (supported by little or no market activity) and significant to their resulting fair value measurement. Unobservable inputs reflect the Company's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

The Company classifies certain newly issued, privately placed, complex or illiquid securities, as well as assets and liabilities relating to GMIB, in Level 3.

**Fixed maturities and equity securities.** Approximately 6% of fixed maturities and equity securities are priced using significant unobservable inputs and classified in this category, including:

| <i>(In millions)</i>                                                     | September 30,<br>2012 | December 31,<br>2011 |
|--------------------------------------------------------------------------|-----------------------|----------------------|
| Other asset and mortgage-backed securities - valued using pricing models | \$ 562                | \$ 565               |
| Corporate and government bonds - valued using pricing models             | 494                   | 335                  |
| Corporate bonds - valued at transaction price                            | 88                    | 72                   |
| Equity securities - valued at transaction price                          | 37                    | 30                   |
| <b>Total</b>                                                             | <b>\$ 1,181</b>       | <b>\$ 1,002</b>      |

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Fair values of other asset and mortgage-backed securities, corporate and government bonds are determined using pricing models that incorporate the specific characteristics of each asset and related assumptions including the investment type and structure, credit quality, industry and maturity date in comparison to current market indices, spreads and liquidity of assets with similar characteristics. For mortgage and asset-backed securities, inputs and assumptions to pricing may also include collateral attributes and prepayment speeds. Recent trades in the subject security or similar securities are assessed when available, and the Company may also review published research, as well as the issuer's financial statements, in its evaluation. Certain subordinated corporate bonds and private equity investments are valued at transaction price in the absence of market data indicating a change in the estimated fair values.

### Quantitative Information about Unobservable Inputs

The following table summarizes the fair value and significant unobservable inputs used in pricing Level 3 securities that were developed directly by the Company as of September 30, 2012. The range and weighted average basis point amounts reflect the Company's best estimates of the unobservable adjustments a market participant would make to the market observable spreads (adjustment to discount rates) used to calculate the fair values in a discounted cash flow analysis.

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**Other asset and mortgage-backed securities.** The significant unobservable inputs used to value the following other asset and mortgage-backed securities are liquidity and weighting of credit spreads. An adjustment for liquidity is made as of the measurement date when there is limited trading activity for the security that considers current market conditions, issuer circumstances and complexity of the security structure. An adjustment to weight credit spreads is needed to value a more complex bond structure with multiple underlying collateral with no standard market valuation technique. The weighting of credit spreads is primarily based on the underlying collateral's characteristics and their proportional cash flows supporting the bond obligations. The resulting wide range of unobservable adjustments in the table below is due to the varying liquidity and quality of the underlying collateral, ranging from high credit quality to below investment grade.

**Corporate and government bonds.** The significant unobservable input used to value the following corporate and government bonds is an adjustment for liquidity. When there is limited trading activity for the security, an adjustment is needed to reflect current market conditions and issuer circumstances.

| As of September 30, 2012                   |            | Unobservable Adjustment to Discount Rates Range (Weighted Average) |                  |
|--------------------------------------------|------------|--------------------------------------------------------------------|------------------|
| (In millions except basis points)          |            | in Basis Points                                                    |                  |
|                                            | Fair Value | Unobservable Input                                                 |                  |
| Other asset and mortgage-backed securities | \$ 558     | Liquidity                                                          | 60 - 700 (150)   |
|                                            |            | Weighting of credit spreads                                        | 70 - 4,020 (400) |
| Corporate and government bonds             | \$ 351     | Liquidity                                                          | 20 - 550 (230)   |

Significant increases in any of these inputs would result in a lower fair value measurement while decreases in these inputs would result in a higher fair value measurement. Generally, the unobservable inputs are not interrelated and a change in the assumption used for one unobservable input is not accompanied by a change in the other unobservable input. The table does not include all of the Level 3 securities because information about specific unobservable inputs used in pricing all of these securities was not reasonably available to the Company. See page 18 for a discussion of the Company's valuation processes and controls.

**Guaranteed minimum income benefit contracts.** The Company reports GMIB liabilities and assets as derivatives at fair value because cash flows of these liabilities and assets are affected by equity markets and interest rates but are without significant life insurance risk and are settled in lump sum payments. The Company estimates the fair value of the assets and liabilities for GMIB contracts using assumptions regarding capital markets (including market returns, interest rates and market volatilities of the underlying equity and bond mutual fund investments), future annuitant behavior (including mortality, lapse, and annuity election rates), and non-performance risk, as well as risk and profit charges. As certain assumptions used to estimate fair values for these contracts are largely unobservable (primarily related to future annuitant behavior), the Company classifies GMIB assets and liabilities in Level 3. The Company considered the following in determining the view of a hypothetical market participant:

- that the most likely transfer of these assets and liabilities would be through a reinsurance transaction with an independent insurer having a market capitalization and credit rating similar to that of the Company; and
- that because this block of contracts is in run-off mode, an insurer looking to acquire these contracts would have similar existing contracts with related administrative and risk management capabilities.

These GMIB assets and liabilities are estimated with an internal model using many scenarios to determine the present value of net amounts expected to be paid, less the present value of net future premiums expected to be received adjusted for risk and profit charges that the Company estimates a hypothetical market participant would require to assume this business. Net amounts expected to be paid include the excess of the expected value of the income benefits over the values of the annuitants' accounts at the time of annuitization. Generally, market return, interest rate and volatility assumptions are based on market observable information. Assumptions related to annuitant behavior reflect the Company's belief that a hypothetical market participant would consider the actual and expected experience of the Company as well as other relevant and available industry resources in setting policyholder behavior assumptions. The significant assumptions used to value the GMIB assets and liabilities as of September 30, 2012 were as follows:

*Assumptions based on observable inputs:*

- The market return (growth interest rate) and discount rate assumptions are based on the market-observable LIBOR swap curve.
- The projected interest rate used to calculate the reinsured income benefits is indexed to the 7-year Treasury Rate at the time of annuitization (claim interest rate) based on contractual terms. That rate was 1.04% at September 30, 2012 and must be projected for future time periods. These projected rates vary by economic scenario and are determined by an interest rate model using current interest rate curves and the prices of instruments available in the market including various interest rate caps and zero-coupon bonds. For a subset of the business, there is a contractually guaranteed floor of 3% for the claim interest rate.

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- The market volatility assumptions for annuitants' underlying mutual fund investments that are modeled based on the S&P 500, Russell 2000 and NASDAQ Composite are based on the market-implied volatility for these indices for three to seven years grading to historical volatility levels thereafter. For the remaining 50% of underlying mutual fund investments modeled based on other indices (with insufficient market-observable data), volatility is based on the average historical level for each index over the past 10 years. Using this approach, volatility ranges from 19% to 29% for equity funds, 6% to 8% for bond funds, and 0% to 1% for money market funds.

*Assumptions based on unobservable inputs:*

- The mortality assumption is 70% of the 1994 Group Annuity Mortality table, with 1% annual improvement beginning January 1, 2000.
- The annual lapse rate assumption reflects experience that differs by the company issuing the underlying variable annuity contracts, ranges from 0% to 12%, and depends on the time since contract issue and the relative value of the guarantee. The weighted average annual lapse rate is 2%.
- The annual annuity election rate assumption reflects experience that differs by the company issuing the underlying variable annuity contracts and depends on the annuitant's age, the relative value of the guarantee and whether a contractholder has had a previous opportunity to elect the benefit. Immediately after the expiration of the waiting period, the assumed probability that an individual will annuitize their variable annuity contract is up to 80%. For the second and subsequent annual opportunities to elect the benefit, the assumed probability of election is up to 20%. The weighted average annual annuity election rate is 8%.
- The nonperformance risk adjustment is incorporated by adding an additional spread to the discount rate in the calculation of both (1) the GMIB liability to reflect a hypothetical market participant's view of the risk of the Company not fulfilling its GMIB obligations, and (2) the GMIB asset to reflect a hypothetical market participant's view of the reinsurers' credit risk, after considering collateral. The estimated market-implied spread is company-specific for each party involved to the extent that company-specific market data is available and is based on industry averages for similarly-rated companies when company-specific data is not available. The spread is impacted by the credit default swap spreads of the specific parent companies, adjusted to reflect subsidiaries' credit ratings relative to their parent company and any available collateral. The additional spread over LIBOR incorporated into the discount rate ranged from 10 to 120 basis points for the GMIB liability with a weighted average of 60 basis points and ranged from 35 to 145 basis points for the GMIB reinsurance asset with a weighted average of 90 basis points for that portion of the interest rate curve most relevant to these policies.
- The risk and profit charge assumption is based on the Company's estimate of the capital and return on capital that would be required by a hypothetical market participant. The assumed return on capital is 10% after-tax.

The Company regularly evaluates each of the assumptions used in establishing these assets and liabilities by considering how a hypothetical market participant would set assumptions at each valuation date. Capital markets assumptions are expected to change at each valuation date reflecting currently observable market conditions. Other assumptions, that require the Company to make critical accounting estimates, may also

change based on a hypothetical market participant's view of actual experience as it emerges over time or other factors that impact the net liability. The significant unobservable inputs used in the fair value measurement of the GMIB assets and liabilities are lapse rates, annuity election rates, and spreads used to calculate nonperformance risk. Significant decreases in assumed lapse rates or spreads used to calculate nonperformance risk, or increases in assumed annuity election rates would result in higher fair value measurements. Generally, a change in one of these assumptions is not necessarily accompanied by a change in another assumption. If the emergence of future experience or future assumptions differs from the assumptions used in estimating these assets and liabilities, the resulting impact could be material to the Company's consolidated results of operations and, in certain situations, could be material to the Company's financial condition.

GMIB liabilities are reported in the Company's Consolidated Balance Sheets in Accounts payable, accrued expenses and other liabilities. GMIB assets associated with these contracts represent net receivables in connection with reinsurance that the Company has purchased from two external reinsurers and are reported in the Company's Consolidated Balance Sheets in Other assets, including other intangibles.

### **Changes in Level 3 Financial Assets and Financial Liabilities Carried at Fair Value**

The following tables summarize the changes in financial assets and financial liabilities classified in Level 3 for the three and nine months ended September 30, 2012 and 2011. These tables exclude separate account assets as changes in fair values of these assets accrue directly to policyholders. Gains and losses reported in these tables may include net changes in fair value that are attributable to both observable and unobservable inputs.

Table of Contents**For the Three Months Ended September 30, 2012***(In millions)*

|                                                                                                       | <b>Fixed Maturities &amp;<br/>Equity Securities</b> | <b>GMIB Assets</b> | <b>GMIB Liabilities</b> | <b>GMIB Net</b> |
|-------------------------------------------------------------------------------------------------------|-----------------------------------------------------|--------------------|-------------------------|-----------------|
| Balance at July 1, 2012                                                                               | \$ 1,128                                            | \$ 707             | \$ (1,332)              | \$ (625)        |
| Gains (losses) included in shareholders' net income:                                                  |                                                     |                    |                         |                 |
| GMIB fair value gain/(loss)                                                                           | -                                                   | (78)               | 131                     | 53              |
| Other                                                                                                 | 1                                                   | -                  | -                       | -               |
| Total gains (losses) included in shareholders' net income                                             | 1                                                   | (78)               | 131                     | 53              |
| Gains included in other comprehensive income                                                          | 11                                                  | -                  | -                       | -               |
| Losses required to adjust future policy benefits for settlement annuities (1)                         | (15)                                                | -                  | -                       | -               |
| Purchases, sales and settlements:                                                                     |                                                     |                    |                         |                 |
| Purchases                                                                                             | 39                                                  | -                  | -                       | -               |
| Settlements                                                                                           | (15)                                                | (4)                | 17                      | 13              |
| Total purchases, sales and settlements                                                                | 24                                                  | (4)                | 17                      | 13              |
| Transfers into/(out of) Level 3:                                                                      |                                                     |                    |                         |                 |
| Transfers into Level 3                                                                                | 36                                                  | -                  | -                       | -               |
| Transfers out of Level 3                                                                              | (4)                                                 | -                  | -                       | -               |
| Total transfers into/(out of) Level 3                                                                 | 32                                                  | -                  | -                       | -               |
| Balance at September 30, 2012                                                                         | \$ 1,181                                            | \$ 625             | \$ (1,184)              | \$ (559)        |
| <b>Total gains (losses) included in income attributable to instruments held at the reporting date</b> | <b>\$ 2</b>                                         | <b>\$ (78)</b>     | <b>\$ 131</b>           | <b>\$ 53</b>    |

*(1) Amounts do not accrue to shareholders.***For the Three Months Ended September 30, 2011***(In millions)*

|                                                                                                       | <b>Fixed Maturities &amp;<br/>Equity Securities</b> | <b>GMIB Assets</b> | <b>GMIB Liabilities</b> | <b>GMIB Net</b> |
|-------------------------------------------------------------------------------------------------------|-----------------------------------------------------|--------------------|-------------------------|-----------------|
| Balance at July 1, 2011                                                                               | \$ 950                                              | \$ 490             | \$ (917)                | \$ (427)        |
| Gains (losses) included in shareholders' net income:                                                  |                                                     |                    |                         |                 |
| GMIB fair value gain/(loss)                                                                           | -                                                   | 259                | (483)                   | (224)           |
| Other                                                                                                 | (2)                                                 | -                  | -                       | -               |
| Total gains (losses) included in shareholders' net income                                             | (2)                                                 | 259                | (483)                   | (224)           |
| Losses included in other comprehensive income                                                         | (1)                                                 | -                  | -                       | -               |
| Gains required to adjust future policy benefits for settlement annuities (1)                          | 34                                                  | -                  | -                       | -               |
| Purchases, sales and settlements:                                                                     |                                                     |                    |                         |                 |
| Purchases                                                                                             | 9                                                   | -                  | -                       | -               |
| Sales                                                                                                 | (1)                                                 | -                  | -                       | -               |
| Settlements                                                                                           | (3)                                                 | (8)                | 16                      | 8               |
| Total purchases, sales and settlements                                                                | 5                                                   | (8)                | 16                      | 8               |
| Transfers into/(out of) Level 3:                                                                      |                                                     |                    |                         |                 |
| Transfers into Level 3                                                                                | 33                                                  | -                  | -                       | -               |
| Transfers out of Level 3                                                                              | (12)                                                | -                  | -                       | -               |
| Total transfers into/(out of) Level 3                                                                 | 21                                                  | -                  | -                       | -               |
| Balance at September 30, 2011                                                                         | \$ 1,007                                            | \$ 741             | \$ (1,384)              | \$ (643)        |
| <b>Total gains (losses) included in income attributable to instruments held at the reporting date</b> | <b>\$ (2)</b>                                       | <b>\$ 259</b>      | <b>\$ (483)</b>         | <b>\$ (224)</b> |

*(1) Amounts do not accrue to shareholders.*

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**For the Nine Months Ended September 30, 2012**

(In millions)

|                                                                                                       | Fixed Maturities &<br>Equity Securities | GMIB Assets    | GMIB Liabilities | GMIB Net     |
|-------------------------------------------------------------------------------------------------------|-----------------------------------------|----------------|------------------|--------------|
| Balance at January 1, 2012                                                                            | \$ 1,002                                | \$ 712         | \$ (1,333)       | \$ (621)     |
| Gains (losses) included in shareholders' net income:                                                  |                                         |                |                  |              |
| GMIB fair value gain/(loss)                                                                           | -                                       | (65)           | 98               | 33           |
| Other                                                                                                 | 4                                       | -              | -                | -            |
| Total gains (losses) included in shareholders' net income                                             | 4                                       | (65)           | 98               | 33           |
| Gains included in other comprehensive income                                                          | 16                                      | -              | -                | -            |
| Losses required to adjust future policy benefits for settlement annuities (1)                         | (19)                                    | -              | -                | -            |
| Purchases, sales and settlements:                                                                     |                                         |                |                  |              |
| Purchases                                                                                             | 106                                     | -              | -                | -            |
| Settlements                                                                                           | (44)                                    | (22)           | 51               | 29           |
| Total purchases, sales and settlements                                                                | 62                                      | (22)           | 51               | 29           |
| Transfers into/(out of) Level 3:                                                                      |                                         |                |                  |              |
| Transfers into Level 3                                                                                | 155                                     | -              | -                | -            |
| Transfers out of Level 3                                                                              | (39)                                    | -              | -                | -            |
| Total transfers into/(out of) Level 3                                                                 | 116                                     | -              | -                | -            |
| Balance at September 30, 2012                                                                         | \$ 1,181                                | \$ 625         | \$ (1,184)       | \$ (559)     |
| <b>Total gains (losses) included in income attributable to instruments held at the reporting date</b> | <b>\$ 2</b>                             | <b>\$ (65)</b> | <b>\$ 98</b>     | <b>\$ 33</b> |

(1) Amounts do not accrue to shareholders.

**For the Nine Months Ended September 30, 2011**

(In millions)

|                                                                                                       | Fixed Maturities &<br>Equity Securities | GMIB Assets   | GMIB Liabilities | GMIB Net        |
|-------------------------------------------------------------------------------------------------------|-----------------------------------------|---------------|------------------|-----------------|
| Balance at January 1, 2011                                                                            | \$ 933                                  | \$ 480        | \$ (903)         | \$ (423)        |
| Gains (losses) included in shareholders' net income:                                                  |                                         |               |                  |                 |
| GMIB fair value gain/(loss)                                                                           | -                                       | 286           | (531)            | (245)           |
| Other                                                                                                 | 5                                       | -             | -                | -               |
| Total gains (losses) included in shareholders' net income                                             | 5                                       | 286           | (531)            | (245)           |
| Gains included in other comprehensive income                                                          | 7                                       | -             | -                | -               |
| Gains required to adjust future policy benefits for settlement annuities (1)                          | 39                                      | -             | -                | -               |
| Purchases, sales and settlements:                                                                     |                                         |               |                  |                 |
| Purchases                                                                                             | 58                                      | -             | -                | -               |
| Sales                                                                                                 | (1)                                     | -             | -                | -               |
| Settlements                                                                                           | (34)                                    | (25)          | 50               | 25              |
| Total purchases, sales and settlements                                                                | 23                                      | (25)          | 50               | 25              |
| Transfers into/(out of) Level 3:                                                                      |                                         |               |                  |                 |
| Transfers into Level 3                                                                                | 52                                      | -             | -                | -               |
| Transfers out of Level 3                                                                              | (52)                                    | -             | -                | -               |
| Total transfers into/(out of) Level 3                                                                 | -                                       | -             | -                | -               |
| Balance at September 30, 2011                                                                         | \$ 1,007                                | \$ 741        | \$ (1,384)       | \$ (643)        |
| <b>Total gains (losses) included in income attributable to instruments held at the reporting date</b> | <b>\$ 4</b>                             | <b>\$ 286</b> | <b>\$ (531)</b>  | <b>\$ (245)</b> |

(1) Amounts do not accrue to shareholders.

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As noted in the tables above, total gains and losses included in shareholders' net income are reflected in the following captions in the Consolidated Statements of Income:

- Realized investment gains (losses) and net investment income for amounts related to fixed maturities and equity securities; and
- GMIB fair value (gain) loss for amounts related to GMIB assets and liabilities.

In the tables above, gains and losses included in other comprehensive income are reflected in Net unrealized appreciation (depreciation) on securities in the Consolidated Statements of Other Comprehensive Income.

Reclassifications impacting Level 3 financial instruments are reported as transfers into or out of the Level 3 category as of the beginning of the quarter in which the transfer occurs. Therefore gains and losses in income only reflect activity for the period the instrument was classified in Level 3.

Transfers into or out of the Level 3 category occur when unobservable inputs, such as the Company's best estimate of what a market participant would use to determine a current transaction price, become more or less significant to the fair value measurement. For the nine months ended September 30, 2012, transfers into Level 3 from Level 2 primarily reflect an increase in the unobservable inputs used to value certain public and private corporate bonds, principally related to liquidity of the securities.

The Company provided reinsurance for other insurance companies that offer a guaranteed minimum income benefit, and then retroceded a portion of the risk to other insurance companies. These arrangements with third-party insurers are the instruments still held at the reporting date for GMIB assets and liabilities in the table above. Because these reinsurance arrangements remain in effect at the reporting date, the Company has reflected the total gain or loss for the period as the total gain or loss included in income attributable to instruments still held at the reporting date. However, the Company reduces the GMIB assets and liabilities resulting from these reinsurance arrangements when annuitants lapse, die, elect their benefit, or reach the age after which the right to elect their benefit expires.

Under FASB's guidance for fair value measurements, the Company's GMIB assets and liabilities are expected to be volatile in future periods because the underlying capital markets assumptions will be based largely on market-observable inputs at the close of each reporting period including interest rates and market-implied volatilities.

Beginning in February 2011, the Company implemented a dynamic equity hedge program to reduce a portion of the equity market exposures related to GMIB contracts (GMIB equity hedge program) by entering into exchange-traded futures contracts. The Company also entered into a dynamic interest rate hedge program that reduces a portion of the interest rate exposure related to GMIB contracts (GMIB growth interest rate hedge program) using LIBOR swap contracts and exchange-traded treasury futures contracts. In June 2012, the GMIB equity hedge program was expanded. See Note 10 for further information.

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During the three months ended September 30, 2012, the Company conducted reviews of annuitization and lapse experience, as well as a review of actual claim amounts compared to projected values in the fair value model. The fair value gains of \$53 million for the three months and \$33 million for the nine months ended September 30, 2012 were primarily due to updates in the claim exposure calculation, a reduction in the annuitization rates, and the effect of increases in underlying account values, partially offset by a reduction in lapse rates and general declines in interest rates.

GMIB fair value losses of \$224 million for the three months ended September 30, 2011 and \$245 million for the nine months ended September 30, 2011 were primarily due to declining interest rates and, to a lesser extent, decreases in underlying account values, driven by unfavorable equity market returns.

Table of Contents**Separate account assets**

Fair values and changes in the fair values of separate account assets generally accrue directly to the policyholders and are excluded from the Company's revenues and expenses. As of September 30, 2012 and December 31, 2011 separate account assets were as follows:

| <b>September 30, 2012</b>                  | <b>Quoted Prices in<br/>Active Markets for<br/>Identical Assets<br/>(Level 1)</b> | <b>Significant Other<br/>Observable Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> | <b>Total</b>    |
|--------------------------------------------|-----------------------------------------------------------------------------------|--------------------------------------------------------------|--------------------------------------------------------------|-----------------|
| <i>(In millions)</i>                       |                                                                                   |                                                              |                                                              |                 |
| Guaranteed separate accounts (See Note 18) | \$ 255                                                                            | \$ 976                                                       | \$ -                                                         | \$ 1,231        |
| Non-guaranteed separate accounts (1)       | 1,952                                                                             | 4,194                                                        | 985                                                          | 7,131           |
| <b>Total separate account assets</b>       | <b>\$ 2,207</b>                                                                   | <b>\$ 5,170</b>                                              | <b>\$ 985</b>                                                | <b>\$ 8,362</b> |

(1) As of September 30, 2012, non-guaranteed separate accounts included \$3.4 billion in assets supporting the Company's pension plans, including \$933 million classified in Level 3.

| <b>December 31, 2011</b>                   | <b>Quoted Prices in<br/>Active Markets for<br/>Identical Assets<br/>(Level 1)</b> | <b>Significant Other<br/>Observable Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> | <b>Total</b>    |
|--------------------------------------------|-----------------------------------------------------------------------------------|--------------------------------------------------------------|--------------------------------------------------------------|-----------------|
| <i>(In millions)</i>                       |                                                                                   |                                                              |                                                              |                 |
| Guaranteed separate accounts (See Note 18) | \$ 249                                                                            | \$ 1,439                                                     | \$ -                                                         | \$ 1,688        |
| Non-guaranteed separate accounts (1)       | 1,804                                                                             | 3,851                                                        | 750                                                          | 6,405           |
| <b>Total separate account assets</b>       | <b>\$ 2,053</b>                                                                   | <b>\$ 5,290</b>                                              | <b>\$ 750</b>                                                | <b>\$ 8,093</b> |

(1) As of December 31, 2011, non-guaranteed separate accounts include \$3.0 billion in assets supporting the Company's pension plans, including \$702 million classified in Level 3.

Separate account assets in Level 1 include exchange-listed equity securities. Level 2 assets primarily include:

- corporate and structured bonds valued using recent trades of similar securities or pricing models that discount future cash flows at estimated market interest rates as described above; and
- actively-traded institutional and retail mutual fund investments and separate accounts priced using the daily net asset value which is the exit price.

Separate account assets classified in Level 3 include investments primarily in securities partnerships, real estate and hedge funds generally valued based on the separate account's ownership share of the equity of the investee including changes in the fair values of its underlying investments.

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The following tables summarize the changes in separate account assets reported in Level 3 for the three and nine months ended September 30, 2012 and September 30, 2011.

| (In millions)                          | Three Months Ended September 30, |               |
|----------------------------------------|----------------------------------|---------------|
|                                        | 2012                             | 2011          |
| Balance at July 1                      | \$ 952                           | \$ 644        |
| Policyholder gains (1)                 | 21                               | 23            |
| Purchases, sales and settlements:      |                                  |               |
| Purchases                              | 30                               | 111           |
| Sales                                  | -                                | (10)          |
| Settlements                            | (20)                             | (18)          |
| Total purchases, sales and settlements | 10                               | 83            |
| Transfers into/(out of) Level 3:       |                                  |               |
| Transfers into Level 3                 | 2                                | 4             |
| Transfers out of Level 3               | -                                | (1)           |
| Total transfers into/(out of) Level 3  | 2                                | 3             |
| <b>Balance at September 30</b>         | <b>\$ 985</b>                    | <b>\$ 753</b> |

(1) Included in this amount are gains of \$20 million attributable to instruments still held at September 30, 2012 and gains of \$23 million attributable to instruments still held at September 30, 2011.

| (In millions)                          | Nine Months Ended September 30, |               |
|----------------------------------------|---------------------------------|---------------|
|                                        | 2012                            | 2011          |
| Balance at January 1                   | \$ 750                          | \$ 594        |
| Policyholder gains (1)                 | 48                              | 101           |
| Purchases, sales and settlements:      |                                 |               |
| Purchases                              | 230                             | 226           |
| Sales                                  | -                               | (51)          |
| Settlements                            | (49)                            | (111)         |
| Total purchases, sales and settlements | 181                             | 64            |
| Transfers into/(out of) Level 3:       |                                 |               |
| Transfers into Level 3                 | 7                               | 4             |
| Transfers out of Level 3               | (1)                             | (10)          |
| Total transfers into/(out of) Level 3  | 6                               | (6)           |
| <b>Balance at September 30</b>         | <b>\$ 985</b>                   | <b>\$ 753</b> |

(1) Included in this amount are gains of \$41 million attributable to instruments still held at September 30, 2012 and gains of \$84 million attributable to instruments still held at September 30, 2011.

***Assets and Liabilities Measured at Fair Value under Certain Conditions***

Some financial assets and liabilities are not carried at fair value each reporting period, but may be measured using fair value only under certain conditions, such as investments in real estate entities and commercial mortgage loans when they become impaired. During the nine months ended September 30, 2012, impaired commercial mortgage loans representing less than 1% of total investments were written down to their fair values, resulting in after-tax realized investment losses of \$7 million. For the nine months ended September 30, 2011, impaired mortgage loans representing less than less than 1% of total investments were written down to their fair values resulting in after-tax realized investment losses of \$11 million.

