

CIGNA CORP  
Form 10-Q  
November 01, 2006

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

**FORM 10-Q**

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

For the quarterly period ended **September 30, 2006**

OR

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

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

Commission file number **1-08323**

**CIGNA Corporation**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction  
of incorporation or organization)

**06-1059331**

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

**Two Liberty Place, 1601 Chestnut Street**

**Philadelphia, Pennsylvania 19192**

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code **(215) 761-1000**

**Not Applicable**

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

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

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

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

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As of September 30, 2006, 102,567,908 shares of the issuer's common stock were outstanding.

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## CIGNA CORPORATION

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As used herein, CIGNA 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***(In millions, except per share amounts)*

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>REVENUES</b>				
Premiums and fees	\$ 3,433	\$ 3,381	\$ 10,070	\$ 10,151
Net investment income	296	334	924	995
Other revenues	360	298	1,150	1,300
Realized investment gains	48	9	198	28
Total revenues	4,137	4,022	12,342	12,474
<b>BENEFITS AND EXPENSES</b>				
Health Care medical claims expense	1,595	1,579	4,536	4,633
Other benefit expenses	743	786	2,356	2,481
Other operating expenses	1,353	1,274	4,068	3,875
Total benefits and expenses	3,691	3,639	10,960	10,989
<b>INCOME FROM CONTINUING OPERATIONS</b>				
<b>BEFORE INCOME TAXES (BENEFITS)</b>	446	383	1,382	1,485
Income taxes (benefits):				
Current	158	(58)	477	169
Deferred	(14)	182	(22)	250
Total taxes	144	124	455	419
<b>INCOME FROM CONTINUING OPERATIONS</b>	302	259	927	1,066
<b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAXES</b>				
	(4)	-	(4)	349
<b>NET INCOME</b>	\$ 298	\$ 259	\$ 923	\$ 1,415
<b>EARNINGS PER SHARE - BASIC</b>				
<b>INCOME FROM CONTINUING OPERATIONS</b>	\$ 2.83	\$ 2.04	\$ 8.14	\$ 8.27
<b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS</b>	(0.03)	-	(0.04)	2.71

<b>NET INCOME</b>	\$ 2.80	\$ 2.04	\$ 8.10	\$ 10.98
<b>EARNINGS PER SHARE - DILUTED</b>				
<b>INCOME FROM CONTINUING OPERATIONS</b>	\$ 2.79	\$ 2.00	\$ 8.00	\$ 8.12
<b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS</b>	(0.04)	-	(0.03)	2.66
<b>NET INCOME</b>	\$ 2.75	\$ 2.00	\$ 7.97	\$ 10.78
<b>DIVIDENDS DECLARED PER SHARE</b>	\$ 0.025	\$ 0.025	\$ 0.075	\$ 0.075

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

**CIGNA CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

*(In millions, except per share amounts)*

	<b>As of September 30, 2006</b>	<b>As of December 31, 2005</b>
<b>ASSETS</b>		
Investments:		
Fixed maturities, at fair value (amortized cost, \$11,549; \$13,873)	\$ 12,345	\$ 14,947
Equity securities, at fair value (cost, \$131; \$113)	148	135
Mortgage loans	4,108	3,934
Policy loans	1,406	1,337
Real estate	105	80
Other long-term investments	394	504
Short-term investments	95	439
Total investments	18,601	21,376
Cash and cash equivalents	1,208	1,709
Accrued investment income	260	282
Premiums, accounts and notes receivable	1,402	1,598
Reinsurance recoverables	7,886	7,018
Deferred policy acquisition costs	684	618
Property and equipment	617	638
Deferred income taxes	1,104	1,087
Goodwill	1,721	1,622
Other assets, including other intangibles	363	306
Separate account assets	8,343	8,609
Total assets	\$ 42,189	\$ 44,863
<b>LIABILITIES</b>		
Contractholder deposit funds	\$ 8,952	\$ 9,676
Future policy benefits	8,466	8,626
Unpaid claims and claim expenses	4,305	4,281
Health Care medical claims payable	1,017	1,165
Unearned premiums and fees	511	515
Total insurance and contractholder liabilities	23,251	24,263
Accounts payable, accrued expenses and other liabilities	4,774	5,127
Short-term debt	455	100
Long-term debt	1,028	1,338
Nonrecourse obligations	81	66
Separate account liabilities	8,343	8,609
Total liabilities	37,932	39,503

**CONTINGENCIES - NOTE 15****SHAREHOLDERS' EQUITY**

Common stock (par value per share, \$0.25; shares issued, 160; 160)		40		40
Additional paid-in capital		2,440		2,385
Net unrealized appreciation, fixed maturities	\$	185	\$	195
Net unrealized appreciation, equity securities		23		24
Net unrealized depreciation, derivatives		(13)		(14)
Net translation of foreign currencies		27		2
Minimum pension liability adjustment		(725)		(716)
Accumulated other comprehensive loss		(503)		(509)
Retained earnings		5,974		5,162
Less treasury stock, at cost		(3,694)		(1,718)
Total shareholders' equity		4,257		5,360
Total liabilities and shareholders' equity	\$	42,189	\$	44,863
<b>SHAREHOLDERS' EQUITY PER SHARE</b>		\$		\$
		41.50		44.23