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During 2011, impaired commercial mortgage loans and real estate entities representing less than 1% of total investments were written down to their fair values, resulting in after-tax realized investment losses of \$15 million.

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These fair values were calculated by discounting the expected future cash flows at estimated market interest rates. Such market rates were derived by calculating the appropriate spread over comparable U.S. Treasury rates, based on the characteristics of the underlying real estate, including its type, quality and location. The fair value measurements were classified in Level 3 because these cash flow models incorporate significant unobservable inputs.

**Fair Value Disclosures for Financial Instruments Not Carried at Fair Value**

Most financial instruments that are subject to fair value disclosure requirements are carried in the Company's Consolidated Financial Statements at amounts that approximate fair value. The following table provides carrying values, fair values and classification in the fair value hierarchy of the Company's financial instruments not recorded at fair value that are subject to fair value disclosure requirements at September 30, 2012 and December 31, 2011:

| (In millions)                                                          | Classification in<br>the Fair Value<br>Hierarchy | Fair<br>Value | September 30, 2012<br>Carrying<br>Value | Fair<br>Value | December 31, 2011<br>Carrying<br>Value |
|------------------------------------------------------------------------|--------------------------------------------------|---------------|-----------------------------------------|---------------|----------------------------------------|
| Commercial mortgage loans                                              | Level 3                                          | \$ 3,096      | \$ 2,946                                | \$ 3,380      | \$ 3,301                               |
| Contractholder deposit funds, excluding universal life products        | Level 3                                          | \$ 1,080      | \$ 1,053                                | \$ 1,056      | \$ 1,035                               |
| Long-term debt, including current maturities, excluding capital leases | Level 2                                          | \$ 5,712      | \$ 4,947                                | \$ 5,281      | \$ 4,946                               |

The fair values presented in the table above have been estimated using market information when available. The following is a description of the valuation methodologies and inputs used by the Company to determine fair value.

**Commercial mortgage loans.** The Company estimates the fair value of commercial mortgage loans generally by discounting the contractual cash flows at estimated market interest rates that reflect the Company's assessment of the credit quality of the loans. Market interest rates are derived by calculating the appropriate spread over comparable U.S. Treasury rates, based on the property type, quality rating and average life of the loan. The quality ratings reflect the relative risk of the loan, considering debt service coverage, the loan-to-value ratio and other factors. Fair values of impaired mortgage loans are based on the estimated fair value of the underlying collateral generally determined using an internal discounted cash flow model. The fair value measurements were classified in Level 3 because the cash flow models incorporate significant unobservable inputs.

**Contractholder deposit funds, excluding universal life products.** Generally, these funds do not have stated maturities. Approximately 55% of these balances can be withdrawn by the customer at any time without prior notice or penalty. The fair value for these contracts is the amount estimated to be payable to the customer as of the reporting date, which is generally the carrying value. Most of the remaining contractholder deposit funds are reinsured by the buyers of the individual life and annuity and retirement benefits businesses. The fair value for these contracts is determined using the fair value of these buyers' assets supporting these reinsured contracts. The Company had a reinsurance recoverable equal to the carrying value of these reinsured contracts. These instruments were classified in Level 3 because certain inputs are unobservable (supported by little or no market activity) and significant to their resulting fair value measurement.

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***Long-term debt, including current maturities, excluding capital leases.*** The fair value of long-term debt is based on quoted market prices for recent trades. When quoted market prices are not available, fair value is estimated using a discounted cash flow analysis and the Company's estimated current borrowing rate for debt of similar terms and remaining maturities. These measurements were classified in Level 2 because the fair values are based on quoted market prices or other inputs that are market observable or can be corroborated by market data.

Fair values of off-balance-sheet financial instruments were not material.

[Table of Contents](#)**Note 9 Investments****Total Realized Investment Gains and Losses**

The following total realized gains and losses on investments include other-than-temporary impairments on debt securities but exclude amounts required to adjust future policy benefits for the run-off settlement annuity business:

| (In millions)                                 | Three Months Ended<br>September 30, |             | Nine Months Ended<br>September 30, |              |
|-----------------------------------------------|-------------------------------------|-------------|------------------------------------|--------------|
|                                               | 2012                                | 2011        | 2012                               | 2011         |
| Fixed maturities                              | \$ 8                                | \$ (14)     | \$ 23                              | \$ 36        |
| Equity securities                             | 1                                   | (9)         | 5                                  | (5)          |
| Commercial mortgage loans                     | 1                                   | -           | (9)                                | (16)         |
| Real estate                                   | -                                   | -           | (1)                                | -            |
| Other investments, including derivatives      | 1                                   | 36          | 2                                  | 41           |
| Realized investment gains before income taxes | 11                                  | 13          | 20                                 | 56           |
| Less income taxes                             | 4                                   | 4           | 4                                  | 19           |
| <b>Net realized investment gains</b>          | <b>\$ 7</b>                         | <b>\$ 9</b> | <b>\$ 16</b>                       | <b>\$ 37</b> |

Included in pre-tax realized investment gains (losses) above were changes in valuation reserves, asset write-downs and other-than-temporary impairments on fixed maturities as follows:

| (In millions)      | Three Months Ended<br>September 30, |                | Nine Months Ended<br>September 30, |                |
|--------------------|-------------------------------------|----------------|------------------------------------|----------------|
|                    | 2012                                | 2011           | 2012                               | 2011           |
| Credit-related (1) | \$ -                                | \$ (5)         | \$ (14)                            | \$ (21)        |
| Other              | -                                   | (22)           | (2)                                | (24)           |
| <b>Total</b>       | <b>\$ -</b>                         | <b>\$ (27)</b> | <b>\$ (16)</b>                     | <b>\$ (45)</b> |

(1) Credit related losses include other-than-temporary declines in fair value of fixed maturities and changes in valuation reserves related to commercial mortgage loans. There were no credit losses on fixed maturities for which a portion of the impairment was recognized in other comprehensive income.

**Fixed Maturities and Equity Securities**

Securities in the following table are included in fixed maturities and equity securities on the Company's Consolidated Balance Sheets. These securities are carried at fair value with changes in fair value reported in other realized investment gains (losses) and interest and dividends reported in net investment income. The Company's hybrid investments include preferred stock or debt securities with call or conversion features.

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| <i>(In millions)</i>                           | As of              |                   |
|------------------------------------------------|--------------------|-------------------|
|                                                | September 30, 2012 | December 31, 2011 |
| Included in fixed maturities:                  |                    |                   |
| Trading securities (amortized cost: \$2; \$2)  | \$ 2               | \$ 2              |
| Hybrid securities (amortized cost: \$10; \$26) | 10                 | 28                |
| <b>Total</b>                                   | <b>\$ 12</b>       | <b>\$ 30</b>      |
| Included in equity securities:                 |                    |                   |
| Hybrid securities (amortized cost: \$84; \$90) | \$ 68              | \$ 65             |

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Fixed maturities included \$54 million at September 30, 2012 that were pledged as collateral to brokers as required under certain futures contracts. These fixed maturities were primarily federal government securities.

The following information about fixed maturities excludes trading and hybrid securities. The amortized cost and fair value by contractual maturity periods for fixed maturities were as follows at September 30, 2012:

| <i>(In millions)</i>                       |           | <b>Amortized<br/>Cost</b> |           | <b>Fair<br/>Value</b> |
|--------------------------------------------|-----------|---------------------------|-----------|-----------------------|
| Due in one year or less                    | \$        | 1,181                     | \$        | 1,201                 |
| Due after one year through five years      |           | 5,085                     |           | 5,498                 |
| Due after five years through ten years     |           | 5,436                     |           | 6,166                 |
| Due after ten years                        |           | 2,865                     |           | 3,857                 |
| Mortgage and other asset-backed securities |           | 998                       |           | 1,134                 |
| <b>Total</b>                               | <b>\$</b> | <b>15,565</b>             | <b>\$</b> | <b>17,856</b>         |

Actual maturities could differ from contractual maturities because issuers may have the right to call or prepay obligations, with or without penalties. Also, in some cases the Company may extend maturity dates.

Gross unrealized appreciation (depreciation) on fixed maturities (excluding trading securities and hybrid securities with a fair value of \$12 million at September 30, 2012 and \$30 million at December 31, 2011) by type of issuer is shown below.

|                                |                           | <b>September 30, 2012</b>          |                                    |           |                       |
|--------------------------------|---------------------------|------------------------------------|------------------------------------|-----------|-----------------------|
| <i>(In millions)</i>           | <b>Amortized<br/>Cost</b> | <b>Unrealized<br/>Appreciation</b> | <b>Unrealized<br/>Depreciation</b> |           | <b>Fair<br/>Value</b> |
| Federal government and agency  | \$ 513                    | \$ 404                             | \$ -                               | \$        | 917                   |
| State and local government     | 2,201                     | 286                                | (1)                                |           | 2,486                 |
| Foreign government             | 1,211                     | 130                                | (2)                                |           | 1,339                 |
| Corporate                      | 10,643                    | 1,356                              | (18)                               |           | 11,981                |
| Federal agency mortgage-backed | 135                       | 2                                  | -                                  |           | 137                   |
| Other mortgage-backed          | 83                        | 12                                 | (5)                                |           | 90                    |
| Other asset-backed             | 779                       | 134                                | (7)                                |           | 906                   |
| <b>Total</b>                   | <b>\$ 15,565</b>          | <b>\$ 2,324</b>                    | <b>\$ (33)</b>                     | <b>\$</b> | <b>17,856</b>         |

|                                |                  | <b>December 31, 2011</b> |                |           |               |
|--------------------------------|------------------|--------------------------|----------------|-----------|---------------|
| <i>(In millions)</i>           |                  |                          |                |           |               |
| Federal government and agency  | \$ 552           | \$ 406                   | \$ -           | \$        | 958           |
| State and local government     | 2,185            | 274                      | (3)            |           | 2,456         |
| Foreign government             | 1,173            | 103                      | (2)            |           | 1,274         |
| Corporate                      | 9,460            | 1,070                    | (45)           |           | 10,485        |
| Federal agency mortgage-backed | 9                | -                        | -              |           | 9             |
| Other mortgage-backed          | 73               | 10                       | (4)            |           | 79            |
| Other asset-backed             | 777              | 160                      | (11)           |           | 926           |
| <b>Total</b>                   | <b>\$ 14,229</b> | <b>\$ 2,023</b>          | <b>\$ (65)</b> | <b>\$</b> | <b>16,187</b> |

The above table includes investments with a fair value of \$3.1 billion supporting the Company's run-off settlement annuity business, with gross unrealized appreciation of \$915 million and gross unrealized depreciation of \$8 million at September 30, 2012. Such unrealized amounts are required to support future policy benefit liabilities of this business and, as such, are not included in accumulated other comprehensive income. At December 31, 2011, investments supporting this business had a fair value of \$3 billion, gross unrealized appreciation of \$851 million and

gross unrealized depreciation of \$25 million.

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Sales information for available-for-sale fixed maturities and equity securities were as follows:

| (In millions)         | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|-----------------------|-------------------------------------|--------|------------------------------------|--------|
|                       | 2012                                | 2011   | 2012                               | 2011   |
| Proceeds from sales   | \$ 92                               | \$ 153 | \$ 447                             | \$ 457 |
| Gross gains on sales  | \$ 6                                | \$ 8   | \$ 25                              | \$ 36  |
| Gross losses on sales | \$ -                                | \$ (3) | \$ (1)                             | \$ (4) |

**Review of declines in fair value.** Management reviews fixed maturities with a decline in fair value from cost for impairment based on criteria that include:

- length of time and severity of decline;
- financial health and specific near term prospects of the issuer;
- changes in the regulatory, economic or general market environment of the issuer's industry or geographic region; and
- the Company's intent to sell or the likelihood of a required sale prior to recovery.

Excluding trading and hybrid securities, as of September 30, 2012, fixed maturities with a decline in fair value from amortized cost (primarily corporate, and other asset and mortgage-backed securities) were as follows, including the length of time of such decline:

| (In millions)          | Fair Value | Amortized Cost | Unrealized Depreciation | Number of Issues |
|------------------------|------------|----------------|-------------------------|------------------|
| Fixed maturities:      |            |                |                         |                  |
| One year or less:      |            |                |                         |                  |
| Investment grade       | \$ 342     | \$ 348         | \$ (6)                  | 160              |
| Below investment grade | \$ 98      | \$ 101         | \$ (3)                  | 69               |
| More than one year:    |            |                |                         |                  |
| Investment grade       | \$ 219     | \$ 231         | \$ (12)                 | 53               |
| Below investment grade | \$ 33      | \$ 45          | \$ (12)                 | 17               |

The unrealized depreciation of investment grade fixed maturities is primarily due to increases in market yields since purchase. There were no equity securities with a fair value significantly lower than cost as of September 30, 2012.

## Commercial Mortgage Loans

Mortgage loans held by the Company are collateralized exclusively by commercial real estate and are diversified by property type, location and borrower. Loans are secured by high quality, primarily completed and substantially leased operating properties, generally carried at unpaid principal balances and issued at a fixed rate of interest.

**Credit quality.** The Company applies a consistent and disciplined approach to evaluating and monitoring credit risk, beginning with the initial underwriting of a mortgage loan and continuing throughout the investment holding period. Mortgage origination professionals employ an internal rating system developed from the Company's experience in real estate investing and mortgage lending. A quality rating, designed to evaluate the relative risk of the transaction, is assigned at each loan's origination and is updated each year as part of the annual portfolio loan review. The Company monitors credit quality on an ongoing basis, classifying each loan as a loan in good standing, potential problem loan or problem loan.

Quality ratings are based on internal evaluations of each loan's specific characteristics considering a number of key inputs, including real estate market-related factors such as rental rates and vacancies, and property-specific inputs such as growth rate assumptions and lease rollover statistics. However, the two most significant contributors to the credit quality rating are the debt service coverage and loan-to-value ratios. The debt service coverage ratio measures the amount of property cash flow available to meet annual interest and principal payments on debt. A debt service coverage ratio below 1.0 indicates that there is not enough cash flow to cover the loan payments. The loan-to-value ratio, commonly expressed as a percentage, compares the amount of the loan to the fair value of the underlying property collateralizing the loan.

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The following tables summarize the credit risk profile of the Company's commercial mortgage loan portfolio based on loan-to-value and debt service coverage ratios, as of September 30, 2012 and December 31, 2011:

| September 30, 2012   |                             |                |                |                |                 |                 |
|----------------------|-----------------------------|----------------|----------------|----------------|-----------------|-----------------|
| <i>(In millions)</i> |                             |                |                |                |                 |                 |
| Loan-to-Value Ratios | Debt Service Coverage Ratio |                |                |                |                 | Total           |
|                      | 1.30x or Greater            | 1.20x to 1.29x | 1.10x to 1.19x | 1.00x to 1.09x | Less than 1.00x |                 |
| Below 50%            | \$ 278                      | \$ 8           | \$ -           | \$ 50          | \$ -            | \$ 336          |
| 50% to 59%           | 703                         | 105            | 25             | 52             | -               | 885             |
| 60% to 69%           | 572                         | 75             | -              | 24             | -               | 671             |
| 70% to 79%           | 194                         | 155            | 133            | 46             | 16              | 544             |
| 80% to 89%           | 45                          | 42             | 131            | -              | 58              | 276             |
| 90% to 99%           | 14                          | 30             | -              | -              | 58              | 102             |
| 100% or above        | -                           | -              | 30             | 36             | 66              | 132             |
| <b>Total</b>         | <b>\$ 1,806</b>             | <b>\$ 415</b>  | <b>\$ 319</b>  | <b>\$ 208</b>  | <b>\$ 198</b>   | <b>\$ 2,946</b> |

| December 31, 2011    |                             |                |                |                |                 |                 |
|----------------------|-----------------------------|----------------|----------------|----------------|-----------------|-----------------|
| <i>(In millions)</i> |                             |                |                |                |                 |                 |
| Loan-to-Value Ratios | Debt Service Coverage Ratio |                |                |                |                 | Total           |
|                      | 1.30x or Greater            | 1.20x to 1.29x | 1.10x to 1.19x | 1.00x to 1.09x | Less than 1.00x |                 |
| Below 50%            | \$ 225                      | \$ 55          | \$ 3           | \$ 50          | \$ 9            | \$ 342          |
| 50% to 59%           | 444                         | 47             | 26             | -              | 53              | 570             |
| 60% to 69%           | 646                         | 140            | 42             | -              | 77              | 905             |
| 70% to 79%           | 117                         | 132            | 120            | 159            | 33              | 561             |
| 80% to 89%           | 99                          | 81             | 79             | 72             | 71              | 402             |
| 90% to 99%           | 36                          | 35             | 30             | 58             | 116             | 275             |
| 100% or above        | -                           | 10             | 50             | 51             | 135             | 246             |
| <b>Total</b>         | <b>\$ 1,567</b>             | <b>\$ 500</b>  | <b>\$ 350</b>  | <b>\$ 390</b>  | <b>\$ 494</b>   | <b>\$ 3,301</b> |

The Company's annual in-depth review of its commercial mortgage loan investments is the primary mechanism for identifying emerging risks in the portfolio. The most recent review was completed by the Company's investment professionals in the second quarter of 2012 and included an analysis of each underlying property's most recent annual financial statements, rent rolls, operating plans, budgets, a physical inspection of the property and other pertinent factors. Based on historical results, current leases, lease expirations and rental conditions in each market, the Company estimates the current year and future stabilized property income and fair value, and categorizes the investments as loans in good standing, potential problem loans or problem loans. Based on property valuations and cash flows estimated as part of this review, and considering updates for loans where material changes were subsequently identified, the portfolio's average loan-to-value ratio improved to 65% at September 30, 2012, decreasing from 70% as of December 31, 2011. The portfolio's average debt service coverage ratio was estimated to be 1.57 at September 30, 2012, a significant improvement from 1.40 at December 31, 2011.

Quality ratings are adjusted between annual reviews if new property information is received or events such as delinquency or a borrower's request for restructure cause management to believe that the Company's estimate of financial performance, fair value or the risk profile of the underlying property has been impacted.

During 2012, the Company restructured a \$119 million problem mortgage loan, net of a valuation reserve, into two notes carried at \$100 million and \$19 million. The \$100 million note was reclassified to impaired commercial mortgage loans with no valuation reserves and the \$19 million note was classified as an other long-term investment. This modification was considered a troubled debt restructuring because the borrower was experiencing financial difficulties and an interest rate concession was granted. No valuation reserve was required because the fair value of the underlying property equaled the carrying value of the outstanding loan. Following the restructuring, the \$100 million note was paid down by \$46 million with the remaining \$54 million note reclassified to good standing due to an improved quality rating based on significant improvements in its loan-to-value and debt service coverage ratios resulting from the annual loan review.



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During 2011, the Company restructured a \$65 million potential problem loan into two notes carried at \$55 million and \$10 million. This modification was considered a troubled debt restructuring because the borrower was experiencing financial difficulties and an interest rate concession was granted. No valuation reserve was required because the fair value of the underlying property exceeded the carrying value of the outstanding loan. As a part of this restructuring, the borrowers and the Company have committed to fund additional capital for leasing and capital requirements.

Other loans were modified during the nine months ended September 30, 2012 and the twelve months ended December 31, 2011, but were not considered troubled debt restructurings. The impact of modifications to these loans was not material to the Company's results of operations, financial condition or liquidity.

Potential problem mortgage loans are considered current (no payment more than 59 days past due), but exhibit certain characteristics that increase the likelihood of future default. The characteristics management considers include, but are not limited to, the deterioration of debt service coverage below 1.0, estimated loan-to-value ratios increasing to 100% or more, downgrade in quality rating and request from the borrower for restructuring. In addition, loans are considered potential problems if principal or interest payments are past due by more than 30 but less than 60 days. Problem mortgage loans are either in default by 60 days or more or have been restructured as to terms, which could include concessions on interest rate, principal payment or maturity date. The Company monitors each problem and potential problem mortgage loan on an ongoing basis, and updates the loan categorization and quality rating when warranted.

Problem and potential problem mortgage loans, net of valuation reserves, totaled \$215 million at September 30, 2012 and \$336 million at December 31, 2011. At September 30, 2012, mortgage loans located in the South Atlantic region represented the most significant component of problem and potential problem mortgage loans, with no significant concentration by property type. At December 31, 2011, mortgage loans collateralized by industrial properties represent the most significant component of problem and potential problem mortgage loans, with no significant concentration by geographic region.

**Impaired commercial mortgage loans.** A commercial mortgage loan is considered impaired when it is probable that the Company will not collect all amounts due (principal and interest) according to the terms of the original loan agreement. The Company assesses each loan individually for impairment, using the information obtained from the quality review process discussed above. Impaired loans are carried at the lower of unpaid principal balance or the fair value of the underlying real estate. Certain commercial mortgage loans without valuation reserves are considered impaired because the Company will not collect all interest due according to the terms of the original agreements; however, the Company does expect to recover their remaining carrying value primarily because it is less than the fair value of the underlying real estate.

The carrying value of the Company's impaired commercial mortgage loans and related valuation reserves were as follows:

| (In millions)                                                 | September 30, 2012 |               |               | December 31, 2011 |                |               |
|---------------------------------------------------------------|--------------------|---------------|---------------|-------------------|----------------|---------------|
|                                                               | Gross              | Reserves      | Net           | Gross             | Reserves       | Net           |
| Impaired commercial mortgage loans with valuation reserves    | \$ 73              | \$ (7)        | \$ 66         | \$ 154            | \$ (19)        | \$ 135        |
| Impaired commercial mortgage loans with no valuation reserves | 60                 | -             | 60            | 60                | -              | 60            |
| <b>Total</b>                                                  | <b>\$ 133</b>      | <b>\$ (7)</b> | <b>\$ 126</b> | <b>\$ 214</b>     | <b>\$ (19)</b> | <b>\$ 195</b> |

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During the nine months ended September 30, 2012, the Company recorded a \$10 million pre-tax (\$7 million after-tax) increase in valuation reserves on three impaired commercial mortgage loans collateralized by industrial properties and one impaired commercial mortgage loan collateralized by a retail property. The average recorded investment in impaired loans was \$176 million during the nine months ended September 30, 2012 and \$166 million during the nine months ended September 30, 2011. The Company recognizes interest income on problem mortgage loans only when payment is actually received because of the risk profile of the underlying investment. Interest income that would have been reflected in net income if interest on non-accrual commercial mortgage loans had been received in accordance with the original terms was not significant for the nine months ended September 30, 2012 or 2011. Interest income on impaired commercial mortgage loans was not significant for the nine months ended September 30, 2012 or 2011.

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The following table summarizes the changes in valuation reserves for commercial mortgage loans:

| <i>(In millions)</i>                                     | 2012        | 2011         |
|----------------------------------------------------------|-------------|--------------|
| Reserve balance, January 1,                              | \$ 19       | \$ 12        |
| Increase in valuation reserves                           | 10          | 16           |
| Charge-offs upon sales and repayments, net of recoveries | (3)         | (1)          |
| Transfers to other long-term investments                 | (16)        | -            |
| Transfers to real estate                                 | (3)         | -            |
| <b>Reserve balance, September 30,</b>                    | <b>\$ 7</b> | <b>\$ 27</b> |

**Short-term investments and cash equivalents.** Short-term investments and cash equivalents includes corporate securities of \$702 million, federal government securities of \$203 million and money market funds of \$151 million as of September 30, 2012. The Company's short-term investments and cash equivalents as of December 31, 2011 included corporate securities of \$4.1 billion, federal government securities of \$164 million and money market funds of \$40 million.

## Note 10 Derivative Financial Instruments

The Company has written and purchased reinsurance contracts under its run-off reinsurance segment that are accounted for as free standing derivatives. The Company also uses derivative financial instruments to manage the equity, foreign currency, and certain interest rate risk exposures of its run-off reinsurance segment. In addition, the Company uses derivative financial instruments to manage the characteristics of investment assets to meet the varying demands of the related insurance and contractholder liabilities. See Note 2 to the Financial Statements contained in the Company's 2011 Annual Report for information on the Company's accounting policy for derivative financial instruments. Derivatives in the Company's separate accounts are excluded from the following discussion because associated gains and losses generally accrue directly to separate account policyholders.

**Collateral and termination features.** The Company routinely monitors exposure to credit risk associated with derivatives and diversifies the portfolio among approved dealers of high credit quality to minimize this risk. Certain of the Company's over-the-counter derivative instruments contain provisions requiring either the Company or the counterparty to post collateral or demand immediate payment depending on the amount of the net liability position and predefined financial strength or credit rating thresholds. Collateral posting requirements vary by counterparty. The net liability positions of these derivatives were not material as of September 30, 2012 or December 31, 2011.

## Derivative instruments associated with the Company's run-off reinsurance segment.

### Guaranteed Minimum Income Benefits (GMIB)

**Purpose.** The Company has written reinsurance contracts with issuers of variable annuity contracts that provide annuitants with certain guarantees of minimum income benefits resulting from the level of variable annuity account values compared with a contractually guaranteed

amount ( GMIB liabilities ). According to the contractual terms of the written reinsurance contracts, payment by the Company depends on the actual account value in the underlying mutual funds and the level of interest rates when the contractholders elect to receive minimum income payments. The Company has purchased retrocessional coverage for a portion of these contracts to reduce a portion of the risks assumed ( GMIB assets ).

*Accounting policy.* Because cash flows are affected by equity markets and interest rates, but are without significant life insurance risk and are settled in lump sum payments, the Company accounts for these GMIB liabilities and assets as written and purchased options at fair value. These derivatives are not designated as hedges and their fair values are reported in other liabilities (GMIB liability) and other assets (GMIB asset), with changes in fair value reported in GMIB fair value (gain) loss.

*Cash flows.* Under the terms of these written and purchased contracts, the Company periodically receives and pays fees based on either contractholders' account values or deposits increased at a contractual rate. The Company will also pay and receive cash depending on changes in account values and interest rates when contractholders first elect to receive minimum income payments. These cash flows are reported in operating activities.

*Volume of activity.* The potential undiscounted future payments for the written options (GMIB liability, as defined in Note 18) was \$1,101 million as of September 30, 2012 and \$1,244 million as of December 31, 2011. The potential undiscounted future receipts for the purchased options (GMIB asset) was \$606 million as of September 30, 2012 and \$684 million as of December 31, 2011.

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The following table provides the effect of these derivative instruments on the financial statements for the indicated periods:

**Fair Value Effect on the Financial Statements (In millions)**

| Instrument                       | Other Assets, including<br>other intangibles |                               | Accounts Payable, Accrued<br>Expenses and Other<br>Liabilities |                               | GMIB Fair Value (Gain) Loss                 |               |                                            |               |
|----------------------------------|----------------------------------------------|-------------------------------|----------------------------------------------------------------|-------------------------------|---------------------------------------------|---------------|--------------------------------------------|---------------|
|                                  | As of<br>September 30,<br>2012               | As of<br>December 31,<br>2011 | As of<br>September 30,<br>2012                                 | As of<br>December 31,<br>2011 | For the three months ended<br>September 30, |               | For the nine months ended<br>September 30, |               |
|                                  | 2012                                         | 2011                          | 2012                                                           | 2011                          | 2012                                        | 2011          | 2012                                       | 2011          |
| Written options (GMIB liability) | \$                                           | \$                            | \$ 1,184                                                       | \$ 1,333                      | \$ (131)                                    | \$ 483        | \$ (98)                                    | \$ 531        |
| Purchased options (GMIB asset)   | 625                                          | 712                           |                                                                |                               | 78                                          | (259)         | 65                                         | (286)         |
| <b>Total</b>                     | <b>\$ 625</b>                                | <b>\$ 712</b>                 | <b>\$ 1,184</b>                                                | <b>\$ 1,333</b>               | <b>\$ (53)</b>                              | <b>\$ 224</b> | <b>\$ (33)</b>                             | <b>\$ 245</b> |

**GMDB and GMIB Hedge Programs**

*Purpose.* The Company also uses derivative financial instruments under a dynamic hedge program designed to substantially reduce domestic and international equity market exposures resulting from changes in variable annuity account values based on underlying mutual funds for certain reinsurance contracts that guarantee minimum death benefits ( GMDB ). During the second quarter of 2012, the Company expanded this hedge program to cover approximately one-half of the equity market exposures associated with its GMIB business, increasing the covered exposure from approximately one-quarter. The Company also operates a dynamic hedge program to reduce the exposure to changes in interest rate levels on the growth rate for approximately one-third of its GMDB and one-quarter of its GMIB businesses ( GMDB and GMIB growth interest rate hedge program ). These hedge programs are dynamic because the Company will regularly rebalance the hedging instruments within established parameters as equity and interest rate exposures of these businesses change. See Notes 7 and 8 for further details regarding these businesses.