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

**CIGNA CORPORATION**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME AND CHANGES IN**  
**SHAREHOLDERS' EQUITY**

*(In millions)*

<b>Three Months Ended September 30,</b>	<b>2006</b>		<b>2005</b>	
<b>Common stock</b>	\$	40	\$	40
<b>Additional paid-in capital, July 1</b>		2,428		2,356
Effect of issuance of stock for employee benefits plans		12		11
<b>Additional paid-in capital, September 30</b>		2,440		2,367
<b>Accumulated other comprehensive loss, July 1</b>		(682)		(390)
Net unrealized appreciation (depreciation), fixed maturities	\$ 152	152	\$ (128)	(128)
Net unrealized appreciation, equity securities	4	4	2	2
Net unrealized appreciation (depreciation) on securities	156		(126)	
Net unrealized appreciation (depreciation), derivatives	10	10	(5)	(5)
Net translation of foreign currencies	13	13	-	-
Other comprehensive income (loss)	179		(131)	
<b>Accumulated other comprehensive loss, September 30</b>		(503)		(521)
<b>Retained earnings, July 1</b>		5,686		4,758
Net income	298	298	259	259
Effects of issuance of stock for employee benefits plans		(7)		(34)
Common dividends declared		(3)		(4)
<b>Retained earnings, September 30</b>		5,974		4,979
<b>Treasury stock, July 1</b>		(2,778)		(885)
Repurchase of common stock		(931)		(466)
Other, primarily issuance of treasury stock for employee benefit plans		15		144
<b>Treasury stock, September 30</b>		(3,694)		(1,207)
<b>TOTAL COMPREHENSIVE INCOME AND SHAREHOLDERS' EQUITY</b>	\$ 477	\$ 4,257	\$ 128	\$ 5,658

**Nine Months Ended September 30,**



<b>Common stock</b>		\$	40		\$	40
<b>Additional paid-in capital, January 1</b>			2,385			2,360
Effects of issuance of stock for employee benefits plans			55			7
<b>Additional paid-in capital, September 30</b>			2,440			2,367
<b>Accumulated other comprehensive loss, January 1</b>			(509)			(336)
Net unrealized depreciation, fixed maturities	\$	(10)	(10)	\$	(147)	(147)
Net unrealized depreciation, equity securities		(1)	(1)		(5)	(5)
Net unrealized depreciation on securities		(11)			(152)	
Net unrealized appreciation, derivatives		1	1		2	2
Net translation of foreign currencies		25	25		(5)	(5)
Minimum pension liability adjustment		(9)	(9)		(30)	(30)
Other comprehensive income (loss)		6			(185)	
<b>Accumulated other comprehensive loss, September 30</b>			(503)			(521)
<b>Retained earnings, January 1</b>			5,162			3,679
Net income		923	923		1,415	1,415
Effects of issuance of stock for employee benefits plans			(102)			(105)
Common dividends declared			(9)			(10)
<b>Retained earnings, September 30</b>			5,974			4,979
<b>Treasury stock, January 1</b>			(1,718)			(540)
Repurchase of common stock			(2,226)			(1,055)
Other, primarily issuance of treasury stock for employee benefit plans			250			388
<b>Treasury stock, September 30</b>			(3,694)			(1,207)
<b>TOTAL COMPREHENSIVE INCOME AND SHAREHOLDERS' EQUITY</b>	\$	929	\$	4,257	\$	1,230
					\$	5,658

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

**CIGNA CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In millions)

**Nine Months Ended September 30,**  
**2006** **2005**

**CASH FLOWS FROM OPERATING  
ACTIVITIES**

Net income	\$	923	\$	1,415
Adjustments to reconcile net income to net cash provided by operating activities:				
(Income) loss from discontinued operations, net of taxes		4		(349)
Insurance liabilities		(283)		(447)
Reinsurance recoverables		81		1
Deferred policy acquisition costs		(45)		(45)
Premiums, accounts and notes receivable		98		159
Accounts payable, accrued expenses and other liabilities		(236)		(401)
Current income taxes		214		(72)
Deferred income taxes		(22)		250
Realized investment (gains)		(198)		(28)
Depreciation and amortization		155		170
Gains on sales of businesses		(48)		(374)
Mortgage loans originated and held for sale		(315)		-
Proceeds from sales of mortgage loans held for sale		99		-
Other, net		(47)		(26)
Net cash provided by operating activities		380		253

**CASH FLOWS FROM INVESTING  
ACTIVITIES**

Proceeds from investments sold:				
Fixed maturities		2,591		2,110
Equity securities		18		10
Mortgage loans		363		262
Other (primarily short-term investments)		1,133		527
Investment maturities and repayments:				
Fixed maturities		677		707
Mortgage loans		291		205
Investments purchased:				
Fixed maturities		(2,172)		(2,377)
Equity securities		(42)		(9)
Mortgage loans		(908)		(858)
Other (primarily short-term investments)		(515)		(804)
Property and equipment, net		(93)		(32)
Conversion of single premium annuity business		(45)		-
Other acquisitions and dispositions, net cash used		(18)		-
		32		-

Cash provided by investing activities of discontinued operations		
Other, net	-	(18)
Net cash provided by (used in) investing activities	1,312	(277)

**CASH FLOWS FROM FINANCING ACTIVITIES**

Deposits and interest credited to contractholder deposit funds	396	464
Withdrawals and benefit payments from contractholder deposit funds	(512)	(748)
Change in cash overdraft position	12	(219)
Repayment of long-term debt	(100)	-
Repurchase common stock	(2,181)	(1,034)
Issuance of common stock	197	301
Common dividends paid	(9)	(10)
Net cash used in financing activities	(2,197)	(1,246)
Effect of foreign currency rate changes on cash and cash equivalents	4	2
Net decrease in cash and cash equivalents	(501)	(1,268)
Cash and cash equivalents, beginning of period	1,709	2,519
Cash and cash equivalents, end of period	\$ 1,208	\$ 1,251
Supplemental Disclosure of Cash Information:		
Income taxes paid, net	\$ 232	\$ 218
Interest paid	\$ 72	\$ 75

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

CIGNA CORPORATION  
NOTES TO THE FINANCIAL STATEMENTS

**NOTE 1 - BASIS OF PRESENTATION**

The consolidated financial statements include the accounts of CIGNA Corporation, its significant subsidiaries, and variable interest entities of which CIGNA is the primary beneficiary, which are referred to collectively as "CIGNA." 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.

The interim 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 CIGNA's Annual Report to Shareholders and Form 10-K for the year ended December 31, 2005.

The preparation of interim financial statements necessarily relies heavily on estimates. This and certain other factors, such as the seasonal nature of portions of the insurance 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 2006 presentation, including the elimination of certain intercompany purchases and sales of short-term investments in the investing activities section of the statement of cash flows. This reclassification had no net impact on the prior year net purchases and sales of short-term investments or the total cash flows from investing activities.

**Discontinued Operations.** Summarized financial data for discontinued operations primarily represents:

- a loss associated with the Brazilian life insurance operations in the third quarter of 2006 as disclosed in [Note 4](#);
- realized gains on the disposition of certain directly owned real estate investments in the third quarter of 2006 as disclosed in [Note 11](#); and
  - certain tax benefits recognized in 2005 as disclosed in [Note 3](#).

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Income before income				
(taxes) benefits	\$ 19	\$ -	\$ 19	\$ -
Income (taxes) benefits	(7)	-	(7)	349
Income from operations	12	-	12	349
Impairment loss, net of tax	(16)	-	(16)	-
Income (loss) from discontinued operations, net of taxes	\$ (4)	\$ -	\$ (4)	\$ 349

Unless otherwise indicated, amounts in these Notes exclude the effects of discontinued operations.

**NOTE 2 - RECENT ACCOUNTING PRONOUNCEMENTS**

***Pension and other retirement benefit plans.*** In 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," requiring that the overfunded or underfunded status of all defined benefit postretirement plans be measured as the difference between the fair value of plan assets and the benefit obligation and recognized in the statement of financial position. Changes in actuarial gains and losses and prior service costs are required to be recognized in other comprehensive income, net of tax, each period. CIGNA will implement this standard as required in the fourth quarter of 2006, with no material effects to the financial statements expected. The estimated

impact at implementation is sensitive to changes in key assumptions including movements in interest rates and the market value of plan assets. SFAS 158 will not impact CIGNA's pension expense, funding requirements or financial covenants.

**Fair value measurements.** In 2006, FASB issued SFAS No. 157, "Fair Value Measurements," to clarify how to measure fair value and to expand disclosures about fair value measurements. Implementation is required in the first quarter of 2008 with any changes to the fair values of assets or liabilities to be reported generally in net income or, for fixed maturities and equity securities held for sale and derivatives that hedge future cash flows, in accumulated comprehensive income for the period. CIGNA is presently evaluating these new requirements to determine if early implementation will be applied and whether any changes to the fair value measurements of its assets and liabilities will result at implementation.

**Uncertain tax positions.** In 2006, the FASB issued an interpretation of SFAS No. 109, "Accounting for Income Taxes," providing guidance to recognize and measure uncertain tax positions that are "more likely than not" to result in a benefit if challenged by the IRS. The guidance clarifies that the amount of tax benefit recognized should be measured using management's best estimate based on the most favorable expected benefit with greater than fifty percent likelihood of being realized. The interpretation also requires that interest expense and penalties be recognized for any reserved portion of an uncertain tax position beginning when the effect of that position is reported to tax authorities. CIGNA expects to implement this interpretation as required in the first quarter of 2007 with no material effects to the financial statements.

**Certain financial instruments.** In 2006, the FASB issued an amendment related to SFAS No. 133, "Accounting for Derivatives and Hedging Activities," for implementation in the first quarter of 2007. The amendment clarifies when certain financial instruments and features of financial instruments must be treated as derivatives and reported on the balance sheet at fair value with changes in fair value reported in net income. CIGNA will implement the amendment beginning with financial instruments acquired in the first quarter of 2007, with no material effects to the financial statements expected at adoption. However, this amendment may affect future income recognition for certain financial instruments if additional derivatives are identified because any changes in their fair values will be recognized in net income each period.

**Measuring financial statement misstatements.** In 2006, the Securities Exchange Commission staff issued Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." This SAB requires that the effects of misstatements be quantified for each financial statement. CIGNA expects to implement this SAB as required in the fourth quarter of 2006 with no material effects to the financial statements because CIGNA currently uses an approach consistent with the new requirement when assessing the effects of prior year misstatements.