The Company manages these hedge programs using exchange-traded equity, foreign currency, and interest rate futures contracts, as well as interest rate swap contracts. These contracts are generally expected to rise in value as equity markets and interest rates decline, and decline in value as equity markets and interest rates rise.

*Accounting policy.* These hedge programs are not designated as accounting hedges. Although these hedge programs effectively reduce equity market, foreign currency, and interest rate exposures, changes in the fair values of these futures and swap contracts may not exactly offset changes in the portions of the GMDB and GMIB liabilities covered by these hedges, in part because the market does not offer contracts that exactly match the targeted exposure profile. Changes in fair value of these futures contracts, as well as interest income and interest expense relating to the swap contracts are reported in other revenues. The fair values of the interest rate swaps are reported in other assets and other liabilities. Amounts reflecting corresponding changes in liabilities for GMDB contracts are included in benefits and expenses.

*Cash flows.* The Company receives or pays cash daily in the amount of the change in fair value of the futures contracts. The Company periodically exchanges cash flows between variable and fixed interest rates under the interest rate swap contracts. Cash flows relating to these

contracts are included in operating activities.

*Volume of activity.* The notional values of futures and swap contracts used in the GMDB and GMIB equity and growth interest rate hedge programs are included in the following table. Equity futures consist primarily of S&P 500, S&P 400, Russell 2000, NASDAQ, TOPIX (Japanese), EUROSTOXX and FTSE (British) equity indices. Currency futures consist of Euros, Japanese yen and British pounds.

| <b>Instrument</b>                                  | <b>Notional Amount (In millions)</b> |                                    |
|----------------------------------------------------|--------------------------------------|------------------------------------|
|                                                    | <b>As of<br/>September 30, 2012</b>  | <b>As of<br/>December 31, 2011</b> |
| Equity and currency futures - equity hedge         | \$ 775                               | \$ 994                             |
| Interest rate swaps - growth interest rate hedge   | 240                                  | 240                                |
| U.S. Treasury futures - growth interest rate hedge | 18                                   | 29                                 |
| Eurodollar futures - growth interest rate hedge    | 597                                  | 598                                |
| <b>Total</b>                                       | <b>\$ 1,630</b>                      | <b>\$ 1,861</b>                    |

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The following tables provide the effect of these derivative instruments on the financial statements for the indicated periods:

**Fair Value Effect on the Financial Statements** *(In millions)*

|                                                | For the three months ended<br>September 30, |               | Other Revenues | For the nine months ended<br>September 30, |              |
|------------------------------------------------|---------------------------------------------|---------------|----------------|--------------------------------------------|--------------|
|                                                | 2012                                        | 2011          |                | 2012                                       | 2011         |
| Equity and currency futures for GMDB exposures | \$ (36)                                     | \$ 100        |                | \$ (100)                                   | \$ 51        |
| Equity and currency futures for GMIB exposures | (8)                                         | 10            |                | (14)                                       | 10           |
| <b>Total equity and currency futures (1)</b>   | <b>\$ (44)</b>                              | <b>\$ 110</b> |                | <b>\$ (114)</b>                            | <b>\$ 61</b> |

|                                              | Other Assets, including<br>other intangibles |                               | For the three months ended |                       | Other Revenues        |                       | For the nine months ended |                       |
|----------------------------------------------|----------------------------------------------|-------------------------------|----------------------------|-----------------------|-----------------------|-----------------------|---------------------------|-----------------------|
|                                              | As of<br>September 30,<br>2012               | As of<br>December 31,<br>2011 | September 30,<br>2012      | September 30,<br>2011 | September 30,<br>2012 | September 30,<br>2011 | September 30,<br>2012     | September 30,<br>2011 |
| Interest rate swaps                          | \$ 38                                        | \$ 33                         | \$ 2                       | \$ 25                 | \$ 9                  | \$ 37                 |                           |                       |
| Interest rate futures (1)                    | -                                            | -                             | -                          | (2)                   | (1)                   | (2)                   |                           |                       |
| <b>Total interest rate swaps and futures</b> | <b>\$ 38</b>                                 | <b>\$ 33</b>                  | <b>\$ 2</b>                | <b>\$ 23</b>          | <b>\$ 8</b>           | <b>\$ 35</b>          |                           |                       |
| Interest rate derivatives for GMDB exposures |                                              |                               | \$ 1                       | \$ 20                 | \$ 6                  | \$ 30                 |                           |                       |
| Interest rate derivatives for GMIB exposures |                                              |                               | 1                          | 3                     | 2                     | 5                     |                           |                       |
| <b>Total interest rate swaps and futures</b> |                                              |                               | <b>\$ 2</b>                | <b>\$ 23</b>          | <b>\$ 8</b>           | <b>\$ 35</b>          |                           |                       |

(1) Balance sheet presentation of amounts receivable or payable relating to futures daily variation margin are not fair values and are excluded from this table.

## Derivative instruments used in the Company's investment risk management.

Derivative financial instruments are also used by the Company as a part of its investment strategy to manage the characteristics of investment assets (such as duration, yield, currency and liquidity) to meet the varying demands of the related insurance and contractholder liabilities (such as paying claims, investment returns and withdrawals). Derivatives are typically used in this strategy to reduce interest rate and foreign currency risks.

### Investment Cash Flow Hedges

*Purpose.* The Company uses interest rate, foreign currency, and combination (interest rate and foreign currency) swap contracts to hedge the interest and/or foreign currency cash flows of its fixed maturity bonds to match associated insurance liabilities.

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*Accounting policy.* Using cash flow hedge accounting, fair values are reported in other long-term investments or other liabilities and accumulated other comprehensive income and amortized into net investment income or reported in other realized investment gains and losses as interest or principal payments are received. Net interest cash flows are reported in operating activities.

*Cash flows.* Under the terms of these various contracts, the Company periodically exchanges cash flows between variable and fixed interest rates and/or between two currencies for both principal and interest. Foreign currency swaps are primarily Euros, Australian dollars, Canadian dollars, Japanese yen, and British pounds, and have terms for periods of up to 9 years.

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*Volume of activity.* The following table provides the notional values of these derivative instruments for the indicated periods:

| Instrument                                           | Notional Amount (In millions) |                   |
|------------------------------------------------------|-------------------------------|-------------------|
|                                                      | As of                         | As of             |
|                                                      | September 30, 2012            | December 31, 2011 |
| Interest rate swaps                                  | \$ 60                         | \$ 134            |
| Foreign currency swaps                               | 134                           | 134               |
| Combination interest rate and foreign currency swaps | 64                            | 64                |
| <b>Total</b>                                         | <b>\$ 258</b>                 | <b>\$ 332</b>     |

The following table provides the effect of these derivative instruments on the financial statements for the indicated periods:

**Fair Value Effect on the Financial Statements (In millions)**

| Instrument                                           | Other Long-Term Investments |                   | Accounts Payable, Accrued Expenses and Other Liabilities |                   | Gain (Loss) Recognized in Other Comprehensive Income (1) |              |                           |             |
|------------------------------------------------------|-----------------------------|-------------------|----------------------------------------------------------|-------------------|----------------------------------------------------------|--------------|---------------------------|-------------|
|                                                      | As of                       | As of             | As of                                                    | As of             | For the three months ended                               |              | For the nine months ended |             |
|                                                      | September 30, 2012          | December 31, 2011 | September 30, 2012                                       | December 31, 2011 | September 30, 2012                                       | 2011         | September 30, 2012        | 2011        |
| Interest rate swaps                                  | \$ 5                        | \$ 7              | \$ -                                                     | \$ -              | \$ (1)                                                   | \$ -         | \$ (2)                    | \$ (2)      |
| Foreign currency swaps                               | 2                           | 3                 | 20                                                       | 19                | (3)                                                      | 10           | (1)                       | -           |
| Combination interest rate and foreign currency swaps | -                           | -                 | 12                                                       | 11                | (2)                                                      | 9            | (1)                       | 4           |
| <b>Total</b>                                         | <b>\$ 7</b>                 | <b>\$ 10</b>      | <b>\$ 32</b>                                             | <b>\$ 30</b>      | <b>\$ (6)</b>                                            | <b>\$ 19</b> | <b>\$ (4)</b>             | <b>\$ 2</b> |

(1) Other comprehensive income for foreign currency swaps excludes amounts required to adjust future policy benefits for the run-off settlement annuity business.

For the three months and nine months ended September 30, 2012 and 2011, the amount of gains (losses) reclassified from accumulated other comprehensive income into net income was not material. The amount of gains (losses) recognized due to ineffectiveness was not material and there were no amounts excluded from the assessment of hedge effectiveness.

**Note 11 Variable Interest Entities**

When the Company becomes involved with a variable interest entity and when the nature of the Company's involvement with the entity changes, in order to determine if the Company is the primary beneficiary and must consolidate the entity, it evaluates:

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- the structure and purpose of the entity;
- the risks and rewards created by and shared through the entity; and
- the entity's participants' ability to direct the activities, receive its benefits and absorb its losses. Participants include the entity's sponsors, equity holders, guarantors, creditors and servicers.

In the normal course of its investing activities, the Company makes passive investments in securities that are issued by variable interest entities for which the Company is not the sponsor or manager. These investments are predominantly asset-backed securities primarily collateralized by foreign bank obligations and mortgage-backed securities. The asset-backed securities largely represent fixed-rate debt securities issued by trusts which hold perpetual floating-rate subordinated notes issued by foreign banks. The mortgage-backed securities represent senior interests in pools of commercial or residential mortgages created and held by special-purpose entities to provide investors with diversified exposure to these assets. The Company owns senior securities issued by several entities and receives fixed-rate cash flows from the underlying assets in the pools. The Company is not the primary beneficiary and does not consolidate any of these entities because either:

- it had no power to direct the activities that most significantly impact the entities' economic performance; or
- it had no right to receive benefits nor obligation to absorb losses that could be significant to these variable interest entities.

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The Company has not provided, and does not intend to provide, financial support to these entities. The Company performs ongoing qualitative analyses of its involvement with these variable interest entities to determine if consolidation is required. The Company's maximum potential exposure to loss related to these entities is limited to the carrying amount of its investment reported in fixed maturities and equity securities, and its aggregate ownership interest is insignificant relative to the total principal amount issued by these entities.

## Note 12 Reinsurance

The Company's insurance subsidiaries enter into agreements with other insurance companies to assume and cede reinsurance. Reinsurance is ceded primarily to limit losses from large exposures and to permit recovery of a portion of direct losses. Reinsurance is also used in acquisition and disposition transactions when the underwriting company is not being acquired. Reinsurance does not relieve the originating insurer of liability. The Company regularly evaluates the financial condition of its reinsurers and monitors its concentrations of credit risk.

**Great American life and annuity business.** The Company had reinsurance recoverables of approximately \$404 million as of September 30, 2012 from Great American Life Insurance Company resulting from the acquisition of Great American's Supplemental Benefits business on August 31, 2012. The life insurance and annuity lines of business written by the acquired legal entities were fully reinsured by the seller as part of the transaction. The resulting reinsurance recoverables are secured primarily by fixed maturities whose book value is equal to or greater than 100% of the reinsured policy liabilities. These fixed maturities are held in a trust established for the benefit of the Company.

**Retirement benefits business.** The Company had reinsurance recoverables of \$1.4 billion as of September 30, 2012 and \$1.6 billion as of December 31, 2011 from Prudential Retirement Insurance and Annuity Company resulting from the sale of the retirement benefits business, which was primarily in the form of a reinsurance arrangement. The reinsurance recoverable, which is reduced as the Company's reinsured liabilities are paid or directly assumed by the reinsurer, is secured primarily by fixed maturities whose book value is equal to or greater than 100% of the reinsured liabilities. These fixed maturities are held in a trust established for the benefit of the Company. As of September 30, 2012, the book value of the trust assets exceeded the recoverable.

**Individual life and annuity reinsurance.** The Company had reinsurance recoverables of \$4.1 billion as of September 30, 2012 and \$4.2 billion as of December 31, 2011 from The Lincoln National Life Insurance Company and Lincoln Life & Annuity of New York resulting from the 1998 sale of the Company's individual life insurance and annuity business through indemnity reinsurance arrangements. The Lincoln National Life Insurance Company and Lincoln Life & Annuity of New York must maintain a specified minimum credit or claims paying rating, or it will be required to fully secure the outstanding balance. As of September 30, 2012 both companies had ratings sufficient to avoid triggering this contractual obligation.

## Other Ceded and Assumed Reinsurance

**Ceded Reinsurance: Ongoing operations.** The Company's insurance subsidiaries have reinsurance recoverables from various reinsurance arrangements in the ordinary course of business for its Health Care, Disability and Life, and International segments as well as the non-leveraged and leveraged corporate-owned life insurance business. Reinsurance recoverables of \$347 million as of September 30, 2012 are expected to be collected from more than 75 reinsurers.

The Company reviews its reinsurance arrangements and establishes reserves against the recoverables in the event that recovery is not considered probable. As of September 30, 2012, the Company's recoverables related to these segments were net of a reserve of \$4 million.

***Assumed and Ceded reinsurance: Run-off Reinsurance segment.*** The Company's Run-off Reinsurance operations assumed risks related to GMDB contracts, GMIB contracts, workers' compensation, and personal accident business and also purchased retrocessional coverage to reduce the risk of loss on these contracts. In 2010, the Company entered into reinsurance arrangements to transfer the remaining liabilities and administration of the workers' compensation and personal accident businesses to a subsidiary of Enstar Group Limited. Under this arrangement, the new reinsurer also assumes the future risk of collection from prior reinsurers.

Liabilities related to GMDB, workers' compensation and personal accident are included in future policy benefits and unpaid claims. Because the GMIB contracts are treated as derivatives under GAAP, the asset related to GMIB is recorded in the caption Other assets, including other intangibles and the liability related to GMIB is recorded in the caption Accounts payable, accrued expenses, and other liabilities on the Company's Consolidated Balance Sheets (see Notes 8 and 18 for additional discussion of the GMIB assets and liabilities).

The reinsurance recoverables for GMDB, workers' compensation, and personal accident total \$177 million as of September 30, 2012.

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Of this amount, approximately 91% are secured by assets in trust or letters of credit.

The Company reviews its reinsurance arrangements and establishes reserves against the recoverables in the event that recovery is not considered probable. As of September 30, 2012, the Company's recoverables related to this segment were net of a reserve of \$1 million.

The Company's payment obligations for underlying reinsurance exposures assumed by the Company under these contracts are based on the ceding companies' claim payments. For GMDB, claim payments vary because of changes in equity markets and interest rates, as well as claim mortality and contractholder behavior. Any of these claim payments can extend many years into the future, and the amount of the ceding companies' ultimate claims, and therefore the amount of the Company's ultimate payment obligations and corresponding ultimate collection from retrocessionaires, may not be known with certainty for some time.

**Summary.** The Company's reserves for underlying reinsurance exposures assumed by the Company, as well as for amounts recoverable from reinsurers/retrocessionaires for both ongoing operations and the run-off reinsurance operation, are considered appropriate as of September 30, 2012, based on current information. However, it is possible that future developments could have a material adverse effect on the Company's consolidated results of operations and, in certain situations, such as if actual experience differs from the assumptions used in estimating reserves for GMDB, could have a material adverse effect on the Company's financial condition. The Company bears the risk of loss if its retrocessionaires do not meet or are unable to meet their reinsurance obligations to the Company.

**Effects of reinsurance.** In the Company's Consolidated Statements of Income, Premiums and fees were net of ceded premiums, and Total benefits and expenses were net of reinsurance recoveries, in the following amounts:

| (In millions)                                       | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |               |
|-----------------------------------------------------|-------------------------------------|---------------|------------------------------------|---------------|
|                                                     | 2012                                | 2011          | 2012                               | 2011          |
| <b>Ceded premiums and fees</b>                      |                                     |               |                                    |               |
| Individual life insurance and annuity business sold | \$ 41                               | \$ 50         | \$ 138                             | \$ 146        |
| Other                                               | 72                                  | 62            | 208                                | 179           |
| <b>Total</b>                                        | <b>\$ 113</b>                       | <b>\$ 112</b> | <b>\$ 346</b>                      | <b>\$ 325</b> |
| <b>Reinsurance recoveries</b>                       |                                     |               |                                    |               |
| Individual life insurance and annuity business sold | \$ 79                               | \$ 67         | \$ 216                             | \$ 219        |
| Other                                               | 54                                  | 64            | 150                                | 157           |
| <b>Total</b>                                        | <b>\$ 133</b>                       | <b>\$ 131</b> | <b>\$ 366</b>                      | <b>\$ 376</b> |

Table of Contents**Note 13 Pension and Other Postretirement Benefit Plans**

The Company and certain of its subsidiaries provide pension, health care and life insurance defined benefits to eligible retired employees, spouses and other eligible dependents through various domestic and foreign plans. The effect of its foreign pension and other postretirement benefit plans is immaterial to the Company's results of operations, liquidity and financial position. Effective July 1, 2009, the Company froze its primary domestic defined benefit pension plans.

For the nine months ended September 30, 2012, the Company's unrecognized actuarial losses and prior service costs (reported in accumulated other comprehensive income) decreased by \$66 million pre-tax in the aggregate (\$44 million after-tax) resulting in an increase in shareholders equity. This decrease was primarily a result of net amortization of actuarial losses and prior service cost, results of the annual actuarial review completed during the second quarter of 2012, and settlement charges in the Company's non-qualified pension plan caused by lump sum payments that exceeded the expected annual interest cost.

**Pension and Other Postretirement Benefits.** Components of net pension and net other postretirement benefit costs were as follows:

| (In millions)                            | Pension Benefits   |             |                   |             | Other Postretirement Benefits |             |                   |             |
|------------------------------------------|--------------------|-------------|-------------------|-------------|-------------------------------|-------------|-------------------|-------------|
|                                          | Three Months Ended |             | Nine Months Ended |             | Three Months Ended            |             | Nine Months Ended |             |
|                                          | September 30,      |             | September 30,     |             | September 30,                 |             | September 30,     |             |
|                                          | 2012               | 2011        | 2012              | 2011        | 2012                          | 2011        | 2012              | 2011        |
| Service cost                             | \$ 1               | \$ -        | \$ 2              | \$ 1        | \$ -                          | \$ -        | \$ 1              | \$ 1        |
| Interest cost                            | 50                 | 57          | 149               | 171         | 4                             | 5           | 12                | 15          |
| Expected long-term return on plan assets | (69)               | (67)        | (203)             | (200)       | -                             | -           | -                 | -           |
| Amortization of:                         |                    |             |                   |             |                               |             |                   |             |
| Net loss from past experience            | 15                 | 10          | 45                | 29          | -                             | -           | -                 | -           |
| Prior service cost                       | -                  | -           | -                 | -           | (3)                           | (4)         | (9)               | (12)        |
| Settlement loss                          | -                  | -           | 6                 | -           | -                             | -           | -                 | -           |
| <b>Net cost</b>                          | <b>\$ (3)</b>      | <b>\$ -</b> | <b>\$ (1)</b>     | <b>\$ 1</b> | <b>\$ 1</b>                   | <b>\$ 1</b> | <b>\$ 4</b>       | <b>\$ 4</b> |

The Company funds its domestic qualified pension plans at least at the minimum amount required by the Pension Protection Act of 2006. For the nine months ended September 30, 2012, the Company contributed \$226 million to those plans, of which \$90 million was required and \$136 million was voluntary. For the remainder of 2012, the Company expects to make additional contributions of \$24 million.

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Short-term and long-term debt were as follows:

| <i>(In millions)</i>                 | September 30,<br>2012 | December 31,<br>2011 |
|--------------------------------------|-----------------------|----------------------|
| <b>Short-term:</b>                   |                       |                      |
| Commercial paper                     | \$ 225                | \$ 100               |
| Current maturities of long-term debt | 1                     | 4                    |
| <b>Total short-term debt</b>         | <b>\$ 226</b>         | <b>\$ 104</b>        |
| <b>Long-term:</b>                    |                       |                      |
| Uncollateralized debt:               |                       |                      |
| 2.75% Notes due 2016                 | \$ 600                | \$ 600               |
| 5.375% Notes due 2017                | 250                   | 250                  |
| 6.35% Notes due 2018                 | 131                   | 131                  |
| 8.5% Notes due 2019                  | 251                   | 251                  |
| 4.375% Notes due 2020                | 249                   | 249                  |
| 5.125% Notes due 2020                | 299                   | 299                  |
| 6.37% Notes due 2021                 | 78                    | 78                   |
| 4.5% Notes due 2021                  | 298                   | 298                  |
| 4% Notes due 2022                    | 743                   | 743                  |
| 7.65% Notes due 2023                 | 100                   | 100                  |
| 8.3% Notes due 2023                  | 17                    | 17                   |
| 7.875% Debentures due 2027           | 300                   | 300                  |
| 8.3% Step Down Notes due 2033        | 83                    | 83                   |
| 6.15% Notes due 2036                 | 500                   | 500                  |
| 5.875% Notes due 2041                | 298                   | 298                  |
| 5.375% Notes due 2042                | 750                   | 750                  |
| Other                                | 39                    | 43                   |
| <b>Total long-term debt</b>          | <b>\$ 4,986</b>       | <b>\$ 4,990</b>      |

As further described in Note 3, the Company acquired HealthSpring on January 31, 2012. At the acquisition date, HealthSpring had \$326 million of debt outstanding. In accordance with debt covenants, HealthSpring's debt obligation was paid immediately following the acquisition. This repayment is reported as a financing activity in the statement of cash flows for the nine months ended September 30, 2012.

The Company has a committed revolving credit and a letter of credit agreement in place for up to \$1.5 billion subject to the maximum debt leverage covenant agreement. As of September 30, 2012, the Company had \$1.4 billion of borrowing capacity under this credit agreement, reflecting \$66 million of letters of credit issued out of the credit facility. Within the maximum debt leverage covenant in the line of credit agreement, the Company has an additional \$4.9 billion of borrowing capacity in addition to the \$5.2 billion of debt outstanding.

Table of Contents**Note 15 Accumulated Other Comprehensive Loss**

Accumulated other comprehensive loss excludes amounts required to adjust future policy benefits for the run-off settlement annuity business. Changes in accumulated other comprehensive loss were as follows:

| <i>(In millions)</i>                                                                                    | <b>Pre-Tax</b> | <b>Tax<br/>(Expense)<br/>Benefit</b> | <b>After-Tax</b> |
|---------------------------------------------------------------------------------------------------------|----------------|--------------------------------------|------------------|
| <b>Three Months Ended September 30, 2012</b>                                                            |                |                                      |                  |
| <b>Net unrealized appreciation, securities:</b>                                                         |                |                                      |                  |
| Net unrealized appreciation on securities arising during the period                                     | \$ 134         | \$ (45)                              | \$ 89            |
| Reclassification adjustment for (gains) included in shareholders' net income                            | (9)            | 3                                    | (6)              |
| Net unrealized appreciation, securities                                                                 | \$ 125         | \$ (42)                              | \$ 83            |
| <b>Net unrealized depreciation, derivatives</b>                                                         | \$ (5)         | \$ 1                                 | \$ (4)           |
| <b>Net translation of foreign currencies</b>                                                            | \$ 39          | \$ (8)                               | \$ 31            |
| <b>Postretirement benefits liability adjustment:</b>                                                    |                |                                      |                  |
| Reclassification adjustment for amortization of net losses from past experience and prior service costs | \$ 12          | \$ (4)                               | \$ 8             |
| Net postretirement benefits liability adjustment                                                        | \$ 12          | \$ (4)                               | \$ 8             |
| <b>Three Months Ended September 30, 2011</b>                                                            |                |                                      |                  |
| <b>Net unrealized appreciation, securities:</b>                                                         |                |                                      |                  |
| Net unrealized appreciation on securities arising during the period                                     | \$ 115         | \$ (39)                              | \$ 76            |
| Reclassification adjustment for losses included in shareholders' net income                             | 23             | (8)                                  | 15               |
| Net unrealized appreciation, securities                                                                 | \$ 138         | \$ (47)                              | \$ 91            |
| <b>Net unrealized appreciation, derivatives</b>                                                         | \$ 20          | \$ (7)                               | \$ 13            |
| <b>Net translation of foreign currencies</b>                                                            | \$ (111)       | \$ 16                                | \$ (95)          |
| <b>Postretirement benefits liability adjustment:</b>                                                    |                |                                      |                  |
| Reclassification adjustment for amortization of net losses from past experience and prior service costs | \$ 6           | \$ (2)                               | \$ 4             |

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| (In millions)                                                                                           | Pre-Tax |      | Tax<br>(Expense)<br>Benefit | After-Tax |    |      |
|---------------------------------------------------------------------------------------------------------|---------|------|-----------------------------|-----------|----|------|
| <b>Nine Months Ended September 30, 2012</b>                                                             |         |      |                             |           |    |      |
| <b>Net unrealized appreciation, securities:</b>                                                         |         |      |                             |           |    |      |
| Net unrealized appreciation on securities arising during the year                                       | \$      | 283  | \$                          | (94)      | \$ | 189  |
| Reclassification adjustment for (gains) included in shareholders' net income                            |         | (28) |                             | 10        |    | (18) |
| Net unrealized appreciation, securities                                                                 | \$      | 255  | \$                          | (84)      | \$ | 171  |
| <b>Net unrealized depreciation, derivatives</b>                                                         | \$      | (5)  | \$                          | 1         | \$ | (4)  |
| <b>Net translation of foreign currencies</b>                                                            | \$      | 37   | \$                          | (14)      | \$ | 23   |
| <b>Postretirement benefits liability adjustment:</b>                                                    |         |      |                             |           |    |      |
| Reclassification adjustment for amortization of net losses from past experience and prior service costs | \$      | 36   | \$                          | (12)      | \$ | 24   |
| Reclassification adjustment for settlement                                                              |         | 6    |                             | (2)       |    | 4    |
| Total reclassification adjustments to shareholders' net income                                          |         | 42   |                             | (14)      |    | 28   |
| Net change due to valuation update                                                                      |         | 24   |                             | (8)       |    | 16   |
| Net postretirement benefits liability adjustment                                                        | \$      | 66   | \$                          | (22)      | \$ | 44   |
| <b>Nine Months Ended September 30, 2011</b>                                                             |         |      |                             |           |    |      |
| <b>Net unrealized appreciation, securities:</b>                                                         |         |      |                             |           |    |      |
| Net unrealized appreciation on securities arising during the year                                       | \$      | 292  | \$                          | (99)      | \$ | 193  |
| Reclassification adjustment for (gains) included in shareholders' net income                            |         | (31) |                             | 10        |    | (21) |
| Net unrealized appreciation, securities                                                                 | \$      | 261  | \$                          | (89)      | \$ | 172  |
| <b>Net unrealized appreciation, derivatives</b>                                                         | \$      | 5    | \$                          | (2)       | \$ | 3    |
| <b>Net translation of foreign currencies</b>                                                            | \$      | (14) | \$                          | 7         | \$ | (7)  |
| <b>Postretirement benefits liability adjustment:</b>                                                    |         |      |                             |           |    |      |
| Reclassification adjustment for amortization of net losses from past experience and prior service costs | \$      | 17   | \$                          | (6)       | \$ | 11   |
| Net change due to valuation update                                                                      |         | 3    |                             | (1)       |    | 2    |
| Net postretirement benefits liability adjustment                                                        | \$      | 20   | \$                          | (7)       | \$ | 13   |

**Note 16 Income Taxes****A. Income Tax Expense**

The Company continues to accrue income taxes on undistributed earnings of certain foreign operations using the foreign jurisdictions' tax rates, as compared to the higher U.S. statutory tax rate. Beginning in the first quarter of 2012, the Company began computing income taxes attributable to its China and Indonesia operations using the same method, based upon a determination that the earnings of these operations would be permanently invested overseas. The Company continues to evaluate the permanent investment of foreign earnings for additional jurisdictions.

Shareholders' net income for the nine months ended September 30, 2012 increased by \$29 million, that included \$13 million attributable to the first quarter implementation of this method for the Company's China and Indonesia operations. Shareholders' net income for the nine months ended September 30, 2011 increased by \$22 million related to this method. Permanent investment of foreign operation earnings has resulted in cumulative unrecognized deferred tax liabilities of \$98 million through September 30, 2012. The year-to-date change in the cumulative unrecognized deferred tax liability includes a \$9 million reduction due to the transition in the accounting for deferred acquisition costs, that was adopted through retrospective adjustment on January 1, 2012. See Note 2 for additional information.



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## B. Unrecognized Tax Benefits

Gross unrecognized tax benefits increased for the nine months ended September 30, 2012 by \$15 million, resulting in a decrease to shareholders net income of \$10 million.

During the first quarter of 2011, the IRS completed its examination of the Company's 2007 and 2008 consolidated federal income tax returns, resulting in an increase to shareholders' net income of \$24 million (\$33 million reported in income tax expense, partially offset by a \$9 million pre-tax charge). The increase in shareholders' net income included a reduction in net unrecognized tax benefits of \$11 million and a reduction of interest expense of \$11 million (reported in income tax expense).

The Company has determined it is at least reasonably possible that within the next twelve months there could be a significant change in the level of unrecognized tax benefits should there be developments relative to certain IRS specific matters. Any changes are not expected to have a material impact on shareholders' net income.

## C. Other Tax Matters

The Company has had a continuing dispute with the IRS for tax years 2004 through 2006 regarding the appropriate reserve methodology for certain reinsurance contracts. Trial was held before the United States Tax Court for the 2004 tax year in September 2011. Prior to trial, the IRS conceded the adjustments, but continued to disagree with the Company's reserve methodology. Though the IRS concession represented a favorable development that significantly limited exposure, the Company continued to pursue the litigation in order to establish that its methodology was appropriate and could be applied prospectively. The IRS raised the same issue in its audit of the Company's 2005 and 2006 tax returns. As a result, the Company filed a petition with the United States Tax Court for these years on September 19, 2011. On September 13, 2012, the United States Tax Court issued its opinion for the 2004 year. While declining to rule on the underlying legal issue, the Tax Court opinion referenced an IRS representation that it would not challenge the Company's reserving methodology in future tax years, thereby providing certainty that the Company may use its current reserve methodology prospectively. Relative to tax years 2005 and 2006, the Tax Court has demonstrated an intention to apply its decision in the 2004 proceedings to these years. The parties are finalizing the necessary documentation to permit the Tax Court to enter its final decision for the 2004, 2005 and 2006 tax years.

The IRS has commenced examination of the Company's 2009 and 2010 consolidated federal income tax returns; this examination is not expected to be completed prior to 2013.

### Note 17 Segment Information

The Company's operating segments generally reflect groups of related products, but the International segment is generally based on geography. Beginning with the acquisition of HealthSpring in January 2012, the financial results of the former Health Care operating segment and this newly acquired Medicare operating segment have been aggregated as the Health Care reportable segment reflecting their similar economic

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characteristics, products and services, customers, distribution methods, operational processes and regulatory environment. Results of the recently acquired Great American Supplemental Benefits business are reported in the supplemental health, life and accident business included in the International segment. Other operating segments that do not require separate disclosure have been combined into Other Operations.

The Company measures the financial results of its segments using segment earnings (loss), which is defined as shareholders' net income (loss) excluding after-tax realized investment gains and losses. As discussed in Note 2, in 2012, the Company adopted amended accounting guidance for deferred acquisition costs through retrospective adjustment of prior periods. See Note 2 for the effect of this amended guidance on previously reported segment revenue and earnings amounts.

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Summarized segment financial information was as follows:

| (In millions)                                                             | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |               |
|---------------------------------------------------------------------------|-------------------------------------|---------------|------------------------------------|---------------|
|                                                                           | 2012                                | 2011          | 2012                               | 2011          |
| <b>Premiums and fees, Mail order pharmacy revenues and Other revenues</b> |                                     |               |                                    |               |
| Health Care                                                               | \$ 5,385                            | \$ 3,671      | \$ 15,788                          | \$ 11,101     |
| International                                                             | 938                                 | 768           | 2,717                              | 2,212         |
| Disability and Life                                                       | 758                                 | 698           | 2,250                              | 2,103         |
| Run-off Reinsurance                                                       | (37)                                | 138           | (90)                               | 114           |
| Other Operations                                                          | 36                                  | 40            | 114                                | 126           |
| Corporate                                                                 | (16)                                | (15)          | (50)                               | (44)          |
| Total                                                                     | \$ 7,064                            | \$ 5,300      | \$ 20,729                          | \$ 15,612     |
| <b>Shareholders' net income</b>                                           |                                     |               |                                    |               |
| Health Care                                                               | \$ 345                              | \$ 248        | \$ 919                             | \$ 775        |
| International                                                             | 70                                  | 62            | 215                                | 180           |
| Disability and Life                                                       | 60                                  | 62            | 214                                | 232           |
| Run-off Reinsurance                                                       | 25                                  | (180)         | (7)                                | (189)         |
| Other Operations                                                          | 22                                  | 25            | 63                                 | 68            |
| Corporate                                                                 | (63)                                | (43)          | (203)                              | (116)         |
| Segment Earnings                                                          | 459                                 | 174           | 1,201                              | 950           |
| Realized investment gains, net of taxes                                   | 7                                   | 9             | 16                                 | 37            |
| <b>Shareholders' net income</b>                                           | <b>\$ 466</b>                       | <b>\$ 183</b> | <b>\$ 1,217</b>                    | <b>\$ 987</b> |

**Concentration of risk.** For the Company's International segment, South Korea is the single largest geographic market. South Korea generated 30% of the segment's revenues and 55% of the segment's earnings for the three months ended September 30, 2012. South Korea generated 29% of the segment's revenues and 49% of the segment's earnings for the nine months ended September 30, 2012. Due to the concentration of business in South Korea, the International segment is exposed to potential losses resulting from economic, regulatory and geopolitical developments in that country, as well as foreign currency movements affecting the South Korean currency, which could have a significant impact on the segment's results and the Company's consolidated financial results.

## Note 18 Contingencies and Other Matters

The Company, through its subsidiaries, is contingently liable for various financial guarantees provided in the ordinary course of business.

## Financial Guarantees Primarily Associated with the Sold Retirement Benefits Business

Separate account assets are contractholder funds maintained in accounts with specific investment objectives. The Company records separate account liabilities equal to separate account assets. In certain cases, primarily associated with the sold retirement benefits business (that was sold in April 2004), the Company guarantees a minimum level of benefits for retirement and insurance contracts written in separate accounts. The Company establishes an additional liability if management believes that the Company will be required to make a payment under these guarantees.

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The Company guarantees that separate account assets will be sufficient to pay certain retiree or life benefits. The sponsoring employers are primarily responsible for ensuring that assets are sufficient to pay these benefits and are required to maintain assets that exceed a certain percentage of benefit obligations. This percentage varies depending on the asset class within a sponsoring employer's portfolio (for example, a bond fund would require a lower percentage than a riskier equity fund) and thus will vary as the composition of the portfolio changes. If employers do not maintain the required levels of separate account assets, the Company or an affiliate of the buyer has the right to redirect the management of the related assets to provide for benefit payments. As of September 30, 2012, employers maintained assets that exceeded the benefit obligations. Benefit obligations under these arrangements were \$1.2 billion as of September 30, 2012. Approximately 65% of these guarantees are reinsured by an affiliate of the buyer of the retirement benefits business. The remaining guarantees are provided by the Company with minimal reinsurance from third parties. There were no additional liabilities required for these guarantees as of September 30, 2012. Separate account assets supporting these guarantees are classified in Levels 1 and 2 of the GAAP fair value hierarchy. See Note 8 for further information on the fair value hierarchy.

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The Company does not expect that these financial guarantees will have a material effect on the Company's consolidated results of operations, liquidity or financial condition.

## Other Financial Guarantees

**Guaranteed minimum income benefit (GMIB) contracts.** The Company's reinsurance operations, that were discontinued in 2000 and are now an inactive business in run-off mode, reinsured minimum income benefits under certain variable annuity contracts issued by other insurance companies. A contractholder can elect to annuitize the benefit within 30 days of any eligible policy anniversary after a specified contractual waiting period. The Company's exposure arises when the guaranteed annuitization benefit exceeds the annuitization benefit based on the policy's current account value. At the time of annuitization, the Company pays the excess (if any) of the guaranteed benefit over the benefit based on the current account value in a lump sum to the direct writing insurance company.

In periods of declining equity markets or declining interest rates, the Company's GMIB liabilities increase. Conversely, in periods of rising equity markets and rising interest rates, the Company's liabilities for these benefits decrease.

The Company estimates the fair value of the GMIB assets and liabilities using assumptions for market returns and interest rates, volatility of the underlying equity and bond mutual fund investments, mortality, lapse, annuity election rates, nonperformance risk, and risk and profit charges. See Note 8 for additional information on how fair values for these liabilities and related receivables for retrocessional coverage are determined and Note 10 for information on the Company's dynamic equity and growth interest rate hedge programs for this business.

The Company is required to disclose the maximum potential undiscounted future payments for GMIB contracts. Under these guarantees, the future payment amounts are dependent on equity and bond fund market and interest rate levels prior to and at the date of annuitization election, which must occur within 30 days of a policy anniversary, after the appropriate waiting period. Therefore, the future payments are not fixed and determinable under the terms of the contract. Accordingly, the Company has estimated the maximum potential undiscounted future payments using hypothetical adverse assumptions, defined as follows:

- no annuitants surrendered their accounts;
- all annuitants lived to elect their benefit;
- all annuitants elected to receive their benefit on the next available date (2012 through 2019); and
- all underlying mutual fund investment values remained at the September 30, 2012 value of \$1.1 billion with no future returns.

The maximum potential undiscounted payments that the Company would make under those assumptions would aggregate \$1.1 billion before reinsurance recoveries. The Company expects the amount of actual payments to be significantly less than this hypothetical undiscounted aggregate amount. The Company has retrocessional coverage in place from two external reinsurers which covers 55% of the exposures on these contracts. The receivable from one of these reinsurers is substantially collateralized by assets held in a trust. The Company bears the risk of loss if its retrocessionaires do not meet or are unable to meet their reinsurance obligations to the Company.

***Certain other guarantees.*** The Company had indemnification obligations to lenders of up to \$294 million as of September 30, 2012, related to borrowings by certain real estate joint ventures which the Company either records as an investment or consolidates. These borrowings, which are nonrecourse to the Company, are secured by the joint ventures' real estate properties with fair values in excess of the loan amounts and mature at various dates beginning in 2013 through 2042. The Company's indemnification obligations would require payment to lenders for actual damages resulting from certain acts such as unauthorized ownership transfers, misappropriation of rental payments by others or environmental damages. Based on initial and ongoing reviews of property management and operations, the Company does not expect that payments will be required under these indemnification obligations. Any payments that might be required could be recovered through a refinancing or sale of the assets. In some cases, the Company also has recourse to partners for their proportionate share of amounts paid. There were no liabilities required for these indemnification obligations as of September 30, 2012.

The Company guaranteed that it would compensate the lessors for a shortfall of up to \$41 million in the market value of certain leased equipment at the end of the lease. Guarantees of \$16 million expire in 2016 and \$25 million expire in 2022. The Company had liabilities for these guarantees of \$2 million as of September 30, 2012.

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The Company has agreements with certain banks that provide banking services to settle claim checks processed by the Company for Administrative Services Only ( ASO ) and certain minimum premium customers. The customers are responsible for adequately funding their accounts as claim checks are presented for payment. Under these agreements, the Company guarantees that the banks will not incur a loss if a customer fails to properly fund its account. The amount of the guarantee fluctuates daily. As of September 30, 2012, the aggregate maximum exposure under these guarantees was approximately \$389 million and there were no liabilities required. There were no after-tax charges related to these guarantees for the nine months ended September 30, 2012 or for the same period in 2011. Through October 25, 2012, the exposure that existed at September 30, 2012 has been reduced by approximately 89% through customers' funding of claim checks when presented for payment. In addition, the Company can limit its exposure under these guarantees by suspending claim payments for any customer who has not adequately funded their bank account.

The Company contracts on an ASO basis with customers who fund their own claims. The Company charges these customers administrative fees based on the expected cost of administering their self-funded programs. In some cases, the Company provides performance guarantees associated with meeting certain service-related and other performance standards. If these standards are not met, the Company may be financially at risk up to a stated percentage of the contracted fee or a stated dollar amount. The Company establishes liabilities for estimated payouts associated with these performance guarantees. Approximately 16% of ASO fees reported for the nine months ended September 30, 2012 were at risk, with reimbursements estimated to be less than 2% of ASO fees.

The Company had indemnification obligations as of September 30, 2012 in connection with acquisition and disposition transactions. These indemnification obligations are triggered by the breach of representations or covenants provided by the Company, such as representations for the presentation of financial statements, the filing of tax returns, compliance with law or the identification of outstanding litigation. These obligations are typically subject to various time limitations, defined by the contract or by operation of law, such as statutes of limitation. In some cases, the maximum potential amount due is subject to contractual limitations based on a percentage of the transaction purchase price, while in other cases limitations are not specified or applicable. The Company does not believe that it is possible to determine the maximum potential amount due under these obligations, since not all amounts due under these indemnification obligations are subject to limitation. There were no liabilities required for these indemnification obligations as of September 30, 2012.

The Company does not expect that these guarantees will have a material adverse effect on the Company's consolidated results of operations, liquidity or financial condition.

## Regulatory and Industry Developments

**Employee benefits regulation.** The business of administering and insuring employee benefit programs, particularly health care programs, is heavily regulated by federal and state laws and administrative agencies, such as state departments of insurance and the Federal Departments of Labor and Justice, as well as the courts. Regulation, legislation and judicial decisions have resulted in changes to industry and the Company's business practices and will continue to do so in the future. In addition, the Company's subsidiaries are routinely involved with various claims, lawsuits and regulatory and IRS audits and investigations that could result in financial liability, changes in business practices, or both.

Health care regulation and legislation in its various forms, including the implementation of the Patient Protection and Affordable Care Act (including the Reconciliation Act) that was signed into law during the first quarter of 2010 and found to be constitutional by the U.S. Supreme Court in June of 2012, could have a material adverse effect on the Company's health care operations if it inhibits the Company's ability to respond to market demands, adversely affects the way the Company does business, or results in increased medical or administrative costs without

improving the quality of care or services.

Other possible regulatory and legislative changes or judicial decisions that could have an adverse effect on the Company's employee benefits businesses include:

- additional mandated benefits or services that increase costs;
- legislation that would grant plan participants broader rights to sue their health plans;
- changes in public policy and in the political environment, that could affect state and federal law, including legislative and regulatory proposals related to health care issues, that could increase cost and affect the market for the Company's health care products and services;
- changes in Employee Retirement Income Security Act of 1974 ( ERISA ) regulations resulting in increased administrative burdens and costs;
- additional restrictions on the use of prescription drug formularies and rulings from pending purported class action litigation, that could result in adjustments to or the elimination of the average wholesale price of pharmaceutical products as a benchmark in establishing certain rates, charges, discounts, guarantees and fees for various prescription drugs;

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- additional privacy legislation and regulations that interfere with the proper use of medical information for research, coordination of medical care and disease and disability management;
- additional variations among state laws mandating the time periods and administrative processes for payment of health care provider claims;
- legislation that would exempt independent physicians from antitrust laws; and
- changes in federal tax laws, such as amendments that could affect the taxation of employer provided benefits.

The employee benefits industry remains under scrutiny by various state and federal government agencies and could be subject to government efforts to bring criminal actions in circumstances that could previously have given rise only to civil or administrative proceedings.

**Guaranty fund assessments.** The Company operates in a regulatory environment that may require the Company to participate in assessments under state insurance guaranty association laws. The Company's exposure for certain obligations of insolvent insurance companies to policyholders and claimants to assessments is based on its share of business it writes in the relevant jurisdictions. For the nine months ended September 30, 2012 and 2011, charges related to guaranty fund assessments were not material to the Company's results of operations.

The Company is aware of an insurer that is in rehabilitation, an intermediate action before insolvency. On May 3, 2012, the state court denied the regulator's amended petitions for liquidation and set forth specific requirements and a deadline for the regulator to develop a plan of rehabilitation without liquidating the insurer. On May 14, 2012 the regulator filed a post-trial motion requesting the court to reconsider its decision. On September 28, 2012, an Order of Judgment was entered finalizing the court's opinion that the insurer is not insolvent and remains in rehabilitation. The regulator has appealed the court's decision. If the state court's decision is reversed and the insurer is declared insolvent and placed in liquidation, the Company and other insurers may be required to pay a portion of policyholder claims through guaranty fund assessments from various states in which the Company's insurance subsidiaries write premiums. Based on current information available, in the event of a reversal of the state court decision and liquidation of the insurer, the Company has estimated that potential future assessments could result in future charges totaling approximately \$60 million after-tax. The Company will continue to monitor the outcome of the courts deliberations.

## Litigation and Other Legal Matters

The Company is routinely involved in numerous claims, lawsuits, regulatory and IRS audits, investigations and other legal matters arising, for the most part, in the ordinary course of managing a health services business, including payments to providers and benefit level disputes. Such legal matters include benefit claims, breach of contract claims, tort claims, disputes regarding reinsurance arrangements, employment related suits, employee benefit claims, wage and hour claims, and intellectual property and real estate related disputes. Litigation of income tax matters is accounted for under FASB's accounting guidance for uncertainty in income taxes. Further information can be found in Note 16. The outcome

of litigation and other legal matters is always uncertain, and unfavorable outcomes that are not justified by the evidence can occur. The Company believes that it has valid defenses to the legal matters pending against it and is defending itself vigorously.

When the Company (in the course of its regular review of pending litigation and legal matters) has determined that a material loss is reasonably possible, the matter is disclosed. In accordance with GAAP, when litigation and regulatory matters present loss contingencies that are both probable and estimable, the Company accrues the estimated loss by a charge to income. The amount accrued represents the Company's best estimate of the probable loss at the time. If only a range of estimated losses can be determined, the Company accrues an amount within the range that, in the Company's judgment, reflects the most likely outcome; if none of the estimates within that range is a better estimate than any other amount, the Company accrues the minimum amount of the range. In cases that the Company has accrued an estimated loss, the accrued amount may differ materially from the ultimate amount of the relevant costs. In many proceedings, it is inherently difficult to determine whether any loss is probable or even possible or to estimate the amount or range of any loss. The Company provides disclosure in the aggregate for material pending litigation and legal matters, including accruals, range of loss, or a statement that such information cannot be estimated. As a litigation or regulatory matter develops, the Company monitors the matter for further developments that could affect the amount previously accrued, if any, and updates such amount accrued or disclosures previously provided as appropriate.

As of September 30, 2012, the Company had accrued pre-tax reserves of \$102 million (\$66 million after-tax) for the matters discussed below. Due to numerous uncertain factors presented in these cases, it is not possible to estimate an aggregate range of loss (if any) for these matters at this time.

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Except as otherwise noted, the Company believes that the legal actions, proceedings and investigations currently pending against it should not have a material adverse effect on the Company's results of operation, financial condition or liquidity based upon current knowledge and taking into consideration current accruals. However, in light of the uncertainties involved in these matters, there is no assurance that their ultimate resolution will not exceed the amounts currently accrued by the Company and that an adverse outcome in one or more of these matters could be material to the Company's results of operation, financial condition or liquidity for any particular period.

***Amara cash balance pension plan litigation.*** On December 18, 2001, Janice Amara filed a class action lawsuit, captioned *Janice C. Amara, Gisela R. Broderick, Annette S. Glanz, individually and on behalf of all others similarly situated v. Cigna Corporation and Cigna Pension Plan*, in the United States District Court for the District of Connecticut against Cigna Corporation and the Cigna Pension Plan on behalf of herself and other similarly situated participants in the Cigna Pension Plan affected by the 1998 conversion to a cash balance formula. The plaintiffs allege various ERISA violations including, among other things, that the Plan's cash balance formula discriminates against older employees; the conversion resulted in a wear away period (when the pre-conversion accrued benefit exceeded the post-conversion benefit); and these conditions are not adequately disclosed in the Plan.

In 2008, the court issued a decision finding in favor of Cigna Corporation and the Cigna Pension Plan on the age discrimination and wear away claims. However, the court found in favor of the plaintiffs on many aspects of the disclosure claims and ordered an enhanced level of benefits from the existing cash balance formula for the majority of the class, requiring class members to receive their frozen benefits under the pre-conversion Cigna Pension Plan and their post-1997 accrued benefits under the post-conversion Cigna Pension Plan. The court also ordered, among other things, pre-judgment and post-judgment interest.

Both parties appealed the court's decisions to the United States Court of Appeals for the Second Circuit which issued a decision on October 6, 2009 affirming the District Court's judgment and order on all issues. On January 4, 2010, both parties filed separate petitions for a writ of certiorari to the United States Supreme Court. Cigna's petition was granted, and on May 16, 2011, the Supreme Court issued its Opinion in which it reversed the lower courts' decisions and remanded the case to the trial judge for reconsideration of the remedy. The Court unanimously agreed with the Company's position that the lower courts erred in granting a remedy for an inaccurate plan description under an ERISA provision that allows only recovery of plan benefits. However, the decision identified possible avenues of appropriate equitable relief that plaintiffs may pursue as an alternative remedy.

The case is now in the trial court following remand. Briefs have been filed on the remedial issues and hearings took place on December 9, 2011 and March 29-30, 2012. The Company will continue to vigorously defend its position in this case.

***Ingenix.*** On February 13, 2008, State of New York Attorney General Andrew M. Cuomo announced an industry-wide investigation into the use of data provided by Ingenix, Inc., a subsidiary of UnitedHealthcare, used to calculate payments for services provided by out-of-network providers. The Company received four subpoenas from the New York Attorney General's office in connection with this investigation and responded appropriately. On February 17, 2009, the Company entered into an Assurance of Discontinuance resolving the investigation. In connection with the industry-wide resolution, the Company contributed \$10 million to the establishment of a new non-profit company that now compiles and provides the data formerly provided by Ingenix.

The Company was named as a defendant in a number of putative nationwide class actions asserting that due to the use of data from Ingenix, Inc., the Company improperly underpaid claims, an industry-wide issue. All of the class actions were consolidated into *Franco v. Connecticut General Life Insurance Company et al.*, which is pending in the United States District Court for the District of New Jersey. The consolidated amended complaint, filed on August 7, 2009, asserts claims under ERISA, the RICO statute, the Sherman Antitrust Act and New Jersey state

law on behalf of subscribers, health care providers and various medical associations.

On September 23, 2011, the court granted in part and denied in part the Company's motion to dismiss the consolidated amended complaint. The court dismissed all claims by the health care provider and medical association plaintiffs for lack of standing to sue, and as a result the case will proceed only on behalf of subscribers. In addition, the court dismissed all of the antitrust claims, the ERISA claims based on disclosure and the New Jersey state law claims. The court did not dismiss the ERISA claims for benefits and claims under the RICO statute. Plaintiffs filed a motion to certify a nationwide class of subscriber plaintiffs on December 19, 2011, which is fully briefed and pending.

It is reasonably possible that others could initiate additional litigation or additional regulatory action against the Company with respect to use of data provided by Ingenix, Inc. The Company denies the allegations asserted in the investigations and litigation and will vigorously defend itself in these matters.

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

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## **INTRODUCTION**

In this filing and in other marketplace communications, the Company makes certain forward-looking statements relating to the Company's financial condition and results of operations, as well as to trends and assumptions that may affect the Company. Generally, forward-looking statements can be identified through the use of predictive words (e.g., "Outlook for 2012"). Actual results may differ materially from the Company's predictions. Some factors that could cause results to differ are discussed throughout Management's Discussion and Analysis

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( MD&A ), including in the Cautionary Statement beginning on page 83. The forward-looking statements contained in this filing represent management's current estimate as of the date of this filing. Management does not assume any obligation to update these estimates.

The following discussion addresses the financial condition of the Company as of September 30, 2012, compared with December 31, 2011, and its results of operations for the three months and nine months ended September 30, 2012 compared with the same periods last year. This discussion should be read in conjunction with the MD&A included in the Company's 2011 Form 10-K filed on February 27, 2012 and as updated by Cigna's Current Report on Form 8-K filed on August 8, 2012 (collectively, the 2011 Annual Report ), to which the reader is directed for additional information.

The Company is a global health services organization dedicated to helping its customers improve their health, well-being and sense of security. Its insurance subsidiaries are major providers of medical, dental, disability, life and accident insurance and related products and services, the majority of which are offered through employers and other groups (e.g. governmental and non-governmental organizations, unions and associations). Cigna also offers Medicare and Medicaid products and supplemental health, life and accident insurance coverage primarily to individuals in the U.S. and selected international markets. In addition to its ongoing operations described above, the Company also has certain run-off operations, including a Run-off Reinsurance segment.

The preparation of interim consolidated financial statements necessarily relies heavily on estimates. This and certain other factors, such as the seasonal nature of portions of the health care and related benefits business, as well as competitive and other market conditions, call for caution in estimating full year results based on interim results of operations.

Unless otherwise indicated, financial information in the MD&A is presented in accordance with GAAP. As discussed in Note 2 to the Consolidated Financial Statements, in 2012, the Company adopted, as required, amended accounting guidance for deferred acquisition costs by selecting retrospective adjustment of prior periods. Summarized below are the impacts of the new guidance on previously reported amounts. This adoption had no impact on the underlying economic value or cash flows of the Company's businesses, nor did it impact the Company's liquidity or the statutory surplus of its insurance subsidiaries.