**Deferred acquisition costs.** In 2005, the American Institute of Certified Public Accountants issued a Statement of Position (SOP), "Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts," for implementation in the first quarter of 2007. The SOP requires that deferred acquisition costs be expensed in full when the original contract is substantially changed by election or amendment of an existing contract feature or by replacement with a new contract. CIGNA expects to implement the SOP for contract changes beginning in the first quarter of 2007 with no material effects to the financial statements at implementation. Although substantial contract changes are not expected to occur, the effect of this SOP in future periods may vary based on the nature and volume of any such contract changes.

**Other-than-temporary impairment.** Effective January 1, 2006, CIGNA implemented guidance provided by the FASB on evaluating fixed maturities and equity securities for other-than-temporary impairment. Because this guidance is largely a summary of existing accounting principles generally accepted in the United States of America, there was no

material effect in accounting for fixed maturities and equity securities with other-than-temporary impairments at implementation on January 1, 2006. See Note 11 for a review of declines in fair value of fixed maturities and equity securities.

**Stock compensation.** SFAS No. 123 (as revised in 2004 and referred to as SFAS 123R,) "Share-Based Payment" was effective January 1, 2006. This standard, which CIGNA early adopted effective October 1, 2004, requires companies to recognize in net income an estimate of expense for stock awards and options over their vesting periods typically determined as of the date of grant. CIGNA records compensation expense for stock options over their vesting periods based on the estimated fair value of the stock options, which is calculated using an option-pricing model. Compensation expense is recorded for restricted stock grants and deferred stock units over their vesting periods based on fair value, which is equal to the market price of CIGNA common stock on the date of grant.

Compensation cost and related tax benefits for stock options, restricted stock and deferred stock units were as follows:

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Compensation cost	\$ 10	\$ 10	\$ 33	\$ 24
Tax benefits	\$ 4	\$ 4	\$ 12	\$ 9

Stock options granted and the average fair value at the date of grant were as follows:

<i>(Options in thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Options granted	17	7	548	825
Weighted average fair value of options granted	\$ 38.01	\$ 41.33	\$ 43.70	\$ 34.08

CIGNA calculated the average fair value using the Black-Scholes option pricing model. The following assumptions were used:

	As of September 30,	
	2006	2005
Dividend yield	0.1%	0.1%
Expected volatility	35.0%	35.0%
Risk-free interest rate	4.6%	3.9%
Expected option life	4.5 years	5.25 years

The expected volatility reflects CIGNA's past daily stock price volatility. Volatility implied in the market prices of traded options was not considered a good indicator of future volatility because remaining maturities of traded options are less than one year. CIGNA developed the expected option life by considering certain factors, including assumptions used by other companies with comparable stock option plan features and CIGNA's cancellation of a replacement option feature in June 2004.

Restricted stock granted and the average fair value at the date of grant were as follows:

Three Months Ended	Nine Months Ended
-----------------------	----------------------



<i>(Grants in thousands)</i>	September 30,		September 30,	
	2006	2005	2006	2005
Restricted stock granted	13	19	210	331
Weighted average fair value	\$ 105.14	\$ 104.90	\$ 121.23	\$ 92.45

**NOTE 3 - INCOME TAXES**

During the second quarter of 2005, the Congressional Joint Committee on Taxation approved CIGNA's refund claim relating to a tax loss incurred from the sale of a business in 1999 and the completion of the IRS audit for 2000-2002. Pursuant to this approval, CIGNA recorded total tax benefits of \$437 million, including \$7 million recorded in the third quarter of 2005, consisting of:

- \$287 million resulting from capital losses realized in connection with the divestiture of the property and casualty insurance operations in 1999, which is included in income from discontinued operations; and
  - \$150 million resulting primarily from the release of tax reserves and valuation allowances of which:
- \$88 million is reported as income from continuing operations. This amount includes \$4 million of interest income; and
- \$62 million relates to the divestiture of CIGNA's Brazilian health care business, which is included in income from discontinued operations.

#### NOTE 4 - ACQUISITIONS AND DISPOSITIONS

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

**Star HRG Acquisition.** On July 11, 2006, CIGNA acquired the operating assets of STAR-HRG, a leading provider of low cost health plans and other employee benefits coverage for hourly and part-time workers and their families, for \$156 million, including assumed liabilities. The acquisition was accounted for as a purchase, and was financed through the issuance of a note payable to the sellers (see Note 12). The purchase price was allocated as follows: \$57 million to identifiable intangible assets and the remaining \$99 million to goodwill.

Intangible assets (primarily customer lists, software and trademarks) associated with the acquisition are being amortized on a straight line basis over periods from 3-10 years.

The results of Star-HRG are included in the accompanying consolidated financial statements from the date of the acquisition.

**Sale of the Brazilian Life Insurance Operations.** In the third quarter of 2006, CIGNA entered into negotiations to sell its Brazilian life insurance business. The sale is expected to close within a year and as a result, CIGNA has classified this business as a discontinued operation. CIGNA recognized an impairment loss with respect to this business of \$16 million after-tax, primarily related to the write-off of unrecoverable foreign tax credits and foreign currency translation losses.

**Sale of Retirement Benefits Business.** On April 1, 2004, CIGNA sold its retirement benefits business, excluding the corporate life insurance business, for cash proceeds of \$2.1 billion. The sale resulted in an initial after-tax gain of \$809 million, of which \$267 million after-tax was recognized immediately. The after-tax gain was subsequently reduced by \$3 million to reflect additional taxes on the sale. In the second quarter of 2006, the after-tax gain was increased by \$12 million to reflect the conversion of the single premium annuity business to indemnity coinsurance (see below). Both of these adjustments are reflected in the deferred portion of the gain.