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## Consolidated Financial Summary

Three Months Ended September 30, 2011

| <i>(In millions)</i>                                                                 | As<br>previously<br>reported | Effect of<br>amended<br>accounting<br>guidance | As<br>retrospectively<br>adjusted |
|--------------------------------------------------------------------------------------|------------------------------|------------------------------------------------|-----------------------------------|
| Revenues, excluding other revenue                                                    | \$ 5,426                     | \$ -                                           | \$ 5,426                          |
| Other revenues                                                                       | 187                          | (3)                                            | 184                               |
| Total revenues                                                                       | 5,613                        | (3)                                            | 5,610                             |
| Benefits and expenses                                                                | 5,316                        | 21                                             | 5,337                             |
| Income before taxes                                                                  | 297                          | (24)                                           | 273                               |
| Income taxes                                                                         | 97                           | (7)                                            | 90                                |
| Net income                                                                           | 200                          | (17)                                           | 183                               |
| Less: net income attributable to noncontrolling interest                             | -                            | -                                              | -                                 |
| Shareholders' net income                                                             | 200                          | (17)                                           | 183                               |
| Less: realized investment gains, net of taxes                                        | 9                            | -                                              | 9                                 |
| <b>Segment earnings</b>                                                              | <b>191</b>                   | <b>(17)</b>                                    | <b>174</b>                        |
| Less: adjustments to reconcile to adjusted income from operations                    |                              |                                                |                                   |
| Results of GMIB business (after-tax)                                                 | (134)                        | -                                              | (134)                             |
| <b>Special item, after-tax</b>                                                       |                              |                                                |                                   |
| Completion of IRS examination (See Note 16 to the Consolidated Financial Statements) | -                            | -                                              | -                                 |
| <b>Adjusted income from operations</b>                                               | <b>\$ 325</b>                | <b>\$ (17)</b>                                 | <b>\$ 308</b>                     |

## International Financial Summary

Three Months Ended September 30, 2011

| <i>(In millions)</i>                           | As<br>previously<br>reported | Effect of<br>amended<br>accounting<br>guidance | As<br>retrospectively<br>adjusted |
|------------------------------------------------|------------------------------|------------------------------------------------|-----------------------------------|
| Revenues, excluding other revenue              | \$ 789                       | \$ -                                           | \$ 789                            |
| Other revenues                                 | 6                            | (3)                                            | 3                                 |
| Total revenues                                 | 795                          | (3)                                            | 792                               |
| Benefits and expenses                          | 685                          | 21                                             | 706                               |
| Income before taxes                            | 110                          | (24)                                           | 86                                |
| Income taxes                                   | 31                           | (7)                                            | 24                                |
| Income attributable to noncontrolling interest | -                            | -                                              | -                                 |
| <b>Segment earnings</b>                        | <b>\$ 79</b>                 | <b>\$ (17)</b>                                 | <b>\$ 62</b>                      |

Table of Contents**Consolidated Financial Summary**

Nine Months Ended September 30, 2011

| <i>(In millions)</i>                                                                 | As<br>previously<br>reported | Effect of<br>amended<br>accounting<br>guidance | As<br>retrospectively<br>adjusted |
|--------------------------------------------------------------------------------------|------------------------------|------------------------------------------------|-----------------------------------|
| Revenues, excluding other revenue                                                    | \$ 16,239                    | \$ -                                           | \$ 16,239                         |
| Other revenues                                                                       | 296                          | (7)                                            | 289                               |
| Total revenues                                                                       | 16,535                       | (7)                                            | 16,528                            |
| Benefits and expenses                                                                | 15,022                       | 62                                             | 15,084                            |
| Income before taxes                                                                  | 1,513                        | (69)                                           | 1,444                             |
| Income taxes                                                                         | 475                          | (19)                                           | 456                               |
| Net income                                                                           | 1,038                        | (50)                                           | 988                               |
| Less: net income attributable to noncontrolling interest                             | 1                            | -                                              | 1                                 |
| Shareholders' net income                                                             | 1,037                        | (50)                                           | 987                               |
| Less: realized investment gains, net of taxes                                        | 37                           | -                                              | 37                                |
| Segment earnings                                                                     | 1,000                        | (50)                                           | 950                               |
| Less: adjustments to reconcile to adjusted income from operations                    |                              |                                                |                                   |
| Results of GMIB business (after-tax)                                                 | (142)                        | -                                              | (142)                             |
| <b>Special item, after-tax</b>                                                       |                              |                                                |                                   |
| Completion of IRS examination (See Note 16 to the Consolidated Financial Statements) | 24                           | -                                              | 24                                |
| <b>Adjusted income from operations</b>                                               | <b>\$ 1,118</b>              | <b>\$ (50)</b>                                 | <b>\$ 1,068</b>                   |

**International Financial Summary**

Nine Months Ended September 30, 2011

| <i>(In millions)</i>                           | As<br>previously<br>reported | Effect of<br>amended<br>accounting<br>guidance | As<br>retrospectively<br>adjusted |
|------------------------------------------------|------------------------------|------------------------------------------------|-----------------------------------|
| Revenues, excluding other revenue              | \$ 2,271                     | \$ -                                           | \$ 2,271                          |
| Other revenues                                 | 19                           | (7)                                            | 12                                |
| Total revenues                                 | 2,290                        | (7)                                            | 2,283                             |
| Benefits and expenses                          | 1,966                        | 62                                             | 2,028                             |
| Income before taxes                            | 324                          | (69)                                           | 255                               |
| Income taxes                                   | 93                           | (19)                                           | 74                                |
| Income attributable to noncontrolling interest | 1                            | -                                              | 1                                 |
| <b>Segment earnings</b>                        | <b>\$ 230</b>                | <b>\$ (50)</b>                                 | <b>\$ 180</b>                     |

Table of Contents**CONSOLIDATED RESULTS OF OPERATIONS**

The Company measures the financial results of its segments using segment earnings (loss), that is defined as shareholders' net income (loss) before after-tax realized investment results. Adjusted income (loss) from operations is defined as consolidated segment earnings (loss) excluding special items (described in the table below) and the results of the GMIB business. Adjusted income (loss) from operations is another measure of profitability used by the Company's management because it presents the underlying results of operations of the Company's businesses and permits analysis of trends in underlying revenue, expenses and shareholders' net income. This measure is not determined in accordance with accounting principles generally accepted in the United States (GAAP) and should not be viewed as a substitute for the most directly comparable GAAP measure, which is shareholders' net income.

The Company excludes special items because management does not believe they are representative of the Company's underlying results of operations. The Company also excludes the results of the GMIB business because the changes in the fair value of GMIB assets and liabilities are volatile and unpredictable. See the Run-off Reinsurance section of the MD&A beginning on 68 for additional information on GMIB. Because of this volatility, and since the GMIB business is in run-off, management does not believe that its results are meaningful in assessing underlying results of operations.

Summarized in the following table is a reconciliation between shareholders' net income and adjusted income from operations.

| <b>FINANCIAL SUMMARY</b><br><i>(In millions)</i>                                                     | <b>Three Months Ended</b><br><b>September 30,</b> |               | <b>Nine Months Ended</b><br><b>September 30,</b> |                 |
|------------------------------------------------------------------------------------------------------|---------------------------------------------------|---------------|--------------------------------------------------|-----------------|
|                                                                                                      | <b>2012</b>                                       | <b>2011</b>   | <b>2012</b>                                      | <b>2011</b>     |
| Premiums and fees                                                                                    | \$ 6,637                                          | \$ 4,748      | \$ 19,464                                        | \$ 14,267       |
| Net investment income                                                                                | 283                                               | 297           | 854                                              | 860             |
| Mail order pharmacy revenues                                                                         | 401                                               | 368           | 1,189                                            | 1,056           |
| Other revenues                                                                                       | 26                                                | 184           | 76                                               | 289             |
| Total realized investment gains                                                                      | 11                                                | 13            | 20                                               | 56              |
| Total revenues                                                                                       | 7,358                                             | 5,610         | 21,603                                           | 16,528          |
| Benefits and expenses                                                                                | 6,640                                             | 5,337         | 19,745                                           | 15,084          |
| Income before taxes                                                                                  | 718                                               | 273           | 1,858                                            | 1,444           |
| Income taxes                                                                                         | 252                                               | 90            | 641                                              | 456             |
| Net income                                                                                           | 466                                               | 183           | 1,217                                            | 988             |
| Less: net income attributable to noncontrolling interest                                             | -                                                 | -             | -                                                | 1               |
| Shareholders' net income                                                                             | 466                                               | 183           | 1,217                                            | 987             |
| Less: realized investment gains, net of taxes                                                        | 7                                                 | 9             | 16                                               | 37              |
| <b>Segment earnings</b>                                                                              | <b>459</b>                                        | <b>174</b>    | <b>1,201</b>                                     | <b>950</b>      |
| Less: adjustments to reconcile to adjusted income from operations:                                   |                                                   |               |                                                  |                 |
| Results of GMIB business (after-tax)                                                                 | 32                                                | (134)         | 22                                               | (142)           |
| Special items (after-tax):                                                                           |                                                   |               |                                                  |                 |
| Charge for realignment and efficiency plan (See Note 6 to the Consolidated Financial Statements)     | (50)                                              | -             | (50)                                             | -               |
| Costs associated with HealthSpring acquisition (See Note 3 to the Consolidated Financial Statements) | (12)                                              | -             | (40)                                             | -               |
| Litigation matter (See Note 18 to the Consolidated Financial Statements)                             | -                                                 | -             | (13)                                             | -               |
| Completion of IRS Examination (See Note 16 to the Consolidated Financial Statements)                 | -                                                 | -             | -                                                | 24              |
| <b>Adjusted income from operations</b>                                                               | <b>\$ 489</b>                                     | <b>\$ 308</b> | <b>\$ 1,282</b>                                  | <b>\$ 1,068</b> |



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Summarized below is adjusted income from operations by segment and other key consolidated financial data:

| (In millions)                                 | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |                 |
|-----------------------------------------------|-------------------------------------|---------------|------------------------------------|-----------------|
|                                               | 2012                                | 2011          | 2012                               | 2011            |
| <b>Adjusted Income (Loss) From Operations</b> |                                     |               |                                    |                 |
| Health Care                                   | \$ 384                              | \$ 248        | \$ 978                             | \$ 774          |
| International                                 | 79                                  | 62            | 224                                | 180             |
| Disability and Life                           | 62                                  | 62            | 216                                | 227             |
| Run-off Reinsurance                           | (7)                                 | (46)          | (29)                               | (47)            |
| Other Operations                              | 22                                  | 25            | 63                                 | 64              |
| Corporate                                     | (51)                                | (43)          | (170)                              | (130)           |
| <b>Total</b>                                  | <b>\$ 489</b>                       | <b>\$ 308</b> | <b>\$ 1,282</b>                    | <b>\$ 1,068</b> |
| <b>Other Key Consolidated Financial Data</b>  |                                     |               |                                    |                 |
| Medical customers (in thousands)(1)           |                                     |               | 13,971                             | 12,667          |
| Cash flows from operating activities          | \$ (320)                            | \$ 664        | \$ 1,557                           | \$ 1,243        |
| Shareholders' equity                          |                                     |               | \$ 9,530                           | \$ 7,430        |

(1) Includes medical customers of the Company's Health Care segment as well as the International health care business, including global health benefits.

## Results of Operations

- **Consolidated Revenues** increased 31% for the three months and nine months ended September 30, 2012, primarily reflecting contributions from HealthSpring as well as higher revenues in each of the Company's ongoing businesses reflecting continued growth in the Company's targeted market segments.
- **Shareholders' net income** increased 155% for the three months and 23% for the nine months ended September 30, 2012, primarily resulting from substantially higher adjusted income from operations as discussed below and significantly improved GMIB results. These favorable effects were partially offset by special items reported in the third quarter and nine months ended September 30, 2012 as well as the absence of the special item reported in the first quarter 2011 related to the settlement of the 2007 and 2008 IRS audit.
- **Adjusted income from operations** increased 59% for the three months ended September 30, 2012 and 20% for the nine months ended September 30, 2012, largely attributable to earnings contributions from HealthSpring, as well as growth from the other ongoing business segments and lower charges in the GMDB business.
- **Medical customers** increased 10% primarily attributable to growth in strategically targeted domestic and international markets as well as the acquisition of HealthSpring.

## Liquidity and Financial Condition

During the nine months ended September 30, 2012, the following items affected the Company's liquidity and financial condition:

- **Cash flows from operating activities.** For the third quarter of 2012, negative cash flows from operating activities were due to the timing of receipts for Medicare Advantage and Medicare Part D programs. For the nine months ended September 30, 2012, cash flows from operating activities were higher primarily attributable to strong earnings and business growth in the Company's ongoing business segments.
- **Acquisitions.** The Company acquired HealthSpring and Great American Supplemental Benefits for a combined purchase price of approximately \$4.1 billion. See Note 3 to the Consolidated Financial Statement for additional information;
- **Repayment of Debt.** The Company repaid the acquired HealthSpring debt of \$326 million. See Note 14 to the Consolidated Financial Statements for additional information;
- **Pension Plan Contributions.** The Company contributed \$226 million to the Company's pension plans; See Note 13 to the Consolidated Financial Statements for additional information; and
- **Share Repurchase.** The Company repurchased 1.9 million shares of stock for \$85 million. See the Liquidity and Capital Resources section of this MD&A beginning on page 73 for additional information.

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Cash at the parent company as of September 30, 2012 was approximately \$435 million. Shareholders' equity increased substantially since the third quarter of 2011, reflecting strong earnings in the fourth quarter of 2011 and the first nine months of 2012 and net proceeds of \$629 million from the fourth quarter 2011 equity offering of 15.2 million shares used to finance the HealthSpring acquisition.

## Outlook for 2012

The Company expects full year 2012 consolidated adjusted income from operations to be higher than 2011, reflecting the strong results for the nine months ended September 30, 2012 and expected fourth quarter earnings contributions from HealthSpring and the other ongoing operating segments. This outlook includes the impact of year-to-date results for GMDB (also known as VADBe), but does not include an estimate for future impacts. Future potential impacts from GMDB are not known or reasonably estimable, including the impact of changes in capital markets or periodic updates to long term reserve assumptions. See Note 7 to the Consolidated Financial Statements as well as the 2011 Annual Report under the Critical Accounting Estimates section of the MD&A for more information on the potential effects of capital market and other assumption changes on results for GMDB.

Information is not available for management to reasonably estimate the future results of the GMIB business or realized investment results due in part to interest rate and stock market volatility and other internal and external factors. In addition, the Company is not able to identify or reasonably estimate the financial impact of special items in the fourth quarter of 2012, however they may include potential adjustments associated with litigation.

The Company's outlook for 2012 is subject to the factors cited above and in the Cautionary Statement beginning on page 83 of this Form 10-Q and the sensitivities discussed in the 2011 Annual Report under the Critical Accounting Estimates section of the MD&A. If unfavorable equity market and interest rate movements occur, the Company could experience losses related to investment impairments and the GMIB and GMDB businesses. These losses could adversely impact the Company's consolidated results of operations and financial condition by potentially reducing the capital of the Company's insurance subsidiaries and reducing their dividend-paying capabilities.

## Revenues

Total revenues increased 31% for the three months and nine months ended September 30, 2012, compared with the same periods in 2011, reflecting the following:

### Premiums and Fees

Premiums and fees increased 40% for the three months and 36% for the nine months ended September 30, 2012, compared with the same periods in 2011, including contributions from the HealthSpring acquisition, customer growth in the other targeted market segments of the Health Care business and continued business growth in the International and Disability and Life segments.

## **Net Investment Income**

Net investment income decreased 5% for the three months and 1% for the nine months ended September 30, 2012, compared with the same periods in 2011, primarily reflecting lower yields and a decline in mortgage prepayment fees, partially offset by higher average investment assets.

## **Mail Order Pharmacy Revenues**

Mail order pharmacy revenue increased 9% for the three months and 13% for the nine months ended September 30, 2012 compared with the same periods of 2011, primarily reflecting higher prescription volume for injectible medications, partially offset by price decreases related to a shift to generic oral medications from brand names.

## **Other Revenues**

Other revenues included pre-tax losses of \$42 million for the three months ended September 30, 2012, compared with pre-tax gains of \$133 million for the three months ended September 30, 2011 and pre-tax losses of \$106 million for the nine months ended September 30, 2012 compared with pre-tax gains of \$96 million for the nine months ended September 30, 2011, related to futures and swaps entered into as part of a dynamic hedge program to manage equity and growth interest rate risks in the Company's run-off reinsurance operations. See the Run-off Reinsurance section of the MD&A beginning on page 68 for more information on this program.

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Excluding the impact of these swaps and futures contracts, other revenues increased 33% for the three months ended September 30, 2012, compared with the same period in 2011 primarily reflecting contributions from HealthSpring. For the nine months ended September 30, 2012, other revenues, excluding the impact of the swaps and futures contracts, decreased 6% compared with the same period last year primarily resulting from the absence of revenue in 2012 from Cigna Government Services, which was sold in the second quarter of 2011, partially offset by contributions from HealthSpring.

## Realized Investment Results

Realized investment results declined for the three months and nine months ended September 30, 2012, compared with the same periods last year, primarily due to the absence of gains on sales of real estate held in joint ventures reported in the third quarter of 2011 and lower prepayment fees received on fixed maturities, partially offset by lower impairment losses and higher valuations on hybrid securities. See Note 9 to the Consolidated Financial Statements for additional information.

## Business Strategy

For information on the Company's business strategy, see the strategy section of the Company's 2011 Form 10-K beginning on page 7. The Company's ability to increase revenue, shareholders' net income and operating cash flows from ongoing operations is directly related to progress in executing its strategy as well as other key factors, including the Company's ability to:

- profitably underwrite and price products and services at competitive levels that manage risk and reflect emerging experience;
- cross sell its various health and related benefit products;
- invest available cash at attractive rates of return for appropriate durations; and
- effectively deploy capital.

In addition to the Company-specific factors cited above, overall results are influenced by a range of economic and other factors, especially:

- cost trends and inflation for medical and related services;
- utilization patterns of medical and other services;
- employment levels;
- developments in the political environment both domestically and internationally, including U.S. Health Care Reform;
- interest rates, equity market returns, foreign currency fluctuations and credit market volatility, including the availability and cost of credit in the future; and
- federal, state and international legislation and regulation.

The Company regularly monitors the trends impacting operating results from the above mentioned key factors to appropriately respond to economic and other factors affecting its operations, both in its ongoing and run-off operations.

## Run-off Operations

The Company's run-off reinsurance operations have significant exposures, primarily for its guaranteed minimum death benefits ( GMDB , also known as VADBe ) and guaranteed minimum income benefits ( GMIB ) products. These products are influenced significantly by changes in equity markets and interest rates. As part of its strategy to effectively manage these exposures, the Company operates an equity hedge program to substantially reduce the impact of equity market movements on the liability for the GMDB business. In 2011, the Company implemented a hedge designed to offset a portion of the equity market risk for GMIB contracts as well as hedges designed to offset a portion of the interest rate risk related to GMDB and GMIB. In the second quarter of 2012, the equity hedge program for GMIB was expanded. The Company actively monitors the performance of the hedging programs, and will continue to evaluate further adjustments to the hedging programs. The Company also studies policyholder behavior for the GMDB and GMIB products, including lapse, mortality, annuity election rates and future partial surrender elections and adjusts future expectations based on the results of those studies.

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## Health Care Reform

In the first quarter of 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act ( Health Care Reform ) were signed into law. Certain of the law's provisions are already effective while others will take effect from 2013 to 2018. The Company has implemented the provisions of Health Care Reform that are currently in effect (including the commercial minimum medical loss ratio requirements) and continues its implementation planning for those provisions that must be adopted in the future. Management is currently unable to estimate the full impact of Health Care Reform on the Company's future results of operations, and its financial condition and liquidity due to uncertainties related to interpretation, implementation and timing of its many provisions as well as the potential for the law to be repealed or amended. It is possible, however, that certain provisions of Health Care Reform could have a material impact on future results of operations.

Certain fees, including the annual health insurer fee, become effective in 2013 and 2014 for Cigna and others to help fund the additional insurance benefits and coverages provided by this legislation. Payment of these fees will result in charges to the Company's financial results in future periods. In addition, because these fees will generally not be tax deductible, the Company's effective tax rate is expected to be adversely impacted in future periods. The amount of the fees is expected to be material, although the Company is unable to estimate the impact of these fees on shareholders' net income and the effective tax rate because guidance for these calculations has not been finalized.

Health Care Reform also impacts Cigna's Medicare Advantage and Medicare Part D prescription drug plan businesses acquired with HealthSpring in a variety of additional ways, including reduced Medicare premium rates (which began with the 2011 contract year), mandated minimum reductions to risk scores (beginning in 2014), transition of Medicare Advantage benchmark rates to Medicare fee-for-service parity, reduced enrollment periods and limitations on disenrollment, providing quality bonuses for Medicare Advantage plans with a rating of four or five stars from CMS, and mandated consumer discounts on brand name and generic prescription drugs for Medicare Part D plan participants in the coverage gap. In addition, effective in 2014, Medicare Advantage plans will be required to maintain a minimum medical loss ratio of 85% under rules that have not yet been issued. Funding for Medicare Advantage plans has been and may continue to be altered by federal legislation.

On June 28, 2012, the U.S. Supreme Court upheld the constitutionality of most parts of Health Care Reform, including the obligation to purchase health care coverage (the individual mandate). Management continues to closely monitor the implementation of Health Care Reform and is actively engaged with regulators and policymakers on the conversion of legislation to regulation. In addition, management is implementing the necessary capabilities to ensure that the Company is compliant with the law and assessing potential opportunities arising from Health Care Reform. These opportunities include the continued evolution and innovation of our broad health and wellness portfolio to improve the health and productivity of our clients and customers as well as the expansion of our physician partnership capabilities to improve the quality of care and service experience for our customers while lowering costs and improving overall value.

## Realignment and Efficiency Plan

During the third quarter of 2012, the Company, in connection with the execution of its strategy, committed to a series of actions to further improve its organizational alignment, operational effectiveness, and efficiency. As a result, the Company recognized charges in other operating expenses of \$77 million pre-tax (\$50 million after-tax) in the third quarter of 2012, consisting primarily of severance costs. The Health Care segment reported \$60 million pre-tax (\$39 million after-tax) of the charge. The remainder was reported as follows: \$14 million pre-tax (\$9 million after-tax) in International and \$3 million pre-tax (\$2 million after-tax) in Disability and Life. The severance costs are expected to be substantially paid in 2013. The Company expects to realize annualized after-tax savings of approximately \$60 million, the majority of which is

expected to be reinvested in the business in order to enhance the Company's ability to provide superior service and affordable products to our customers.

## Acquisitions

In line with its growth strategy, the Company has strengthened its market position through various acquisition transactions. See Note 3 to the Consolidated Financial Statements for additional information.

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## CRITICAL ACCOUNTING ESTIMATES

The preparation of Consolidated Financial Statements in accordance with GAAP requires management to make estimates and assumptions that affect reported amounts and related disclosures in the Consolidated Financial Statements. Management considers an accounting estimate to be critical if:

- it requires assumptions to be made that were uncertain at the time the estimate was made; and
- changes in the estimate or different estimates that could have been selected could have a material effect on the Company's consolidated results of operations or financial condition.

Management has discussed the development and selection of its critical accounting estimates and reviewed the disclosures presented below with the Audit Committee of the Company's Board of Directors.

The Company's most critical accounting estimates, as well as the effects of hypothetical changes in material assumptions used to develop each estimate, are described in the 2011 Annual Report:

- future policy benefits    guaranteed minimum death benefits;
- Health Care medical claims payable;
- accounts payable, accrued expenses and other liabilities, and other assets    guaranteed minimum income benefits;
- accounts payable, accrued expenses and other liabilities    pension liabilities; and
- valuation of fixed maturity investments.

The Company regularly evaluates items which may impact critical accounting estimates. As of September 30, 2012, there are no significant changes to the critical accounting estimates from what was reported in the 2011 Annual Report.

## Summary

There are other accounting estimates used in the preparation of the Company's Consolidated Financial Statements, including estimates of liabilities for future policy benefits other than those identified above, as well as estimates with respect to goodwill, unpaid claims and claim expenses, post-employment and postretirement benefits other than pensions, certain compensation accruals and income taxes.

Management believes the current assumptions used to estimate amounts reflected in the Company's Consolidated Financial Statements are appropriate. However, if actual experience differs from the assumptions used in estimating amounts reflected in the Company's Consolidated Financial Statements, the resulting changes could have a material adverse effect on the Company's consolidated results of operations, and in certain situations, could have a material adverse effect on liquidity and the Company's financial condition.

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## SEGMENT REPORTING

Operating segments generally reflect groups of related products, but the International segment is generally based on geography. Beginning with the acquisition of HealthSpring in January 2012, the financial results of the former Health Care operating segment and newly acquired Medicare operating segment have been aggregated into the Health Care reportable segment, reflecting their similar economic characteristics, products and services, customers, distribution methods, operational processes and regulatory environment. Results of the recently acquired Great American Supplemental Benefits business are reported in the supplemental health, life and accident business included in the International segment. Other operating segments that do not require separate disclosure have been combined into Other Operations.

The Company measures the financial results of its segments using segment earnings (loss), which is defined as shareholders' income (loss) from continuing operations excluding after-tax realized investment gains and losses. Adjusted income from operations for each segment is defined as segment earnings excluding special items and the results of the Company's GMIB business. Adjusted income from operations is another measure of profitability used by the Company's management because it presents the underlying results of operations of the segment and permits analysis of trends. This measure is not determined in accordance with GAAP and should not be viewed as a substitute for the most directly comparable GAAP measure, which is segment earnings. Each segment provides a reconciliation between segment earnings and adjusted income from operations.

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## Health Care Segment

### Segment Description

Beginning with the acquisition of HealthSpring in January 2012, the Health Care segment is an aggregation of the former Health Care operating segment and the newly acquired Medicare operating segment. Together, these operating segments offer insured and self-insured medical, dental, behavioral health, vision, and prescription drug benefit plans, health advocacy programs and other products and services that may be integrated to provide comprehensive health care benefit programs. Cigna HealthCare companies offer these products and services in all 50 states, the District of Columbia and the U.S. Virgin Islands. These products and services are offered through a variety of funding arrangements such as guaranteed cost, retrospectively experience-rated and administrative services only (ASO) arrangements.

The Company measures the operating effectiveness of the Health Care segment using the following key factors:

- segment earnings and adjusted income from operations;
- customer growth;
- sales of specialty products to core medical customers;
- operating expenses per customer;
- operating expense as a percentage of segment revenues (operating expense ratio); and
- medical expense as a percentage of premiums (medical care ratio) in the guaranteed cost and Medicare businesses.

Results for the Health Care segment include HealthSpring from the date of acquisition, January 31, 2012.

**Results of Operations**

| <b>FINANCIAL SUMMARY</b><br><i>(In millions)</i>                                                 | <b>Three Months Ended</b><br><b>September 30,</b> |               | <b>Nine Months Ended</b><br><b>September 30,</b> |               |
|--------------------------------------------------------------------------------------------------|---------------------------------------------------|---------------|--------------------------------------------------|---------------|
|                                                                                                  | <b>2012</b>                                       | <b>2011</b>   | <b>2012</b>                                      | <b>2011</b>   |
| Premiums and fees                                                                                | \$ 4,922                                          | \$ 3,255      | \$ 14,431                                        | \$ 9,861      |
| Net investment income                                                                            | 66                                                | 74            | 197                                              | 208           |
| Mail order pharmacy revenues                                                                     | 401                                               | 368           | 1,189                                            | 1,056         |
| Other revenues                                                                                   | 62                                                | 48            | 168                                              | 184           |
| Segment revenues                                                                                 | 5,451                                             | 3,745         | 15,985                                           | 11,309        |
| Mail order pharmacy cost of goods sold                                                           | 324                                               | 309           | 975                                              | 874           |
| Benefits and other expenses                                                                      | 4,589                                             | 3,052         | 13,566                                           | 9,229         |
| Benefits and expenses                                                                            | 4,913                                             | 3,361         | 14,541                                           | 10,103        |
| Income before taxes                                                                              | 538                                               | 384           | 1,444                                            | 1,206         |
| Income taxes                                                                                     | 193                                               | 136           | 525                                              | 431           |
| <b>Segment earnings</b>                                                                          | <b>345</b>                                        | <b>248</b>    | <b>919</b>                                       | <b>775</b>    |
| Less: special items (after-tax) included in segment earnings:                                    |                                                   |               |                                                  |               |
| Charge for realignment and efficiency plan (See Note 6 to the Consolidated Financial Statements) | (39)                                              | -             | (39)                                             | -             |
| Costs associated with the HealthSpring acquisition                                               | -                                                 | -             | (7)                                              | -             |
| Completion of IRS examination (See Note 16 to the Consolidated Financial Statements)             | -                                                 | -             | -                                                | 1             |
| Charge related to litigation matters (See Note 18 to the Consolidated Financial Statements)      | -                                                 | -             | (13)                                             | -             |
| <b>Adjusted income from operations</b>                                                           | <b>\$ 384</b>                                     | <b>\$ 248</b> | <b>\$ 978</b>                                    | <b>\$ 774</b> |
| Realized investment gains, net of taxes                                                          | \$ 3                                              | \$ 10         | \$ 10                                            | \$ 25         |

Segment earnings increased 39% for the three months and 19% for the nine months ended September 30, 2012 compared with the same periods in 2011, due to higher adjusted income from operations, partially offset by the special item related to the realignment and efficiency plan charge in the third quarter. In addition, segment earnings for the nine months ended September 30, 2012 were also impacted by special items related to costs associated with the acquisition of HealthSpring and a litigation matter.

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The Health Care segment's adjusted income from operations increased 55% for the three months and 26% for the nine months ended September 30, 2012, compared with the same periods in 2011 primarily reflecting:

- strong earnings contributions from the acquired HealthSpring business, due to effective medical cost and pharmacy management programs;
- revenue growth primarily due to a higher ASO customer base driven by strong retention and sales in targeted market segments, including additional sales in stop loss and specialty products to these customers; and
- increased specialty margins including behavioral and pharmacy products.

These impacts were partially offset by:

- higher operating expenses primarily attributable to investments in technology and initiatives to expand business capabilities, as well as to support business growth; and
- modestly higher medical care ratios in our commercial risk businesses due to slightly higher utilization.

**Revenues**

The table below shows premiums and fees for the Health Care segment:

| (In millions)             | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---------------------------|-------------------------------------|----------|------------------------------------|----------|
|                           | 2012                                | 2011     | 2012                               | 2011     |
| Medical:                  |                                     |          |                                    |          |
| Guaranteed cost (1), (2)  | \$ 1,075                            | \$ 1,040 | \$ 3,160                           | \$ 3,147 |
| Experience-rated (2), (3) | 480                                 | 469      | 1,510                              | 1,429    |
| Stop loss                 | 422                                 | 368      | 1,242                              | 1,073    |
| Dental                    | 251                                 | 225      | 744                                | 664      |
| Medicare                  | 1,342                               | 124      | 3,653                              | 370      |

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|                                |                 |                 |                  |                 |
|--------------------------------|-----------------|-----------------|------------------|-----------------|
| Medicaid                       | 60              | -               | 135              | -               |
| Medicare Part D                | 322             | 139             | 1,105            | 525             |
| Other (4)                      | 168             | 149             | 501              | 441             |
| Total medical                  | 4,120           | 2,514           | 12,050           | 7,649           |
| Life and other non-medical     | 17              | 21              | 55               | 57              |
| Total premiums                 | 4,137           | 2,535           | 12,105           | 7,706           |
| Fees (2), (5)                  | 785             | 720             | 2,326            | 2,155           |
| <b>Total premiums and fees</b> | <b>\$ 4,922</b> | <b>\$ 3,255</b> | <b>\$ 14,431</b> | <b>\$ 9,861</b> |

(1) Includes guaranteed cost premiums primarily associated with open access, commercial HMO and voluntary/limited benefits, as well as other risk-related products.

(2) Premiums and/or fees associated with certain specialty products are also included.

(3) Includes minimum premium business that has a risk profile similar to experience-rated funding arrangements. The risk portion of minimum premium revenue is reported in experience-rated medical premium whereas the self-funding portion of minimum premium revenue is recorded in fees. Also, includes certain non-participating cases for which special customer level reporting of experience is required.

(4) Other medical premiums include risk revenue for specialty products.

(5) Fees related to Medicare Part D of \$17 million for the three months ended and \$43 million for the nine months ended September 30, 2011 have been reclassified to premiums to conform to the current presentation.

**Premiums and fees** increased 51% for the three months and 46% for the nine months ended September 30, 2012 compared with the same periods of 2011, primarily reflecting the acquisition of HealthSpring, as well as rate increases, organic ASO customer growth and related Stop Loss and specialty product penetration. These increases reflect the Company's success in delivering differentiated value to our customers with a focus on providing products and services that expand access and provide superior clinical outcomes.

**Net investment income** decreased 11% for the three months and 5% for the nine months ended September 30, 2012 compared with the same periods of 2011, reflecting lower yields, partially offset by the impact of the HealthSpring acquisition.

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**Mail order pharmacy revenue** increased 9% for the three months and 13% for the nine months ended September 30, 2012 compared with the same periods of 2011 primarily reflecting higher prescription volume for injectible medications, partially offset by price decreases related to a shift to generic oral medications from brand names.

**Other revenues** for the Health Care segment consist of revenues earned on direct channel sales of certain specialty products, including behavioral health and disease management, as well as revenues for management services provided to independent physician associations and health plans. The increase in other revenues of 29% for the three months ended September 30, 2012, compared with the same period last year, primarily reflects revenue contributions from HealthSpring. For the nine months ended September 30, 2012, the decrease in Other revenues is primarily driven by the divestiture of Cigna Government Services in the second quarter of 2011, partially offset by revenue contributions from HealthSpring.

**Benefits and Expenses**

Health Care segment benefits and expenses consist of the following:

| (In millions)                                | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                  |
|----------------------------------------------|-------------------------------------|-----------------|------------------------------------|------------------|
|                                              | 2012                                | 2011            | 2012                               | 2011             |
| Medical claims expense                       | \$ 3,269                            | \$ 2,014        | \$ 9,711                           | \$ 6,125         |
| Other benefit expenses                       | 15                                  | 18              | 51                                 | 63               |
| Mail order pharmacy cost of goods sold       | 324                                 | 309             | 975                                | 874              |
| Operating expenses (excluding special items) | 1,245                               | 1,020           | 3,713                              | 3,041            |
| Special item(s)                              | 60                                  | -               | 91                                 | -                |
| <b>Total benefits and expenses</b>           | <b>\$ 4,913</b>                     | <b>\$ 3,361</b> | <b>\$ 14,541</b>                   | <b>\$ 10,103</b> |

**Medical claims expense** increased by 62% for the three months and 59% for the nine months ended September 30, 2012 compared with the same periods in 2011, primarily reflecting the acquisition of HealthSpring, as well as medical cost inflation, partially offset by a decline in commercial risk customers.

**Operating expenses** (including special items) increased by 28% for the three months and 25% for the nine months ended September 30, 2012 compared with 2011. Excluding special items, operating expenses increased by 22% for the three months and the nine months ended September 30, 2012 compared with the same periods last year, primarily due to the acquisition of HealthSpring, investments in technology, business initiatives, and customer-driven volume growth, with the nine months ended partially offset by the divestiture of Cigna Government Services in the second quarter of 2011.

One measure of the segment's overall operating efficiency is the operating expense ratio calculated as total operating expenses divided by segment revenues. The table below shows operating expense ratios for the Health Care segment.

|                                                   | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |       |
|---------------------------------------------------|-------------------------------------|-------|------------------------------------|-------|
|                                                   | 2012                                | 2011  | 2012                               | 2011  |
| Operating expense ratio (including special items) | 23.9%                               | 27.2% | 23.8%                              | 26.9% |
| Operating expense ratio (excluding special items) | 22.8%                               | 27.2% | 23.2%                              | 26.9% |

The operating expense ratios improved for the three months and the nine months ended September 30, 2012 compared to the same periods in 2011, primarily driven by the acquisition of HealthSpring, as well as operating expense efficiencies achieved due to organic revenue growth, partially offset by higher investments in technology and business initiatives. The HealthSpring acquired business largely reflects fully insured, premium-based products with substantially lower operating expense ratios than the Company's existing businesses. The Company's existing businesses are heavily weighted to ASO fee-based products that have relatively higher operating expense ratios.

Table of Contents**Other Items Affecting Health Care Results***Health Care Medical Claims Payable*

Medical claims payable is higher for the nine months ended September 30, 2012 reflecting the acquisition of HealthSpring. (See Note 5 to the Consolidated Financial Statements for additional information).

*Medical Customers*

A medical customer reported within the Health Care segment (excluding customers in the International and Disability and Life segments) is defined as a person meeting any one of the following criteria:

- is covered under an insurance policy or service agreement issued by the Company;
- has access to the Company's provider network for covered services under their medical plan;
- has medical claims that are administered by the Company; or
- is covered under an insurance policy that is (i) marketed by the Company, and (ii) for which the Company assumes reinsurance of at least 50%.

As of September 30, estimated total medical customers were as follows:

| <i>(In thousands)</i> | 2012  | 2011  |
|-----------------------|-------|-------|
| Guaranteed cost (1)   | 1,119 | 1,128 |
| Experience-rated (2)  | 762   | 785   |
| Total commercial risk | 1,881 | 1,913 |
| Medicare              | 420   | 44    |

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|                                |               |               |
|--------------------------------|---------------|---------------|
| Medicaid                       | 21            | -             |
| Total risk                     | 2,322         | 1,957         |
| Service                        | 10,409        | 9,514         |
| <b>Total medical customers</b> | <b>12,731</b> | <b>11,471</b> |

(1) *Includes customers primarily associated with open access, commercial HMO and voluntary/limited benefits as well as other risk-related products.*

(2) *Includes minimum premium customers, who have a risk profile similar to experience-rated customers. Also, includes certain non-participating cases for which special customer level reporting of experience is required.*

The Company's overall medical customer base as of September 30, 2012 increased 11% when compared with September 30, 2011, primarily reflecting ASO customer growth, as well as the impact of the acquisition of HealthSpring, partially offset by a decline in commercial risk customers.

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## International Segment

### Segment Description

The International segment includes supplemental health, life and accident insurance products and international health care products and services, including those offered to expatriate employees of multinational corporations and other organizations. Effective with the acquisition of Great American Supplemental Benefits on August 31, 2012, the results of that business are included in the International Segment.

The key factors for this segment are:

- premium and fee growth, including new business and customer retention;
- benefits expense as a percentage of earned premium (loss ratio);
- operating expense as a percentage of revenue (expense ratio); and
- impact of foreign currency movements.

Beginning in 2012, the Company adopted, as required, amended accounting guidance for deferred acquisition costs by selecting retrospective adjustment of prior periods. See the Introduction section of this MD&A for the effect of this new guidance on previously reported amounts in the International segment. Implementation of this amended accounting guidance has no impact on the underlying economic value or cash flows of the International segment, nor does it impact the International segment's liquidity or the statutory surplus of its insurance subsidiaries.

### Results of Operations

| FINANCIAL SUMMARY<br>(In millions) | Three Months Ended<br>September 30,<br>2012 |  | Nine Months Ended<br>September 30,<br>2012 |  |
|------------------------------------|---------------------------------------------|--|--------------------------------------------|--|
|                                    | 2011                                        |  | 2011                                       |  |

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|                                                                                                  |              |              |               |               |
|--------------------------------------------------------------------------------------------------|--------------|--------------|---------------|---------------|
| Premiums and fees                                                                                | \$ 930       | \$ 765       | \$ 2,694      | \$ 2,200      |
| Net investment income                                                                            | 25           | 24           | 75            | 71            |
| Other revenues                                                                                   | 8            | 3            | 23            | 12            |
| Segment revenues                                                                                 | 963          | 792          | 2,792         | 2,283         |
| Benefits and expenses                                                                            | 863          | 706          | 2,492         | 2,028         |
| Income before taxes                                                                              | 100          | 86           | 300           | 255           |
| Income taxes                                                                                     | 30           | 24           | 85            | 74            |
| Income attributable to noncontrolling interest                                                   | -            | -            | -             | 1             |
| <b>Segment earnings</b>                                                                          | <b>70</b>    | <b>62</b>    | <b>215</b>    | <b>180</b>    |
| Less: special items (after-tax) included in segment earnings:                                    |              |              |               |               |
| Charge for realignment and efficiency plan (See Note 6 to the Consolidated Financial Statements) | (9)          | -            | (9)           | -             |
| <b>Adjusted income from operations</b>                                                           | <b>\$ 79</b> | <b>\$ 62</b> | <b>\$ 224</b> | <b>\$ 180</b> |
| Impact of foreign currency movements on current period segment earnings                          | \$ (3)       |              | \$ (7)        |               |
| Realized investment gains, net of taxes                                                          | \$ 1         | \$ 1         | \$ 4          | \$ 1          |

International segment earnings increased 13% for the three months and 19% for the nine months ended September 30, 2012 compared to the same periods last year. Segment earnings for the three and nine months ended September 30, 2012 include an after-tax charge of \$9 million (presented in the table above) associated with the realignment and efficiency plan. For the nine months ended September 30, 2012, results also include an \$8 million favorable adjustment related to the first quarter 2012 expansion of a capital management strategy to permanently invest the earnings of its China and Indonesia operations overseas (see further discussion in the Liquidity and Capital Resources section of the MD&A beginning on page 73). Excluding these adjustments and the unfavorable impact of foreign currency movements (presented in the table above) adjusted income from operations increased 32% for the three months and 24% for the nine months ended September 30, 2012 compared with the same periods last year. These increases were primarily driven by significantly higher earnings in the supplemental health, life and accident business (primarily South Korea) reflecting higher margins and revenue growth. The margin improvement was largely attributable to disciplined management of solicitation spending. Excluding the first quarter 2012 implementation effect of the capital management strategy, the International segment's effective tax rate for the nine months ended September 30, 2012 was 30.9%, compared with 29.0% for the same period last year.

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Throughout this discussion, the impact of foreign currency movements was calculated by comparing the reported results to what the results would have been had the exchange rates remained constant with the prior year's comparable period exchange rates.

***Revenues***

***Premiums and fees.*** Excluding the effect of foreign currency movements, premiums and fees increased by 26% for the three months and nine months ended September 30, 2012, compared with the same periods last year. These increases are primarily attributable to the higher revenue associated with the conversion of the Vanbreda business from service to insurance contracts in the global health benefits business as well as the acquisitions of FirstAssist and Great American Supplemental Benefits (the acquisitions), strong persistency, and new sales growth in the supplemental health, life and accident business, particularly in South Korea.

***Net investment income*** increased by 4% for the three months ended and 6% for the nine months ended September 30, 2012 compared with the same periods last year. These increases were primarily due to asset growth, particularly in South Korea.

***Benefits and Expenses***

Excluding the impact of foreign currency movements, benefits and expenses increased by 27% for the three months and nine months ended September 30, 2012, compared with the same periods last year. These increases were primarily due to the acquisitions, the conversion of the Vanbreda business from service to insurance contracts and business growth.

Loss ratios increased for the three months and nine months ended September 30, 2012 in the global health benefits business compared to the same periods last year reflecting the conversion of the Vanbreda business from service to insurance contracts.

Policy acquisition expenses increased for the three months and nine months ended September 30, 2012, reflecting the acquisitions, and business growth, partially offset by lower acquisition costs in Europe reflecting a decision to cease selling activities in certain markets.

Expense ratios decreased for the three months and nine months ended September 30, 2012 compared to the same periods last year. These decreases reflect the favorable effect of the conversion of the Vanbreda business from service to insurance contracts partially offset by the impact of the higher expense ratios associated with FirstAssist in the supplemental health, life and accident business.

### **Other Items Affecting International Results**

For the Company's International segment, South Korea is the single largest geographic market. South Korea generated 30% of the segment's revenues and 55% of the segment's earnings for the three months ended September 30, 2012. South Korea generated 29% of the segment's revenues and 49% of the segment's earnings for the nine months ended September 30, 2012. Due to the concentration of business in South Korea, the International segment is exposed to potential losses resulting from economic, regulatory and geopolitical developments in that country, as well as foreign currency movements affecting the South Korean currency, which could have a significant impact on the segment's results and the Company's consolidated financial results.

Table of Contents**Disability and Life Segment****Segment Description**

The Disability and Life segment includes group disability, life, accident and specialty insurance.

Key factors for this segment are:

- premium and fee growth, including new business and customer retention;
- net investment income;
- benefits expense as a percentage of earned premium (loss ratio); and
- other operating expense as a percentage of earned premiums and fees (expense ratio).

**Results of Operations**

| FINANCIAL SUMMARY<br>(In millions)                                                               | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|--------------------------------------------------------------------------------------------------|-------------------------------------|--------|------------------------------------|----------|
|                                                                                                  | 2012                                | 2011   | 2012                               | 2011     |
| Premiums and fees                                                                                | \$ 758                              | \$ 698 | \$ 2,250                           | \$ 2,103 |
| Net investment income                                                                            | 69                                  | 67     | 207                                | 199      |
| Segment revenues                                                                                 | 827                                 | 765    | 2,457                              | 2,302    |
|                                                                                                  | 742                                 |        | 2,154                              |          |
| Income before taxes                                                                              | 85                                  | 89     | 303                                | 319      |
|                                                                                                  | 25                                  |        | 89                                 |          |
| Segment earnings                                                                                 | 60                                  | 62     | 214                                | 232      |
|                                                                                                  |                                     |        |                                    |          |
| Charge for realignment and efficiency plan (See Note 6 to the Consolidated Financial Statements) | (2)                                 | -      | (2)                                | -        |
|                                                                                                  |                                     |        |                                    |          |
| Adjusted income from operations                                                                  | \$ 62                               | \$ 62  | \$ 216                             | \$ 227   |

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|                                         |    |   |    |     |    |   |    |   |
|-----------------------------------------|----|---|----|-----|----|---|----|---|
| Realized investment gains, net of taxes | \$ | 1 | \$ | (5) | \$ | 3 | \$ | 4 |
|-----------------------------------------|----|---|----|-----|----|---|----|---|

Segment earnings and adjusted income from operations for the three months ended September 30, 2012 were flat compared with the same period in 2011, primarily reflecting a lower life loss ratio offset by a higher disability loss ratio (see Benefits and Expenses below). Earnings in the three months ended September 30, 2012 include the \$5 million after-tax favorable impact of life and specialty reserve studies. Earnings for the same period in 2011 included the \$4 million after-tax favorable impact of accident and specialty reserve studies.

Segment earnings for the nine months ended September 30, 2012 decreased 8% compared with the same period in 2011 reflecting lower adjusted income from operations, a special item for a realignment and efficiency plan charge in 2012 as well as the absence of the 2011 special item related to the completion of the 2007 and 2008 IRS examination. Segment adjusted income from operations decreased 5%, primarily attributable to higher disability and accident loss ratios and a higher operating expense ratio offset by a lower life loss ratio (see Benefits and Expenses below). Results in 2012 include the \$43 million after-tax favorable impact of reserve studies. Results in 2011 include the \$39 million after-tax favorable impact of reserve studies offset by a \$7 million after-tax litigation accrual.

### Revenues

**Premiums and fees** increased 9% for the three months and 7% for the nine months ended September 30, 2012 compared with the same periods of 2011 reflecting strong disability and life new sales, in-force growth and continued strong persistency.

**Net investment income** increased 3% for the three months and 4% for the nine months ended September 30, 2012 compared with the same periods of 2011 due to higher invested assets and partnership income offset by lower yields.

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***Benefits and Expenses***

Benefits and expenses increased 10% for the three months ended September 30, 2012 compared with the same period in 2011 as a result of premium growth in the disability and life business, a higher loss ratio in the disability business and the realignment and efficiency plan charge, partially offset by a lower loss ratio in the life business. The disability loss ratio primarily reflects unfavorable claims experience. The lower life loss ratio primarily reflects lower new claims. Benefits and expenses include the favorable impact of reserve studies of \$7 million for the three months ended September 30, 2012, compared with \$6 million for the three months ended September 30, 2011.

Benefits and expenses increased 9% for the nine months ended September 30, 2012 compared with the same period in 2011 as a result of premium growth in the disability and life business, higher loss ratios in the disability and accident businesses and a higher operating expense ratio, partially offset by a lower loss ratio in the life business. The disability and accident loss ratios primarily reflect higher new claims. The higher operating expense ratio is driven by higher commissions and strategic information technology and claim office investments. The lower life loss ratio primarily reflects lower new claims. Benefits and expenses include the favorable impact of reserve studies of \$60 million in 2012 as compared with the \$58 million favorable impact of reserve studies offset by a \$10 million litigation accrual in 2011.

**Run-off Reinsurance Segment**

**Segment Description**

The Company's reinsurance operations were discontinued and are now an inactive business in run-off mode since the sale of the U.S. individual life, group life and accidental death reinsurance business in 2000. This segment is predominantly comprised of guaranteed minimum death benefit (GMDB, also known as VADBe) and guaranteed minimum income benefit (GMIB) products. In 2010, the Company essentially exited from its workers' compensation and personal accident reinsurance business by purchasing retrocessional coverage from a Bermuda subsidiary of Enstar Group Limited.

The determination of liabilities for GMDB and GMIB requires the Company to make assumptions and critical accounting estimates. The Company describes the assumptions used to develop the reserves for GMDB in Note 7 to the Consolidated Financial Statements and for the assets and liabilities associated with GMIB in Note 8 to the Consolidated Financial Statements. The Company also provides the effects of hypothetical changes in assumptions in the Critical Accounting Estimates section of the MD&A of the Company's 2011 Annual Report.

The Company excludes the results of the GMIB business from adjusted income from operations because the fair value of GMIB assets and liabilities must be recalculated each quarter using updated capital market assumptions. The resulting changes in fair value, which are reported in shareholders' net income, are volatile and unpredictable.

**Results of Operations**

| FINANCIAL SUMMARY<br><i>(In millions)</i> | Three Months Ended<br>September 30, |                | Nine Months Ended<br>September 30, |                |
|-------------------------------------------|-------------------------------------|----------------|------------------------------------|----------------|
|                                           | 2012                                | 2011           | 2012                               | 2011           |
| Premiums and fees                         | \$ 5                                | \$ 5           | \$ 16                              | \$ 18          |
| Net investment income                     | 25                                  | 28             | 77                                 | 77             |
| Other revenues                            | (42)                                | 133            | (106)                              | 96             |
| Segment revenues                          | (12)                                | 166            | (13)                               | 191            |
| Benefits and expenses                     | (50)                                | 441            | (2)                                | 481            |
| Income (loss) before income taxes         | 38                                  | (275)          | (11)                               | (290)          |
| Income tax expense (benefit)              | 13                                  | (95)           | (4)                                | (101)          |
| <b>Segment income (loss)</b>              | <b>25</b>                           | <b>(180)</b>   | <b>(7)</b>                         | <b>(189)</b>   |
| Less: results of GMIB business            | 32                                  | (134)          | 22                                 | (142)          |
| <b>Adjusted loss from operations</b>      | <b>\$ (7)</b>                       | <b>\$ (46)</b> | <b>\$ (29)</b>                     | <b>\$ (47)</b> |
| Realized investment gains net of taxes    | \$ 1                                | \$ 1           | \$ -                               | \$ 1           |

Segment results for the three months and nine months ended September 30, 2012, compared to the same periods last year, reflect significantly improved results for the GMIB business (presented in the table above) and lower reserve strengthening for GMDB.

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See the Benefits and Expenses section for further discussion around the results of the GMIB and GMDB businesses.

**Other Revenues**

Other revenues consisted of gains and losses from futures and swap contracts used in the GMDB and GMIB equity and interest rate hedge programs. See Note 10 to the Consolidated Financial Statements for additional information. The components were as follows:

|                                           | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |              |
|-------------------------------------------|-------------------------------------|---------------|------------------------------------|--------------|
|                                           | 2012                                | 2011          | 2012                               | 2011         |
| (In millions)                             |                                     |               |                                    |              |
| GMDB - Equity Hedge Program               | \$ (36)                             | \$ 100        | \$ (100)                           | \$ 51        |
| GMDB - Growth Interest Rate Hedge Program | 1                                   | 20            | 6                                  | 30           |
| GMIB - Equity Hedge Program               | (8)                                 | 9             | (14)                               | 9            |
| GMIB - Growth Interest Rate Hedge Program | 1                                   | 4             | 2                                  | 6            |
| <b>Total Other Revenues</b>               | <b>\$ (42)</b>                      | <b>\$ 133</b> | <b>\$ (106)</b>                    | <b>\$ 96</b> |

The hedging programs generally produce losses when equity markets and interest rates are rising and gains when equity markets and interest rates are falling. Amounts reflecting related changes in liabilities for GMDB contracts were included in benefits and expenses consistent with GAAP when a premium deficiency exists, resulting in no effect on shareholders' net income (see below Other Benefits and Expenses). Changes in liabilities for GMIB contracts, including the portion covered by the hedges, are recorded in GMIB fair value (gain) loss.

**Benefits and Expenses**

Benefits and expenses were comprised of the following:

|                              | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |               |
|------------------------------|-------------------------------------|---------------|------------------------------------|---------------|
|                              | 2012                                | 2011          | 2012                               | 2011          |
| (In millions)                |                                     |               |                                    |               |
| GMIB fair value (gain) loss  | \$ (53)                             | \$ 224        | \$ (33)                            | \$ 245        |
| Other benefits and expenses  | 3                                   | 217           | 31                                 | 236           |
| <b>Benefits and expenses</b> | <b>\$ (50)</b>                      | <b>\$ 441</b> | <b>\$ (2)</b>                      | <b>\$ 481</b> |

**GMIB fair value (gain)/loss.** Under GAAP guidance for fair value measurements, the Company's results of operations are expected to be volatile in future periods because capital market assumptions needed to estimate the assets and liabilities for the GMIB business are based largely on market-observable inputs at the close of each reporting period including interest rates (LIBOR swap curve) and market-implied volatilities. See Note 8 to the Consolidated Financial Statements for additional information about assumptions and asset and liability balances related to GMIB and Note 10 for additional information regarding the program to hedge a portion of equity and interest rate risks in GMIB contracts.

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During the three months ended September 30, 2012, the Company conducted reviews of annuitization and lapse experience, as well as a review of actual claim amounts compared to projected values in the fair value model. The fair value gain of \$53 million for the three months and \$33 million for the nine months ended September 30, 2012 was primarily due to updates in the claim exposure calculation, a reduction in annuitization rates, and the effect of increases in underlying account values, partially offset by a reduction in lapse rates and general declines in interest rates.

GMIB fair value losses of \$224 million for the three months ended September 30, 2011 and \$245 million for the nine months ended September 30, 2011 were primarily due to declining interest rates and to a lesser extent decreases in underlying account values, driven by unfavorable equity market returns.