As this transaction was primarily in the form of a reinsurance arrangement under which CIGNA retains the contractual obligation to pay these liabilities, \$542 million of the initial after-tax gain was deferred. Subsequent to the original reinsurance transaction, the buyer of the retirement benefits business has entered into agreements with most of the insured parties relieving CIGNA of any remaining contractual obligation to those parties (novation). Additional such agreements are expected.

The deferred gain is amortized at the rate at which earnings from the sold business would have been expected to emerge (primarily 15 years on a declining basis) until CIGNA is relieved of any remaining contractual obligation. At the time of novation, CIGNA accelerates amortization of a portion of the deferred gain and also reduces the associated contractholder deposit funds, future policy benefits, reinsurance recoverables and separate account balances. As of September 30, 2006 the remaining contractholder deposit funds and future policy benefits associated with the sold retirement benefits business totaled \$2.4 billion. See Note 8 for additional information on reinsurance recoverables associated with the sale of the retirement benefits business.

CIGNA recognized deferred gain amortization in other revenues in the Run-off Retirement segment as follows:

<i>(In millions)</i>		Pre-Tax		After-Tax
<b>Three Months Ended September 30, 2006</b>				
Accelerated deferred gain amortization	\$	2	\$	1
Normal deferred gain amortization	\$	2	\$	1
<b>2005</b>				
Accelerated deferred gain amortization	\$	10	\$	2
Normal deferred gain amortization	\$	3	\$	2
<b>Nine Months Ended September 30, 2006</b>				
Accelerated deferred gain amortization	\$	8	\$	7
Normal deferred gain amortization	\$	8	\$	5
<b>2005</b>				
Accelerated deferred gain amortization	\$	315	\$	200
Normal deferred gain amortization	\$	21	\$	14

The remaining pre-tax deferred gain as of September 30, 2006 was \$67 million.

In 2005, in connection with a modified coinsurance arrangement, CIGNA received units of the buyer's separate accounts and continues to carry those units as separate account assets on its balance sheet for the business not yet directly assumed by the buyer. At September 30, 2006, there were approximately \$3.2 billion of separate account assets and liabilities associated with this business not yet directly assumed by the buyer.

From April 1, 2004 through March 31, 2006, CIGNA had a modified coinsurance arrangement relating to the single premium annuity business sold to the buyer. Under the arrangement, CIGNA retained the invested assets supporting the reinsured liabilities. These invested assets were held in a business trust established by CIGNA.

Effective April 1, 2006, the buyer converted this modified coinsurance arrangement to an indemnity reinsurance structure and took ownership of the trust assets. CIGNA transferred invested assets to the buyer and recorded a reinsurance recoverable of approximately \$1.6 billion in the second quarter of 2006, which corresponds to the liabilities for the single premium annuity business held by CIGNA as of March 31, 2006. As a result of the conversion to indemnity coinsurance, CIGNA increased the pre-tax deferred gain by approximately \$17 million (\$12 million after-tax). The additional deferred gain will be amortized on a basis consistent with the original deferred gain.

#### **NOTE 5 - EARNINGS PER SHARE**

Basic and diluted earnings per share were computed as follows:

<i>(Dollars in millions, except per share amounts)</i>		Basic		Effect of Dilution		Diluted
<b>Three Months Ended September 30, 2006</b>						
<b>Income from continuing operations</b>	\$	302	-	\$		302
Shares <i>(in thousands)</i> :						
Weighted average		106,581	-			106,581
Options and restricted stock grants			1,654			1,654
<b>Total shares</b>		106,581	1,654			108,235

<b>EPS</b>	\$	2.83	\$	(0.04)	\$	2.79
<b>2005</b>						
<b>Income from continuing operations</b>	\$	259		-	\$	259
Shares ( <i>in thousands</i> ):						
Weighted average		126,888		-		126,888
Options and restricted stock grants				2,795		2,795
<b>Total shares</b>		126,888		2,795		129,683
<b>EPS</b>	\$	2.04	\$	(0.04)	\$	2.00
<b>Nine Months Ended September 30, 2006</b>						
<b>Income from continuing operations</b>	\$	927		-	\$	927
Shares ( <i>in thousands</i> ):						
Weighted average		113,930		-		113,930
Options and restricted stock grants				1,929		1,929
<b>Total shares</b>		113,930		1,929		115,859
<b>EPS</b>	\$	8.14	\$	(0.14)	\$	8.00
<b>2005</b>						
<b>Income from continuing operations</b>	\$	1,066		-	\$	1,066
Shares ( <i>in thousands</i> ):						
Weighted average		128,852		-		128,852
Options and restricted stock grants				2,386		2,386
<b>Total shares</b>		128,852		2,386		131,238
<b>EPS</b>	\$	8.27	\$	(0.15)	\$	8.12

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 CIGNA's common stock for the period.

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Antidilutive options	1.8	0.3	1.5	3.3

CIGNA held 57,460,553 shares of common stock in Treasury as of September 30, 2006, and 34,248,300 shares as of September 30, 2005.

#### NOTE 6 - 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 (IBNR), those which have been reported but not yet paid (reported claims in process) and other medical expense payable, which primarily comprises accruals for provider incentives and other amounts payable to providers. IBNR comprises the majority of the reserve balance as follows:

<i>(In millions)</i>	September 30, 2006	December 31, 2005
IBNR	\$ 868	\$ 1,004
Reported claims in process	84	116
Other medical expense payable	65	45
Medical claims payable	\$ 1,017	\$ 1,165

Activity in medical claims payable was as follows:

<i>(In millions)</i>	As of September 30, 2006	As of December 31, 2005
Beginning Balance - Jan. 1	\$ 1,165	\$ 1,594
Less: Reinsurance and other amounts recoverable	342	497
Beginning Balance, net	823	1,097
Incurred claims related to:		
Current year	4,705	6,631
Prior years	(169)	(326)
Total incurred	4,536	6,305
Paid claims related to:		
Current year	4,012	5,844
Prior years	593	735
Total paid	4,605	6,579
Ending Balance, net	754	823
Add: Reinsurance and other amounts recoverable	263	342
Ending Balance	\$ 1,017	\$ 1,165

For the nine months ended September 30, 2006, actual experience differed from CIGNA's key assumptions, resulting in favorable incurred claims related to prior years' medical claims payable of \$169 million, or 2.5% of the current year incurred claims as reported for the year ended December 31, 2005. For the year ended December 31, 2005, actual experience differed from CIGNA's key assumptions, resulting in favorable incurred claims related to prior years' medical claims payable of \$326 million, or 4.7% of the current year incurred claims as reported for the year ended December 31, 2004. Specifically, the favorable impact is due to faster than expected completion factors and lower than expected medical cost trends, both of which included an assumption for moderately adverse experience.

Actual completion factors were faster than expected, resulting in a reduction of the medical claims payable of \$92 million for the nine months ended September 30, 2006 and \$205 million for the year ended December 31, 2005. This reduction represented 1.4% in 2006 and 3.0% in 2005 of the current year incurred claims as reported for the years ended December 31, 2005 and 2004, respectively, for the insured book of business. The faster completion factors reflected better than expected time to process claims, driven by higher auto-adjudication rates, the impact of claim recoveries and more timely submissions of provider claims.

Actual medical cost trend was lower than estimated, resulting in a reduction of the medical claims payable of \$77 million for the nine months ended September 30, 2006 and \$121 million for the year ended December 31, 2005. This reduction represented 1.2% in 2006 and 1.7% in 2005 of the current year incurred claims as reported for the years ended December 31, 2005 and 2004, respectively, for the insured book of business. The better than expected medical cost trend was driven by lower inpatient, outpatient and pharmacy service utilization and lower than expected unit cost trends. The lower than expected unit cost trends reflected provider contracting initiatives and the mix of services provided.

The corresponding impact of favorable prior year development on net income was \$43 million for the nine months ended September 30, 2006 and \$137 million for the year ended December 31, 2005, or 0.6% in 2006 and 2.0% in 2005 of the current year incurred claims as reported for the years ended December 31, 2005 and 2004, respectively. 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 CIGNA's net income recognized for the following reasons:

First, due to the nature of CIGNA's retrospectively experience-rated business, only adjustments to medical claims payable on accounts in deficit affect net income. An increase or decrease to medical claims payable on accounts in deficit, in effect, accrue to CIGNA and directly impact 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 net income. An account is in surplus when the accumulated premium received exceeds the accumulated medical costs and administrative charges, including profit charges.

Second, CIGNA consistently recognizes the actuarial best estimate of the ultimate liability within a level of confidence, as required by actuarial standards of practice, which require that the liabilities be adequate under moderately adverse conditions. As CIGNA establishes the liability for each incurrence year, CIGNA 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 deemed appropriate to address moderately adverse conditions for the current year incurred claims, CIGNA does not consider that offset amount as having any impact on net income.

The determination of liabilities for health care medical claims payable requires CIGNA to make critical accounting estimates. See "Critical Accounting Estimates" [on page 26](#) for additional information.

#### **NOTE 7 - GUARANTEED MINIMUM DEATH BENEFIT AND INCOME BENEFIT CONTRACTS**

CIGNA's reinsurance operations, which were discontinued in 2000 and are now an inactive business in run-off mode, reinsured a guaranteed minimum death benefit under certain variable annuities issued by other insurance companies. These variable annuities are essentially investments in mutual funds combined with a death benefit. CIGNA has equity and other market exposures as a result of this product.

The determination of liabilities for guaranteed minimum death benefits requires CIGNA to make critical accounting estimates. CIGNA describes the assumptions used to develop the reserves for these death benefits, and provides the effects of hypothetical changes in those assumptions on page 26 of CIGNA's 2005 Annual Report to Shareholders. CIGNA regularly evaluates the assumptions used in establishing reserves and changes its estimates if actual experience or other evidence suggests that earlier assumptions should be revised. If actual experience differs from the assumptions (including lapse, partial surrender, mortality, interest rates and volatility) used in estimating these reserves, the resulting change could have a material adverse effect on CIGNA's consolidated results of operations, and in certain situations, could have a material adverse effect on CIGNA's financial condition.

During the first quarter of 2005, CIGNA completed its normal review of assumptions and recorded an after-tax charge of \$11 million (\$17 million pre-tax). This charge primarily resulted from an update to lapse assumptions based on emerging experience. The charge also reflected updates to partial surrender assumptions, reflecting the impact of



stock market declines, as well as other assumptions. CIGNA had future policy benefit reserves for guaranteed minimum death benefit contracts of \$904 million as of September 30, 2006, and \$951 million as of December 31, 2005.