The GMIB liabilities and related assets are calculated using an internal model and assumptions from the viewpoint of a hypothetical market participant. This resulting liability (and related asset) is higher than the Company believes will ultimately be required to settle claims primarily because market-observable interest rates are used to project growth in policyholder account values of the underlying mutual funds to estimate fair value from the viewpoint of a hypothetical market participant. The Company's payments for GMIB claims are expected to occur over the next 15 to 20 years and will be based on actual values of the underlying mutual funds and the 7-year Treasury rate at the dates benefits are elected. Management does not believe that current market-observable interest rates reflect (i) actual growth expected for the underlying mutual funds over that timeframe, or (ii) the interest rates expected to be achieved from the invested assets supporting the block, and therefore believes that the recorded liability and related asset do not represent what management believes will ultimately be required as this business runs off.

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However, significant declines in mutual fund values that underlie the contracts (increasing the exposure to the Company) together with declines in the 7-year Treasury rates (used to determine claim payments) similar to what occurred periodically during the last few years would increase the expected amount of claims that would be paid out for contractholders who choose to annuitize. It is also possible that such unfavorable market conditions would have an impact on the level of contractholder annuitizations, particularly if such unfavorable market conditions persisted for an extended period.

**Other Benefits and Expenses.** Other benefits and expenses are comprised of the following:

| (In millions)                                             | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |               |
|-----------------------------------------------------------|-------------------------------------|---------------|------------------------------------|---------------|
|                                                           | 2012                                | 2011          | 2012                               | 2011          |
| Results of GMDB equity and interest rate hedging programs | \$ (35)                             | \$ 120        | \$ (94)                            | \$ 81         |
| Reserve strengthening                                     | 10                                  | 70            | 43                                 | 70            |
| Other GMDB, primarily accretion of discount               | 21                                  | 20            | 60                                 | 62            |
| GMDB benefit expense                                      | (4)                                 | 210           | 9                                  | 213           |
| Other, including operating expenses                       | 7                                   | 7             | 22                                 | 23            |
| <b>Other benefits and expenses</b>                        | <b>\$ 3</b>                         | <b>\$ 217</b> | <b>\$ 31</b>                       | <b>\$ 236</b> |

**Capital market movements.** Benefits expense related to capital market movements as represented by the results of the hedging programs for the three months and nine months ended September 30, 2012 reflects favorable equity market performance. For the three months and nine months ended September 30, 2011, the increase in benefits expense reflects unfavorable equity market performance. As explained in Other revenues above, these changes do not affect shareholders' net income because they are offset by gains or losses on futures contracts used to hedge equity market and interest rate performance.

**Reserve strengthening.** The Company recorded additional other benefits and expenses of \$10 million (\$6 million after-tax) for the three months and \$43 million (\$27 million after-tax) for the nine months ended September 30, 2012 to strengthen GMDB reserves. The reserve strengthening in the third quarter primarily reflected an update to management's consideration of the anticipated impact of continued low short-term interest rates. This impact was partially offset by favorable equity market conditions. For the nine months ended September 30, 2012, reserve strengthening also included reductions to the lapse rate assumptions and, to a lesser extent, an increase to the volatility and correlation assumptions.

During the third quarter of 2011, the Company recorded additional other benefits and expenses of \$70 million (\$45 million after-tax) to strengthen GMDB reserves. The reserve strengthening was driven primarily by volatility-related impacts due to the turbulent equity market conditions, an update to management's consideration of the anticipated impact of the continued low level of short-term interest rates, and the adverse impacts of overall market declines, including an increase in the provision for future partial surrenders and declines in the value of contract holders' non-equity investments such as bond funds, neither of which are included in the hedge program.

See Note 7 to the Consolidated Financial Statements for additional information about assumptions and reserve balances related to GMDB.

## Segment Summary

The Company's payment obligations for underlying reinsurance exposures assumed by the Company under these contracts are based on ceding companies' claim payments. For GMDB and GMIB, claim payments vary because of changes in equity markets and interest rates, as well as mortality and policyholder behavior. Any of these claim payments can extend many years into the future, and the amount of the ceding companies' ultimate claims, and therefore the amount of the Company's ultimate payment obligations and corresponding ultimate collection from its retrocessionaires may not be known with certainty for some time.

The Company's reserves for underlying reinsurance exposures assumed by the Company, as well as for amounts recoverable from retrocessionaires, are considered appropriate as of September 30, 2012, based on current information. However, it is possible that future developments, which could include but are not limited to worse than expected claim experience and higher than expected volatility, could have a material adverse effect on the Company's consolidated results of operations and financial condition. The Company bears the risk of loss if its payment obligations to cedents increase or if its retrocessionaires are unable to meet, or successfully challenge, their reinsurance obligations to the Company.

Table of Contents**Other Operations Segment****Segment Description**

Other Operations consist of:

- corporate owned life insurance ( COLI );
- deferred gains recognized from the 1998 sale of the individual life insurance and annuity business and the 2004 sale of the retirement benefits business; and
- run-off settlement annuity business.

**Results of Operations**

| <b>FINANCIAL SUMMARY</b><br><i>(In millions)</i>                                                                                                        | <b>Three Months Ended<br/>September 30,</b> |              | <b>Nine Months Ended<br/>September 30,</b> |              |
|---------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------|--------------|--------------------------------------------|--------------|
|                                                                                                                                                         | <b>2012</b>                                 | <b>2011</b>  | <b>2012</b>                                | <b>2011</b>  |
| Premiums and fees                                                                                                                                       | \$ 22                                       | \$ 25        | \$ 73                                      | \$ 85        |
| Net investment income                                                                                                                                   | 96                                          | 102          | 293                                        | 301          |
| Other revenues                                                                                                                                          | 14                                          | 15           | 41                                         | 41           |
| Segment revenues                                                                                                                                        | 132                                         | 142          | 407                                        | 427          |
| Benefits and expenses                                                                                                                                   | 99                                          | 106          | 312                                        | 340          |
| Income before taxes                                                                                                                                     | 33                                          | 36           | 95                                         | 87           |
| Income taxes                                                                                                                                            | 11                                          | 11           | 32                                         | 19           |
| <b>Segment earnings</b>                                                                                                                                 | <b>22</b>                                   | <b>25</b>    | <b>63</b>                                  | <b>68</b>    |
| Less: special item (after-tax) included in segment earnings:<br>Completion of IRS examination (See Note 16 to the Consolidated<br>Financial Statements) | -                                           | -            | -                                          | 4            |
| <b>Adjusted income from operations</b>                                                                                                                  | <b>\$ 22</b>                                | <b>\$ 25</b> | <b>\$ 63</b>                               | <b>\$ 64</b> |
| Realized investment gains (losses), net of taxes                                                                                                        | \$ 1                                        | \$ 2         | \$ (1)                                     | \$ 6         |

Segment earnings and adjusted income from operations decreased 12% for the three months ended September 30, 2012 compared with the same period in 2011, primarily reflecting lower COLI interest margins and mortality gains.

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Segment earnings decreased 7% for the nine months ended September 30, 2012 compared with the same period in 2011, primarily reflecting the absence of a \$4 million special item in the first half of 2011 related to completing the Company's 2007 and 2008 IRS examination and lower earnings from the continued decline in deferred gain amortization associated with the sold businesses.

Adjusted income from operations decreased 2% for the nine months ended September 30, 2012 compared with the same period in 2011, primarily reflecting lower earnings from the continued decline in deferred gain amortization associated with the sold businesses.

**Premiums and fees.** Premiums and fees decreased 12% for the three months and 14% for the nine months ended September 30, 2012, compared with the same periods in 2011 due to lower policyholder death benefit coverage.

**Net investment income.** Net investment income decreased 6% for the three months and 3% for the nine months ended September 30, 2012, compared with the same periods in 2011, primarily reflecting lower average yields.

**Other revenues.** Other revenues decreased 7% for the three months and were flat for the nine months ended September 30, 2012, compared with the same periods in 2011 primarily due to lower deferred gain amortization related to the sold retirement benefits and individual life insurance and annuity businesses. Nine month results were offset by higher investment management fees.

For more information regarding the sale of these businesses, see Note 12 to the Consolidated Financial Statements.

**Benefits and expenses.** Benefits and expenses decreased 7% for the three months and 8% for the nine months ended September 30, 2012, compared with the same periods in 2011, primarily due to favorable COLI claims experience and lower policyholder death benefit coverage. The nine months results also reflect a charge recorded in the first quarter of 2011 to reimburse the buyer of the retirement benefits business with a portion of the tax benefits resulting from the completion of the 2007 and 2008 IRS examination as required under a tax sharing agreement.

Table of Contents**Corporate****Description**

Corporate reflects amounts not allocated to operating segments, such as net interest expense (defined as interest on corporate debt less net investment income on investments not supporting segment operations), interest on uncertain tax positions, certain litigation matters, intersegment eliminations, compensation cost for stock options and certain corporate overhead expenses such as directors' expenses and pension expense related to the Company's frozen pension plans.

| FINANCIAL SUMMARY                                                                    | Three Months Ended<br>September 30, |                | Nine Months Ended<br>September 30, |                 |
|--------------------------------------------------------------------------------------|-------------------------------------|----------------|------------------------------------|-----------------|
|                                                                                      | 2012                                | 2011           | 2012                               | 2011            |
| <i>(In millions)</i>                                                                 |                                     |                |                                    |                 |
| <b>Segment loss</b>                                                                  | <b>\$ (63)</b>                      | <b>\$ (43)</b> | <b>\$ (203)</b>                    | <b>\$ (116)</b> |
| Less: special items (after-tax) included in segment loss:                            |                                     |                |                                    |                 |
| Costs associated with HealthSpring acquisition                                       | (12)                                | -              | (33)                               | -               |
| Completion of IRS examination (See Note 16 to the Consolidated Financial Statements) | -                                   | -              | -                                  | 14              |
| <b>Adjusted loss from operations</b>                                                 | <b>\$ (51)</b>                      | <b>\$ (43)</b> | <b>\$ (170)</b>                    | <b>\$ (130)</b> |

Corporate's segment loss was higher for the three months ended September 30, 2012 compared with the same period in 2011 primarily reflecting higher interest expense resulting from the \$2.1 billion of long-term debt issued in the fourth quarter of 2011 to fund the HealthSpring acquisition and the effect of a special item related to the HealthSpring acquisition.

For the nine months ended September 30, 2012, segment loss for Corporate was significantly higher than the same period in 2011, primarily reflecting:

- the effect of the special items related to the HealthSpring acquisition costs in 2012;
- the absence of a tax benefit recorded in the first quarter of 2011 resulting from the completion of the IRS examination;
- higher interest expense resulting from the \$2.1 billion of long-term debt issued in the fourth quarter of 2011 to fund the HealthSpring acquisition; and
- estimated penalties associated with management's notice to terminate a service contract.



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## **LIQUIDITY AND CAPITAL RESOURCES**

### **Liquidity**

The Company maintains liquidity at two levels: the subsidiary level and the parent company level.

Liquidity requirements at the subsidiary level generally consist of:

- claim and benefit payments to policyholders; and
- operating expense requirements, primarily for employee compensation and benefits.

The Company's subsidiaries normally meet their operating requirements by:

- maintaining appropriate levels of cash, cash equivalents and short-term investments;
- using cash flows from operating activities;
- selling investments;
- matching investment durations to those estimated for the related insurance and contractholder liabilities; and
- borrowing from its parent company.

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Liquidity requirements at the parent company level generally consist of:

- debt service and dividend payments to shareholders; and
- pension plan funding.

The parent company normally meets its liquidity requirements by:

- maintaining appropriate levels of cash, cash equivalents and short-term investments;
- collecting dividends from its subsidiaries;
- using proceeds from issuance of debt and equity securities; and
- borrowing from its subsidiaries.

Cash flows for the nine months ended September 30, were as follows:

| <i>(In millions)</i> | 2012       | 2011       |
|----------------------|------------|------------|
| Operating activities | \$ 1,557   | \$ 1,243   |
| Investing activities | \$ (3,864) | \$ (1,226) |
| Financing activities | \$ (150)   | \$ 277     |

Cash flows from operating activities consist of cash receipts and disbursements for premiums and fees, mail order pharmacy and other revenues, gains (losses) recognized in connection with the Company's GMDB and GMIB equity hedge programs, investment income, taxes, and benefits and expenses. Because certain income and expense transactions do not generate cash, and because cash transactions related to revenues and expenses may occur in periods different from when those revenues and expenses are recognized in shareholders' net income, cash flows from operating activities can be significantly different from shareholders' net income.

Cash flows from investing activities generally consist of net investment purchases or sales and net purchases of property and equipment, which includes capitalized software, as well as cash used to acquire businesses.

Cash flows from financing activities are generally comprised of issuances and re-payment of debt at the parent company level, proceeds on the issuance of common stock resulting from stock option exercises, and stock repurchases. In addition, the subsidiaries report net

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deposits/withdrawals to/from investment contract liabilities (which include universal life insurance liabilities) because such liabilities are considered financing activities with policyholders.

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**2012:**

*Operating activities*

For the nine months ended September 30, 2012, cash flows from operating activities were greater than net income by \$340 million. A portion of the difference between net income and cash flows from operating activities is due to the following pre-tax income and expense items which neither provide nor use operating cash flow:

- GMIB fair value gain of \$33 million did not provide operating cash flow;
- depreciation and amortization charges of \$406 million did not use operating cash flow; and
- realized investment gains of \$20 million did not provide operating cash flow.

The total of the items listed above is a net non-cash charge of \$353 million. The remaining \$13 million is primarily attributable to cash outflows associated with the GMDB equity hedge program and pension contributions, partially offset by reserve increases driven by business growth and tax payments being significantly lower than tax expense.

Cash flows from operating activities increased by \$314 million for the nine months ended September 30, 2012 compared with the same period last year, primarily the result of strong earnings growth in the ongoing business segments in 2012. In addition, 2011 operating cash flows were adversely affected by significant claim run-out from the Medicare IPFFS business, that the Company exited in 2011. These favorable effects were partially offset by higher cash outflows of \$151 million associated with the GMDB equity hedge program.

*Investing activities*

Cash used in investing activities was \$3,864 million for the nine months ended September 30, 2012. This use of cash consisted primarily of the acquisition of HealthSpring of \$3.2 billion (net of cash acquired), the acquisition of Great American Supplemental Benefits of \$271 million (net of cash acquired), net purchases of investments of \$67 million and net purchases of property and equipment (primarily internal-use software) of \$329 million.

### *Financing activities*

Cash used in financing activities for the nine months ended September 30, 2012 primarily reflects the repayment of debt assumed in the HealthSpring acquisition of \$326 million and the repurchase of 1.9 million shares of stock for \$85 million. These effects were partially offset by the change in short-term debt of \$123 million primarily from the issuance of commercial paper, proceeds from the issuance of common stock from employee benefit plans of \$58 million and net deposits to contractholder deposit funds of \$72 million.

**Share Repurchase.** The Company maintains a share repurchase program, which was authorized by its Board of Directors. The decision to repurchase shares depends on market conditions and alternate uses of capital. The Company has, and may continue from time to time, to repurchase shares on the open market through a Rule 10b5-1 plan which permits a company to repurchase its shares at times when it otherwise might be precluded from doing so under insider trading laws or because of self-imposed trading blackout periods. The Company suspends activity under this program from time to time and also removes such suspensions, generally without public announcement.

The Company repurchased 4.4 million shares for approximately \$207 million through October 31, 2012. The total remaining share repurchase authorization as of October 31, 2012 was \$315 million. Through October 28, 2011, the Company repurchased 5.3 million shares for approximately \$225 million.

### **2011:**

### *Operating activities*

For the nine months ended September 30, 2011, cash flows from operating activities were higher than net income by \$255 million. A portion of the difference between net income and cash flows from operating activities is due to the following pre-tax income and expense items which neither provide nor use operating cash flow:

- GMIB fair value loss of \$245 million did not use operating cash flow;
- net pre-tax charges related to special items of \$9 million did not use operating cash flow;
- tax benefits related to the resolution of federal tax matters of \$33 million did not provide operating cash flow;
- depreciation and amortization charges of \$252 million did not use operating cash flow; and

- realized investment gains of \$56 million did not provide operating cash flow.

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Excluding the \$417 million of net non-cash charges noted above cash flows from operating activities were lower than net income by \$162 million. Excluding cash inflows of \$51 million associated with the GMDB equity hedge program (which did not affect shareholders' net income), cash flows from operating activities were lower than net income by \$213 million. This result primarily reflects pension contributions of \$231 million.

*Investing activities*

Cash used in investing activities was \$1,226 million for the nine months ended September 30, 2011. This use of cash primarily consisted of net purchases of investments of \$936 million and net purchases of property and equipment of \$291 million.

*Financing activities*

Cash provided from financing activities for the nine months ended September 30, 2011 consisted primarily of net proceeds from the issuance of long-term debt of \$587 million, proceeds from issuances of common stock from employee benefit plans of \$100 million and net deposits to contractholder deposit funds of \$107 million. These inflows were partially offset by the repayment of debt of \$224 million, cash used for common stock repurchase of \$225 million and changes in the cash overdraft position of \$57 million.

**Interest Expense**

Interest expense on long-term debt, short-term debt and capital leases was as follows:

| (In millions)    | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |        |
|------------------|-------------------------------------|-------|------------------------------------|--------|
|                  | 2012                                | 2011  | 2012                               | 2011   |
| Interest expense | \$ 68                               | \$ 49 | \$ 201                             | \$ 141 |

The increase in interest expense for the nine months ended September 30, 2012 was primarily due to the issuance of \$2.1 billion of long-term debt in the fourth quarter of 2011 to fund the acquisition of HealthSpring, partially offset by a lower weighted average interest rate reflecting the more favorable rates of this debt issued.

**Capital Resources**

The Company's capital resources (primarily retained earnings and the proceeds from the issuance of debt and equity securities) provide protection for policyholders, furnish the financial strength to underwrite insurance risks and facilitate continued business growth.

Management, guided by regulatory requirements and rating agency capital guidelines, determines the amount of capital resources that the Company maintains. Management allocates resources to new long-term business commitments when returns, considering the risks, look promising and when the resources available to support existing business are adequate.

The Company prioritizes its use of capital resources to:

- provide capital necessary to support growth and maintain or improve the financial strength ratings of subsidiaries which includes evaluating potential solutions for the Company's run-off reinsurance business and pension funding obligations;
- consider acquisitions that are strategically and economically advantageous; and
- return capital to investors through share repurchase.

The availability of capital resources will be impacted by equity and credit market conditions. Extreme volatility in credit or equity market conditions may reduce the Company's ability to issue debt or equity securities.

## Liquidity and Capital Resources Outlook

At September 30, 2012, there was approximately \$435 million in cash and short-term investments available at the parent company level. For the remainder of 2012, the parent company's cash requirements include scheduled interest payments of approximately \$60 million on long-term debt of \$5.0 billion outstanding at September 30, 2012. In addition, \$225 million of commercial paper will mature over the next three months. The Company expects to make additional contributions to the pension plan of approximately \$24 million for the remainder of the year. The parent company expects to fund these cash requirements by using available cash, subsidiary

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dividends and by refinancing the maturing commercial paper borrowings with new commercial paper.

The availability of resources at the parent company level is partially dependent on dividends from the Company's subsidiaries, most of which are subject to regulatory restrictions and rating agency capital guidelines, and partially dependent on the availability of liquidity from the issuance of debt or equity securities.

The Company expects, based on current projections for cash activity, to have sufficient liquidity to meet the obligations discussed above.

However, the Company's cash projections may not be realized and the demand for funds could exceed available cash if:

- ongoing businesses experience unexpected shortfalls in earnings;
- regulatory restrictions or rating agency capital guidelines reduce the amount of dividends available to be distributed to the parent company from the insurance and HMO subsidiaries (including the impact of equity market deterioration and volatility on subsidiary capital);
- significant disruption or volatility in the capital and credit markets reduces the Company's ability to raise capital or creates unexpected losses related to the GMDB and GMIB businesses;
- a substantial increase in funding over current projections is required for the Company's pension plans; or
- a substantial increase in funding is required for the Company's hedge programs in the run-off reinsurance operations.

In those cases, the Company expects to have the flexibility to satisfy liquidity needs through a variety of measures, including intercompany borrowings and sales of liquid investments. The parent company may borrow up to \$600 million from Connecticut General Life Insurance Company (CGLIC) without prior state approval. As of September 30, 2012, the parent company had no outstanding borrowings from CGLIC.

In addition, the Company may use short-term borrowings, such as the commercial paper program and the committed revolving credit and letter of credit agreement of up to \$1.5 billion subject to the maximum debt leverage covenant in its line of credit agreement. As of September 30, 2012, the Company had \$1.4 billion of borrowing capacity under the credit agreement, reflecting \$66 million of letters of credit issued out of the credit facility. Within the maximum debt leverage covenant in the line of credit agreement, the Company has an additional \$4.9 billion of borrowing capacity in addition to the \$5.2 billion of debt outstanding.

During the first quarter of 2012, the Company's International segment expanded its capital management strategy to permanently invest the earnings of its China and Indonesia operations overseas. The implementation effect was an increase to segment earnings of \$8 million. The Company has implemented a similar strategy for certain of its operations in prior years. Permanently invested earnings are generally deployed in these countries, and where possible, other foreign jurisdictions, in support of the liquidity and capital needs of the Company's foreign operations. This strategy does not materially limit the Company's ability to meet its liquidity and capital needs in the United States. As of September 30, 2012 the Company's cash and cash equivalents in its foreign operations were \$647 million, and permanently reinvested earnings were approximately \$435 million. Repatriation of foreign cash via a dividend of the previously-designated permanently reinvested earnings would result in a charge representing the U.S. taxes due on the repatriation.

Though the Company believes it has adequate sources of liquidity, continued significant disruption or volatility in the capital and credit markets could affect the Company's ability to access those markets for additional borrowings or increase costs associated with borrowing funds.

## Guarantees and Contractual Obligations

The Company, through its subsidiaries, is contingently liable for various contractual obligations entered into in the ordinary course of business. See Note 18 to the Consolidated Financial Statements for additional information.

**Contractual obligations.** The Company has updated its contractual obligations previously provided in the Company's 2011 Annual Report for operating lease information as a result of the acquisition of HealthSpring. The Company has not updated its contractual obligations for the acquired Great American Supplemental Benefits business as a significant portion of the insurance liabilities were reinsured by the seller as part of the transaction and the associated net cash flows are not expected to impact the Company. The remaining net cash flows were not considered material.

| <i>(In millions, on an undiscounted basis)</i> |    | <b>Total</b> | <b>Less than 1 year</b> | <b>1-3 years</b> | <b>4-5 years</b> | <b>After 5 years</b> |
|------------------------------------------------|----|--------------|-------------------------|------------------|------------------|----------------------|
| <b>Off-Balance Sheet:</b>                      |    |              |                         |                  |                  |                      |
| Operating leases                               | \$ | 639          | \$ 123                  | \$ 206           | \$ 139           | \$ 171               |

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## INVESTMENT ASSETS

The Company's investment assets do not include separate account assets. Additional information regarding the Company's investment assets and related accounting policies is included in Notes 2, 8, 9, 10, 11 and 15 to the Consolidated Financial Statements. More detailed information about the fixed maturities portfolios by type of issuer, maturity dates, and, for mortgages, by debt service coverage and loan-to-value ratios is included in Note 9 to the Consolidated Financial Statements and Notes 2, 11, 12 and 18 to the Consolidated Financial Statements in the Company's 2011 Annual Report.

As of September 30, 2012, the Company's mix of investments and their primary characteristics had not materially changed since December 31, 2011. The Company's fixed maturity portfolio is diversified by issuer and industry type, with the largest single industry constituting approximately 10% of total invested assets as of September 30, 2012. The Company's commercial mortgage loan portfolio is diversified by property type, geographic location and borrower.

### Fixed Maturities

Investments in fixed maturities include publicly-traded and privately-placed debt securities, mortgage and other asset-backed securities, preferred stocks redeemable by the investor, hybrid and trading securities. Fair values are based on quoted market prices when available. When market prices are not available, fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality. In instances where there is little or no market activity for the same or similar instruments, the Company estimates fair value using methods, models and assumptions that the Company believes a hypothetical market participant would use to determine a current transaction price.

The prices the Company used to value investment assets are representative of prices that would be received to sell the assets at the measurement date (exit prices) and are classified appropriately in the fair value hierarchy as defined in Note 8 to the Consolidated Financial Statements. The Company performs ongoing analyses of prices used to value invested assets to determine that they represent appropriate estimates of fair value. This process involves quantitative and qualitative analyses that are overseen by the Company's investment professionals, including reviews of pricing methodologies, judgments of valuation inputs, and assessments of the significance of any unobservable inputs, pricing statistics and trends. These reviews are also designed to ensure prices do not become stale, have reasonable explanations as to why they have changed from prior valuations, or require additional review for other anomalies. The Company also performs sample testing of sales values to confirm the accuracy of prior fair value estimates. Exceptions identified during these processes indicate that adjustments to prices are infrequent and result in immaterial adjustments to the valuations.

The net appreciation of the Company's fixed maturity portfolio increased approximately \$330 million in the nine months ended September 30, 2012 driven by a decrease in market yields. Although overall asset values are well in excess of amortized cost, there are specific securities with amortized cost in excess of fair value by \$33 million as of September 30, 2012. See Note 9 to the Consolidated Financial Statements for further information.

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The Company's investment in state and local government securities is diversified by issuer and geography with no single exposure greater than \$34 million. The Company assesses each issuer's credit quality based on a fundamental analysis of underlying financial information and does not rely solely on statistical rating organizations or monoline insurer guarantees. As of September 30, 2012, 97% of the Company's investments in these securities were rated A3 or better excluding guarantees by monoline bond insurers, consistent with the prior year. As of September 30, 2012, approximately 63% or \$1,567 million of the Company's total investments in state and local government securities were guaranteed by monoline bond insurers, providing additional credit quality support. The quality ratings of these investments with and without this guaranteed support as of September 30, 2012 were as follows:

| As of September 30, 2012                 |                |                 |                   |
|------------------------------------------|----------------|-----------------|-------------------|
| Fair Value                               |                |                 |                   |
| (In millions)                            | Quality Rating | With Guarantee  | Without Guarantee |
| State and local governments              | Aaa            | \$ 129          | \$ 128            |
|                                          | Aa1-Aa3        | 1,138           | 1,072             |
|                                          | A1-A3          | 260             | 325               |
|                                          | Baa1-Baa3      | 40              | 20                |
|                                          | Ba1-Ba3        | -               | 22                |
| <b>Total state and local governments</b> |                | <b>\$ 1,567</b> | <b>\$ 1,567</b>   |

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The Company also invests in high quality foreign government obligations, with an average quality rating of AA as of September 30, 2012. These investments are primarily concentrated in Asia consistent with the geographic distribution of the Company's international business operations; including government obligations of South Korea, Indonesia, Taiwan and Hong Kong. Foreign government obligations also include \$167 million of investments in European sovereign debt, including \$10 million in countries with the most significant political or economic concerns.

As of September 30, 2012, the Company's investments in other asset and mortgage-backed securities totaling \$1,135 million included \$497 million of private placement securities with an average quality rating of BAA- that are guaranteed by monoline bond insurers. Quality ratings without considering the guarantees for these other asset-backed securities were not available.