The following provides information about CIGNA's reserving methodology and assumptions for guaranteed minimum death benefits as of September 30, 2006:

- The reserves represent estimates of the present value of net amounts expected to be paid, less the present value of net future premiums. Included in net amounts expected to be paid is the excess of the guaranteed death benefits over the values of the contractholders' accounts (based on underlying equity and bond mutual fund investments).
- The reserves include an estimate for partial surrenders that essentially lock in the death benefit for a particular policy based on annual election rates that vary from 0-23% depending on the net amount at risk for each policy and whether surrender charges apply.
- The mean investment performance assumption is 5% considering CIGNA's program to reduce equity market exposures using futures contracts. In addition, the results of futures contracts are reflected in the liability calculation as a component of investment returns.
- The volatility assumption is 15-30%, varying by equity fund type; 3-8%, varying by bond fund type; and 1% for money market funds.
  - The discount rate is 5.75%.
- The mortality assumption is 70-75% of the 1994 Group Annuity Mortality table, with 1% annual improvement beginning January 1, 2000.
- The lapse rate assumption is 0-15%, depending on contract type, policy duration and the ratio of the net amount at risk to account value.

As of September 30, 2006, the aggregate fair value of the underlying mutual fund investments was \$37.1 billion. The death benefit coverage in force as of that date (representing the amount that CIGNA would have to pay if all of the approximately 900,000 contractholders had died on that date) was \$5.9 billion. The death benefit coverage in force represents the excess of the guaranteed benefit amount over the fair value of the underlying mutual fund investments.

The notional amount of futures contract positions held by CIGNA at September 30, 2006, was \$979 million. CIGNA recorded in other revenues pre-tax losses of \$32 million for the third quarter and \$56 million for the nine months of 2006, compared with pre-tax losses of \$45 million for the third quarter and \$28 million for the nine months of 2005 primarily from futures contracts. Expense offsets reflecting corresponding changes in liabilities for these guaranteed minimum death benefit contracts were included in benefits and expenses.

For further information and details on these contracts and the program adopted to reduce related equity market risk, refer to Note 6 of CIGNA's 2005 Annual Report to Shareholders.

CIGNA has also written reinsurance contracts with issuers of variable annuity contracts that provide annuitants with certain guarantees related to minimum income benefits. See [Note 15](#) for further information.

#### **NOTE 8 - REINSURANCE**

In the normal course of business, CIGNA'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 does not relieve the originating insurer of liability. CIGNA evaluates the financial condition of its reinsurers and monitors their concentrations of credit risk.

**Retirement benefits business.** CIGNA had a reinsurance recoverable of \$2.4 billion as of September 30, 2006, and \$1.2 billion as of December 31, 2005 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 change from 2005 includes an increase of \$1.6 billion as a result of the conversion of the single premium annuity business to indemnity coinsurance effective April 1, 2006. The reinsurance recoverable is secured by fixed maturities held in business trusts established by the reinsurer. This recoverable is reduced as CIGNA's reinsured liabilities are paid or directly assumed by the reinsurer.

**Individual life and annuity reinsurance.** CIGNA had a reinsurance recoverable of \$4.8 billion at September 30, 2006, and \$5.0 billion at December 31, 2005, from The Lincoln National Life Insurance Company that arose from the 1998 sale of CIGNA's individual life insurance and annuity business through an indemnity reinsurance arrangement.

**Unicover and other run-off reinsurance.** The Run-off Reinsurance operations participate in a workers' compensation reinsurance pool, which ceased accepting new risks in early 1999. This pool was formerly managed by Unicover Managers, Inc. The pool purchased significant reinsurance (retrocessional) protection for its assumed risks. Disputes concerning these retrocessional contracts have been substantially resolved or settled.

Run-off Reinsurance also includes other (non-Unicover) workers' compensation reinsurance contracts and personal accident reinsurance contracts, including contracts assumed in the London market. CIGNA is engaged in arbitrations, disputes or investigations with several ceding companies over the validity of, or amount of liabilities assumed under, their contracts. These arbitrations, disputes and investigations are in various stages.

CIGNA bought retrocessional reinsurance for a significant portion of its assumed reinsurance liabilities. Some of the retrocessionaires have disputed the validity of, or amount of liabilities assumed under, their contracts with CIGNA. Many of these disputes with retrocessionaires have been resolved or settled. CIGNA is appealing in court an adverse award in a retrocessional enforcement arbitration and recently commenced another retrocessional enforcement arbitration. These arbitrations and disputes are in various stages.

Unfavorable claims experience related to workers' compensation and personal accident risks is possible and could result in future losses, including losses attributable to the inability to recover amounts claimed from retrocessionaires because of disputes with them or their financial condition.

CIGNA's reserves for amounts recoverable from retrocessionaires, as well as for underlying reinsurance exposures assumed by CIGNA, are considered appropriate as of September 30, 2006, based on current information. However, it is possible that future developments could have a material adverse effect on CIGNA's consolidated results of operations and, in certain situations, could have a material adverse effect on CIGNA's financial condition. In addition, CIGNA bears the risk of loss if the retrocessionaires are unable to meet their reinsurance obligations to CIGNA.

**Other reinsurance.** CIGNA could have losses if reinsurers fail to indemnify CIGNA on other reinsurance arrangements, either because of reinsurer insolvencies or contract disputes. However, management does not expect charges for other unrecoverable reinsurance to have a material adverse effect on CIGNA's consolidated results of operations, liquidity or financial condition.