As of September 30, 2012, the Company had no direct investments in monoline bond insurers. Guarantees provided by various monoline bond insurers for certain of the Company's investments in state and local governments and other asset-backed securities as of September 30, 2012 were:

(In millions)

As of September 30, 2012

| Guarantor                                                               | Indirect Exposure |
|-------------------------------------------------------------------------|-------------------|
| National Public Finance Guarantee (formerly MBIA, Inc.)                 | \$ 1,250          |
| Assured Guaranty Municipal Corp (formerly Financial Security Assurance) | 590               |
| AMBAC                                                                   | 186               |
| Financial Guaranty Insurance Co.                                        | 38                |
| <b>Total</b>                                                            | <b>\$ 2,064</b>   |

## Commercial Mortgage Loans

The Company's commercial mortgage loans are fixed rate loans, diversified by property type, location and borrower to reduce exposure to potential losses. Loans are secured by high quality commercial properties and are generally made at less than 75% of the property's value at origination of the loan. In addition to property value, debt service coverage, building tenancy and stability of cash flows are important financial underwriting considerations. Property type, location, quality, and borrower are important underwriting considerations as well. The Company holds no direct residential mortgage loans and does not securitize or service mortgage loans.

The Company completed its annual in depth review of its commercial mortgage loan portfolio during the second quarter of 2012. This review included an analysis of each property's year-end 2011 financial statements, rent rolls, operating plans and budgets for 2012, a physical inspection of the property and other pertinent factors. Based on property values and cash flows estimated as part of this review and subsequent portfolio activity, the overall health of the portfolio improved from the 2011 review, consistent with recovery in many commercial real estate markets. The portfolio's average loan-to-value ratio improved to 65% at September 30, 2012, decreasing from 70% as of December 31, 2011, due primarily to increased valuations for the majority of the underlying properties. Valuation changes varied by property type as office properties and apartments demonstrated the strongest recovery, hotels and retail properties showed modest improvement while industrial properties exhibited a decline, indicative of a slower recovery for rental rates and demand. The portfolio's average debt service coverage ratio was

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estimated to be 1.57 at September 30, 2012, substantially higher than 1.40 as of December 31, 2011, including improvement across all property types.

Commercial real estate capital markets remain most active for well leased, quality commercial real estate located in strong institutional investment markets. The vast majority of properties securing the mortgages in the Company's mortgage portfolio possess these characteristics. While commercial real estate fundamentals continued to improve, the improvement has varied across geographies and property types. A broad recovery is dependent on continued improvement in the national economy.

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The following table reflects the commercial mortgage loan portfolio as of September 30, 2012 summarized by loan-to-value ratio based on the annual loan review completed during the second quarter of 2012.

## Loan-to-Value Distribution

### Loan-to-Value Ratios

### Amortized Cost

| <i>(In millions)</i> | Senior          | Subordinated  | Total           | % of Mortgage Loans |
|----------------------|-----------------|---------------|-----------------|---------------------|
| Below 50%            | \$ 274          | \$ 62         | \$ 336          | 11%                 |
| 50% to 59%           | 853             | 32            | 885             | 30%                 |
| 60% to 69%           | 642             | 29            | 671             | 23%                 |
| 70% to 79%           | 531             | 13            | 544             | 19%                 |
| 80% to 89%           | 249             | 27            | 276             | 9%                  |
| 90% to 99%           | 102             | -             | 102             | 3%                  |
| 100% or above        | 132             | -             | 132             | 5%                  |
| <b>Totals</b>        | <b>\$ 2,783</b> | <b>\$ 163</b> | <b>\$ 2,946</b> | <b>100%</b>         |

As summarized above, \$163 million or 6% of the commercial mortgage loan portfolio is comprised of subordinated notes that were fully underwritten and originated by the Company using its standard underwriting procedures and are secured by first mortgage loans. Senior interests in these first mortgage loans were then sold to other institutional investors. This strategy allowed the Company to effectively utilize its origination capabilities to underwrite high quality loans, limit individual loan exposures, and achieve attractive risk adjusted yields. In the event of a default, the Company would pursue remedies up to and including foreclosure jointly with the holders of the senior interest, but would receive repayment only after satisfaction of the senior interest.

In the table above, there are three loans in the 100% or above category with an aggregate carrying value of \$66 million that exceed the value of their underlying properties by \$6 million. All of these loans have current debt service coverage of 1.0 or greater, along with significant borrower commitment.

The commercial mortgage portfolio contains approximately 155 loans. Four impaired loans with a carrying value totaling \$126 million are classified as problem or potential problem loans, including two loans totaling \$60 million that are current based on restructured terms and two loans totaling \$66 million, net of reserves, that are current but full collection of principal is not expected. All of the remaining loans continue to perform under their contractual terms. The Company has \$402 million of loans maturing in the next twelve months. Given the quality and diversity of the underlying real estate, positive debt service coverage and significant borrower cash investment averaging nearly 30%, the Company remains confident that the vast majority of borrowers will continue to perform as expected under their contract terms.

## Other Long-term Investments

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The Company's other long-term investments include \$1,103 million in security partnership and real estate funds as well as direct investments in real estate joint ventures. The funds typically invest in mezzanine debt or equity of privately held companies (securities partnerships) and equity real estate. Given its subordinate position in the capital structure of these underlying entities, the Company assumes a higher level of risk for higher expected returns. To mitigate risk, investments are diversified across approximately 75 separate partnerships, and approximately 50 general partners who manage one or more of these partnerships. Also, the funds' underlying investments are diversified by industry sector or property type, and geographic region. No single partnership investment exceeds 7% of the Company's securities and real estate partnership portfolio.

Although the total fair values of these investments exceeded their carrying values as of September 30, 2012, the fair value of the Company's ownership interest in certain funds that are carried at cost was less than carrying value by \$39 million. Fund investment values continued to improve, but remained at depressed levels reflecting the impact of declines in value experienced predominantly during 2008 and 2009 due to economic weakness and disruption in the capital markets, particularly in the commercial real estate market. The Company expects to recover its carrying value over the average remaining life of these investments of approximately 6 years. Given the current economic environment, future impairments are possible; however, management does not expect those losses to have a material effect on the Company's results of operations, financial condition or liquidity.

Table of Contents**Problem and Potential Problem Investments**

Problem bonds and commercial mortgage loans are either delinquent by 60 days or more or have been restructured as to terms, including concessions by the Company for modification of interest rate, principal payment or maturity date. Potential problem bonds and commercial mortgage loans are considered current (no payment more than 59 days past due), but management believes they have certain characteristics that increase the likelihood that they may become problems. The characteristics management considers include, but are not limited to, the following:

- request from the borrower for restructuring;
- principal or interest payments past due by more than 30 but fewer than 60 days;
- downgrade in credit rating;
- collateral losses on asset-backed securities; and
- for commercial mortgages, deterioration of debt service coverage below 1.0 or estimated loan-to-value ratios increasing to 100% or more.

The Company recognizes interest income on problem bonds and commercial mortgage loans only when payment is actually received because of the risk profile of the underlying investment. The additional amount that would have been reflected in net income if interest on non-accrual investments had been recognized in accordance with the original terms was not significant for the nine months ended September 30, 2012 or 2011.

The following table shows problem and potential problem investments at amortized cost, net of valuation reserves and write-downs:

| (In millions)                               | September 30, 2012 |                |               | December 31, 2011 |                |               |
|---------------------------------------------|--------------------|----------------|---------------|-------------------|----------------|---------------|
|                                             | Gross              | Reserve        | Net           | Gross             | Reserve        | Net           |
| Problem bonds                               | \$ 35              | \$ (13)        | \$ 22         | \$ 40             | \$ (13)        | \$ 27         |
| Problem commercial mortgage loans (1)       | 104                | (16)           | 88            | 224               | (19)           | 205           |
| Foreclosed real estate                      | 30                 | -              | 30            | 34                | -              | 34            |
| <b>Total problem investments</b>            | <b>\$ 169</b>      | <b>\$ (29)</b> | <b>\$ 140</b> | <b>\$ 298</b>     | <b>\$ (32)</b> | <b>\$ 266</b> |
| Potential problem bonds                     | \$ 30              | \$ (9)         | \$ 21         | \$ 36             | \$ (10)        | \$ 26         |
| Potential problem commercial mortgage loans | 163                | (7)            | 156           | 141               | -              | 141           |
| <b>Total potential problem investments</b>  | <b>\$ 193</b>      | <b>\$ (16)</b> | <b>\$ 177</b> | <b>\$ 177</b>     | <b>\$ (10)</b> | <b>\$ 167</b> |

*(1) At September 30, 2012, included \$29 million of restructured loans classified in Other long-term investments that were previously reported in commercial mortgage loans and at December 31, 2011, included a \$10 million restructured loan classified in Other long-term investments that was previously reported in commercial mortgage loans.*

Net problem investments represent less than 1% of total investments excluding policy loans at September 30, 2012. Net problem investments decreased by \$126 million from December 31, 2011, primarily due to a substantial paydown on a prior period problem mortgage loan and the subsequent reclassification of the remaining balance of that loan to good standing based on the results of the annual loan review completed in June 2012.

Net potential problem investments represent less than 1% of total investments excluding policy loans at September 30, 2012. Net potential problem investments increased by \$10 million during the nine months ended September 30, 2012, primarily due to the addition of two mortgage loans.

Commercial mortgage loans are considered impaired when it is probable that the Company will not collect all amounts due according to the terms of the original loan agreement. In the above table, problem and potential problem commercial mortgage loans totaling \$126 million (net of valuation reserves) at September 30, 2012, are considered impaired. During the nine months ended September 30, 2012, the Company recorded a \$10 million pre-tax (\$7 million after-tax) increase to valuation reserves on impaired commercial mortgage loans. See Note 9 to the Consolidated Financial Statements for additional information regarding impaired commercial mortgage loans.

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Included in after-tax realized investment results were changes in valuation reserves related to commercial mortgage loans and other-than-temporary impairments on fixed maturity securities as follows:

| (In millions)      | Three Months Ended<br>September 30, |          | 2011      | Nine Months Ended<br>September 30, |           | 2011        |
|--------------------|-------------------------------------|----------|-----------|------------------------------------|-----------|-------------|
|                    | 2012                                |          |           | 2012                               |           |             |
| Credit-related (1) | \$                                  | -        | \$        | (3)                                | \$        | (14)        |
| Other              |                                     | -        |           | (15)                               |           | (16)        |
| <b>Total</b>       | <b>\$</b>                           | <b>-</b> | <b>\$</b> | <b>(18)</b>                        | <b>\$</b> | <b>(30)</b> |

(1) Credit-related losses include other-than-temporary declines in fair value of fixed maturities and changes in valuation reserves related to commercial mortgage loans. There were no credit losses on fixed maturities for which a portion of the impairment was recognized in other comprehensive income.

## Investment Outlook

The financial markets continue to be impacted by economic uncertainty in the United States and Europe; however, despite volatility in financial market conditions, September 30, 2012 asset values remained consistent with levels as of December 31, 2011. Future realized and unrealized investment results will be impacted largely by market conditions that exist when a transaction occurs or at the reporting date. These future conditions are not reasonably predictable. Management believes that the vast majority of the Company's fixed maturity investments will continue to perform under their contractual terms, and that declines in their fair values below carrying value are temporary. Based on the strategy to match the duration of invested assets to the duration of insurance and contractholder liabilities, the Company expects to hold a significant portion of these assets for the long term. Future credit-related losses are not expected to have a material adverse effect on the Company's financial condition or liquidity.

While management believes the commercial mortgage loan portfolio is positioned to perform well due to its solid aggregate loan-to-value ratio, strong debt service coverage and minimal underwater positions, broad commercial real estate market fundamentals are improving at an uneven pace across geographies and property types. Should these conditions remain for an extended period or worsen substantially, it could result in an increase in problem and potential problem loans. Given the current economic environment, future impairments are possible; however, management does not expect those losses to have a material adverse effect on the Company's financial condition or liquidity.

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## MARKET RISK

### Financial Instruments

The Company's assets and liabilities include financial instruments subject to the risk of potential losses from adverse changes in market rates and prices. The Company's primary market risk exposures are interest-rate risk, foreign currency exchange rate risk and equity price risk.

The Company uses futures contracts as part of a GMDB equity hedge program to substantially reduce the effect of equity market changes on certain reinsurance contracts that guarantee minimum death benefits based on unfavorable changes in underlying variable annuity account values. The hypothetical effect of a 10% increase in the S&P 500, S&P 400, Russell 2000, NASDAQ, TOPIX (Japanese), EUROSTOXX and FTSE (British) equity indices and a 10% weakening in the U.S. dollar to the Japanese yen, British pound and euro would have been a decrease of approximately \$65 million in the fair value of the futures contracts outstanding under this program as of September 30, 2012. A corresponding decrease in liabilities for GMDB contracts would result from the hypothetical 10% increase in these equity indices and 10% weakening in the U.S. dollar. See Note 7 to the Consolidated Financial Statements for further discussion of this program and related GMDB contracts.

### Stock Market Performance

The performance of equity markets can have a significant effect on the Company's businesses, including on:

- risks and exposures associated with GMDB (see Note 7 to the Consolidated Financial Statements) and GMIB contracts (see Note 8 to the Consolidated Financial Statements); and
- pension liabilities since equity securities comprise a significant portion of the assets of the Company's employee pension plans.

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**CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

Cigna Corporation and its subsidiaries (the Company) and its representatives may from time to time make written and oral forward-looking statements, including statements contained in press releases, in the Company's filings with the Securities and Exchange Commission, in its reports to shareholders and in meetings with analysts and investors. Forward-looking statements may contain information about financial prospects, economic conditions, trends and other uncertainties. These forward-looking statements are based on management's beliefs and assumptions and on information available to management at the time the statements are or were made. Forward-looking statements include, but are not limited to, the information concerning possible or assumed future business strategies, financing plans, competitive position, potential growth opportunities, potential operating performance improvements, trends and, in particular, the Company's strategic initiatives, litigation and other legal matters, operational improvement initiatives in the Health Care operations, and the outlook for the Company's full year 2012 and beyond results. Forward-looking statements include all statements that are not historical facts and can be identified by the use of forward-looking terminology such as the words believe, expect, plan, intend, anticipate, estimate, predict, potential, may, should, expressions.

By their nature, forward-looking statements: (i) speak only as of the date they are made, (ii) are not guarantees of future performance or results and (iii) are subject to risks, uncertainties and assumptions that are difficult to predict or quantify. Therefore, actual results could differ materially and adversely from those forward-looking statements as a result of a variety of factors. Some factors that could cause actual results to differ materially from the forward-looking statements include:

1. increased medical costs that are higher than anticipated in establishing premium rates in the Company's Health Care operations, including increased use and costs of medical services;
2. increased medical, administrative, technology or other costs resulting from new legislative and regulatory requirements imposed on the Company's businesses;
3. challenges and risks associated with implementing operational improvement initiatives and strategic actions in the ongoing operations of the businesses, including those related to: (i) growth in targeted geographies, product lines, buying segments and distribution channels, (ii) offering products that meet emerging market needs, (iii) strengthening underwriting and pricing effectiveness, (iv) strengthening medical cost results and a growing medical customer base, (v) delivering quality service to members and health care professionals using effective technology solutions, and (vi) lowering administrative costs;
4. adverse changes in state, federal and international laws and regulations, including health care reform legislation and regulation that could, among other items, affect the way the Company does business, increase costs, limit the ability to effectively estimate, price for and manage medical costs, and affect the Company's products, services, market segments, technology and processes;
5. the ability to successfully complete the integration of acquired businesses, including the acquired HealthSpring businesses by, among other things, operating Medicare Advantage coordinated care plans and HealthSpring's prescription drug plan,

retaining and growing the customer base, realizing revenue, expense and other synergies, renewing contracts on competitive terms, successfully leveraging the information technology platform of the acquired businesses, and retaining key personnel;

6. the ability of the Company to execute its growth plans by successfully leveraging its capabilities and those of the businesses acquired in serving the Seniors market segment and the Company's other market segments, including through successful execution of the Company's physician engagement strategy;
7. the possibility that the acquired HealthSpring business may be adversely affected by economic, business and/or competitive factors; or by federal and/or state regulation, including health care reform, reductions in funding levels for Medicare programs, and potential changes in risk adjustment data validation audit and payment adjustment methodology;
8. risks associated with pending and potential state and federal class action lawsuits, disputes regarding reinsurance arrangements, other litigation and regulatory actions challenging the Company's businesses, including disputes related to payments to health care professionals, government investigations and proceedings, tax audits and related litigation, and regulatory market conduct and other reviews, audits and investigations;
9. heightened competition, particularly price competition, that could reduce product margins and constrain growth in the Company's businesses, primarily the Health Care business;

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10. risks associated with the Company's mail order pharmacy business that, among other things, includes any potential operational deficiencies or service issues as well as loss or suspension of state pharmacy licenses;
11. significant changes in interest rates or sustained deterioration in the commercial real estate markets;
12. downgrades in the financial strength ratings of the Company's insurance subsidiaries, that could, among other things, adversely affect new sales and retention of current business; downgrades in financial strength ratings of reinsurers, that could result in increased statutory reserves or capital requirements of the Company's insurance subsidiaries;
13. limitations on the ability of the Company's insurance subsidiaries to dividend capital to the parent company as a result of downgrades in the subsidiaries' financial strength ratings, changes in statutory reserve or capital requirements or other financial constraints;
14. inability of the hedge programs adopted by the Company to substantially reduce equity market and certain interest rate risks in the run-off reinsurance operations;
15. adjustments to the reserve assumptions (including lapse, partial surrender, mortality, interest rates and volatility) used in estimating the Company's liabilities for reinsurance contracts covering guaranteed minimum death benefits under certain variable annuities;
16. adjustments to the assumptions (including interest rates, annuity election rates and amounts collectible from reinsurers) used in estimating the Company's assets and liabilities for reinsurance contracts covering guaranteed minimum income benefits under certain variable annuities;
17. significant stock market declines, that could, among other things, result in increased expenses for guaranteed minimum income benefit contracts, guaranteed minimum death benefit contracts and the Company's pension plans in future periods as well as the recognition of additional pension obligations;
18. significant deterioration in economic conditions and significant market volatility, that could have an adverse effect on the Company's operations, investments, liquidity and access to capital markets;
19. significant deterioration in economic conditions and significant market volatility, that could have an adverse effect on the businesses of our customers (including the amount and type of health care services provided to their workforce, loss in workforce and our customers' ability to pay their obligations) and our vendors (including their ability to provide services);
20. amendments to income tax laws, that could affect the taxation of employer-provided benefits, the taxation of certain insurance products such as corporate-owned life insurance, or the financial decisions of individuals whose variable annuities are covered under reinsurance contracts issued by the Company;
21. potential public health epidemics, pandemics, natural disasters and bio-terrorist activity, that could, among other things, cause the Company's covered medical and disability expenses, pharmacy costs and mortality experience to rise significantly, and cause operational disruption, depending on the severity of the event and number of individuals affected;
22. risks associated with security or interruption of information systems, that could, among other things, cause operational disruption;

- 23. challenges and risks associated with the successful management of the Company's outsourcing projects or key vendors; and
- 24. the unique political, legal, operational, regulatory and other challenges associated with expanding our business globally.

This list of important factors is not intended to be exhaustive. Other sections of the Company's most recent Annual Report on Form 10-K, including the "Risk Factors" section, and other documents filed with the Securities and Exchange Commission include both expanded discussion of these factors and additional risk factors and uncertainties that could preclude the Company from realizing the forward-looking statements. The Company does not assume any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

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## **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Information responsive to this item is contained under the caption "Market Risk" in Item 2 above, Management's Discussion and Analysis of Financial Condition and Results of Operations.

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## **Item 4. CONTROLS AND PROCEDURES**

Based on an evaluation of the effectiveness of Cigna's disclosure controls and procedures conducted under the supervision and with the participation of Cigna's management, Cigna's Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, Cigna's disclosure controls and procedures are effective to ensure that information required to be disclosed by Cigna in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Security and Exchange Commission's rules and forms and is accumulated and communicated to Cigna's management, including Cigna's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

During the period covered by this report, other than the changes resulting from the HealthSpring, Inc. acquisition discussed below, there have been no changes in Cigna's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, Cigna's internal control over financial reporting.

On January 31, 2012, the Company acquired HealthSpring, Inc. The Company is in the process of integrating HealthSpring, Inc. operations, processes and internal controls. See Note 3 to the Consolidated Financial Statements for additional information related to the HealthSpring, Inc. acquisition.

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## **Item 1.           LEGAL PROCEEDINGS**

The information contained under "Litigation and Other Legal Matters" in Note 18 to the Consolidated Financial Statements is incorporated herein by reference.

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## **Item 1A. RISK FACTORS**

Cigna's Annual Report on Form 10-K for the year ended December 31, 2011 includes a detailed description of its risk factors.

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## Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

### (c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table provides information about Cigna's share repurchase activity for the quarter ended September 30, 2012:

#### Issuer Purchases of Equity Securities

| Period               | Total # of shares purchased (1) | Average price paid per share | Total # of shares purchased as part of publicly announced program (2) | Approximate dollar value of shares that may yet be purchased as part of publicly announced program (3) |
|----------------------|---------------------------------|------------------------------|-----------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|
| July 1-31, 2012      | 249                             | \$ 43.14                     | -                                                                     | \$ 522,328,439                                                                                         |
| August 1-31, 2012    | 1,936,675                       | 44.20                        | 1,933,670                                                             | 436,846,158                                                                                            |
| September 1-30, 2012 | 3,591                           | 46.28                        | -                                                                     | 436,846,158                                                                                            |
| <b>Total</b>         | <b>1,940,515</b>                | <b>\$ 44.21</b>              | <b>1,933,670</b>                                                      | <b>N/A</b>                                                                                             |

(1) Includes shares tendered by employees as payment of taxes withheld on the exercise of stock options and the vesting of restricted stock granted under the Company's equity compensation plans. Employees tendered **249** shares in July, 3,005 shares in August and 3,591 shares in September 2012.

(2) Cigna has had a repurchase program for many years, and has had varying levels of repurchase authority and activity under this program. The program has no expiration date. Cigna suspends activity under this program from time to time and also removes such suspensions, generally without public announcement. Remaining authorization under the program was approximately \$437 million as of September 30, 2012 and \$315 million as of October 31, 2012.

(3) Approximate dollar value of shares is as of the last date of the applicable month.

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## Item 6. EXHIBITS

- (a) See Exhibit Index.

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## SIGNATURE

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

### Cigna Corporation

Date: November 1, 2012

By: /s/ Ralph J. Nicoletti

**Ralph J. Nicoletti**

*Executive Vice President*

*Chief Financial Officer*

*(Duly Authorized Officer and Principal Financial Officer)*

Table of Contents**INDEX TO EXHIBITS**

| <b>Number</b> | <b>Description</b>                                                                                                    | <b>Method of Filing</b>                                                                                                          |
|---------------|-----------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------|
| 3.1           | Restated Certificate of Incorporation of the registrant as last amended April 23, 2008                                | Filed as Exhibit 3.1 to the registrant's Form 10-Q for the period ended March 31, 2008 and incorporated herein by reference.     |
| 3.2           | By-Laws of the registrant as last amended and restated October 20, 2010                                               | Filed as Exhibit 3.1 to the registrant's Form 8-K filed on October 26, 2010 and incorporated herein by reference.                |
| 4.1           | (a) Indenture dated August 16, 2006 between Cigna Corporation and U.S. Bank National Association                      | Filed as Exhibit 4.1 to the registrant's Form S-3ASR on August 17, 2006 and incorporated herein by reference.                    |
|               | (b) Supplemental Indenture No. 1 dated November 10, 2006 between Cigna Corporation and U.S. Bank National Association | Filed as Exhibit 4.1 to the registrant's Form 8-K on November 14, 2006 and incorporated herein by reference.                     |
|               | (c) Supplemental Indenture No. 2 dated March 15, 2007 between Cigna Corporation and U.S. Bank National Association    | Filed as Exhibit 4.1 (c) to the registrant's Form 10-Q for the period ended March 31, 2011 and incorporated herein by reference. |
|               | (d) Supplemental Indenture No. 3 dated March 7, 2008 between Cigna Corporation and U.S. Bank National Association     | Filed as Exhibit 4.1 to the registrant's Form 8-K on March 10, 2008 and incorporated herein by reference.                        |
|               | (e) Supplemental Indenture No. 4 dated May 7, 2009 between Cigna Corporation and U.S. Bank National Association       | Filed as Exhibit 99.2 to the registrant's Form 8-K on May 12, 2009 and incorporated herein by reference.                         |
|               | (f) Supplemental Indenture No. 5 dated May 17, 2010 between Cigna Corporation and U.S. Bank National Association      | Filed as Exhibit 99.2 to the registrant's Form 8-K on May 28, 2010 and incorporated herein by reference.                         |
|               | (g) Supplemental Indenture No. 6 dated December 8, 2010 between Cigna Corporation and U.S. Bank National Association  | Filed as Exhibit 99.2 to the registrant's Form 8-K on December 9, 2010 and incorporated herein by reference.                     |
|               | (h) Supplemental Indenture No. 7 dated March 7, 2011 between Cigna Corporation and U.S. Bank Association              | Filed as Exhibit 99.2 to the registrant's Form 8-K on March 8, 2011 and incorporated herein by reference.                        |

# Edgar Filing: CIGNA CORP - Form 10-Q

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|      |                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                                                                                                                               |
|------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------|
| 4.2  | Indenture dated January 1, 1994 between Cigna Corporation and Marine Midland Bank                                                                                                                                                                                                                                                                                                                                                                     | Filed as Exhibit 4.2 to the registrant's Form 10-K for the year ended December 31, 2009 and incorporated herein by reference. |
| 4.3  | Indenture dated June 30, 1988 between Cigna Corporation and Bankers Trust                                                                                                                                                                                                                                                                                                                                                                             | Filed as Exhibit 4.3 to the registrant's Form 10-K for the year ended December 31, 2009 and incorporated herein by reference. |
| 12   | Computation of Ratio of Earnings to Fixed Charges                                                                                                                                                                                                                                                                                                                                                                                                     | Filed herewith.                                                                                                               |
| 31.1 | Certification of Chief Executive Officer of Cigna Corporation pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934                                                                                                                                                                                                                                                                                                     | Filed herewith.                                                                                                               |
| 31.2 | Certification of Chief Financial Officer of Cigna Corporation pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934                                                                                                                                                                                                                                                                                                     | Filed herewith.                                                                                                               |
| 32.1 | Certification of Chief Executive Officer of Cigna Corporation pursuant to Rule 13a-14(b) or Rule 15d-14(b) and 18 U.S.C. Section 1350                                                                                                                                                                                                                                                                                                                 | Furnished herewith.                                                                                                           |
| 32.2 | Certification of Chief Financial Officer of Cigna Corporation pursuant to Rule 13a-14(b) or Rule 15d-14(b) and 18 U.S.C. Section 1350                                                                                                                                                                                                                                                                                                                 | Furnished herewith.                                                                                                           |
| 101  | Financial statements from the quarterly report on Form 10-Q of Cigna Corporation for the quarter ended September 30, 2012 formatted in XBRL: (i) the Consolidated Statements of Income; (ii) the Consolidated Statements of Comprehensive Income; (iii) the Consolidated Balance Sheets; (iv) the Consolidated Statements of Total Equity; (v) the Consolidated Statements of Cash Flow; and (vi) the Notes to the Consolidated Financial Statements. | Filed herewith.                                                                                                               |