**Effects of reinsurance.** In CIGNA's consolidated income statements, premiums and fees were net of ceded premiums, and benefits and expenses were net of reinsurance recoveries, in the following amounts:

(In millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
<b>Premiums and fees</b>				
Individual life insurance and annuity business sold	\$ 59	\$ 66	\$ 187	\$ 202
Other	57	51	155	147
Total	\$ 116	\$ 117	\$ 342	\$ 349
<b>Reinsurance recoveries</b>				
Individual life insurance				

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and annuity business sold	\$	85	\$	93	\$	238	\$	233
Other		60		68		105		136
Total	\$	145	\$	161	\$	343	\$	369

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**NOTE 9 - PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS**

**Pension benefits.** Components of net pension cost were as follows:

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Service cost	\$ 18	\$ 18	\$ 53	\$ 54
Interest cost	56	56	167	166
Expected return on plan assets	(52)	(46)	(156)	(136)
Amortization of:				
Net loss from past experience	38	35	114	105
Prior service cost	-	-	-	(1)
Net pension cost	\$ 60	\$ 63	\$ 178	\$ 188

Through the nine months of 2006, CIGNA's minimum pension liability increased primarily due to the annual update of plan census data. This resulted in a decrease to shareholder's equity of \$9 million after-tax. Through the nine months of 2005, CIGNA recorded a similar charge which resulted in a decrease to shareholder's equity of \$30 million after-tax.

CIGNA funds its qualified pension plans by at least the minimum amount required by the Employee Retirement Income Security Act of 1974, as amended (ERISA).

During 2005, CIGNA made pension contributions to the domestic and international pension plans totaling \$544 million, which included an acceleration of expected contributions to meet domestic pension plan funding requirements in 2006 and 2007. Therefore, CIGNA does not expect to make domestic pension plan contributions in 2006.

**Other postretirement benefits.** Components of net other postretirement benefit cost were as follows:

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Service cost	\$ 1	\$ 1	\$ 2	\$ 2
Interest cost	7	7	19	20
Expected return on plan assets	-	(1)	(1)	(2)
Amortization of:				
Net gain from past experience	(1)	-	(2)	(1)
Prior service cost	(5)	(4)	(13)	(12)
Net other postretirement benefit cost	\$ 2	\$ 3	\$ 5	\$ 7

**NOTE 10 - COST REDUCTION PROGRAM**

**First quarter 2005 program.** In the first quarter of 2005, CIGNA implemented a plan to further streamline operations in the health care business and in supporting areas. As a result, CIGNA recognized in other operating expenses a total pre-tax charge of \$51 million (\$33 million after-tax) for severance costs during the first quarter of 2005. The table below quantifies CIGNA's cost reduction activity (pre-tax) for severance under this program:

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<i>(In millions)</i>	Health Care	Corporate	Total
Balance as of December 31, 2005	\$ 6	\$ 13	\$ 19
First quarter 2006 activity	(5)	(3)	(8)
Balance as of March 31, 2006	1	10	11
Second quarter 2006 activity	-	(5)	(5)
Balance as of June 30, 2006	1	5	6
Third quarter 2006 activity	(1)	-	(1)
Balance as of September 30, 2006	\$ -	\$ 5	\$ 5

CIGNA substantially completed this program during the second quarter of 2006.

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**NOTE 11 - INVESTMENTS****Realized Investment Gains and Losses**

The following realized gains and losses on investments exclude amounts required to adjust future policy benefits for certain annuities:

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Fixed maturities	\$ (18)	\$ 10	\$ (32)	\$ 25
Equity securities	(1)	2	(6)	2
Mortgage loans	(1)	-	(7)	(2)
Real estate	-	1	-	-
Other investments, including derivatives	68	(4)	243	3
Realized investment gains from continuing operations, before income taxes	48	9	198	28
Less income taxes	14	3	67	10
Realized investment gains from continuing operations	34	6	131	18
Realized investment gains from discontinued operations before income taxes	19	-	19	-
Less income taxes	7	-	7	-
Realized investment gains from discontinued operations	12	-	12	-
Net realized investment gains	\$ 46	\$ 6	\$ 143	\$ 18

For the third quarter and nine months of 2006, realized investment results from continuing operations primarily reflect:

- gains on other investments from sales of equity interests in real estate limited liability entities; and
- losses on fixed maturities largely due to the impact of rising interest rates.

For the third quarter and nine months of 2006, realized investment results from discontinued operations reflect gains on sale of directly owned real estate properties held for the production of investment income. Proceeds on these sales have been separately identified in the statement of cash flows.

**Fixed Maturities and Equity Securities**

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

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Proceeds from sales	\$ 847	\$ 635	\$ 2,609	\$ 2,120

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Gross gains from sales	\$	5	\$	11	\$	32	\$	33
Gross losses from sales	\$	(22)	\$	(4)	\$	(55)	\$	(18)

Fixed maturities included securities of \$31 million at September 30, 2006 and \$39 million at December 31, 2005 classified as trading. These securities are carried at fair value with changes in fair value reported in other revenues.

**Review of Declines in Fair Value.** Management reviews fixed maturities and equity securities 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
- ability and intent to hold until recovery.

As of September 30, 2006, fixed maturities (primarily investment grade corporate bonds) with a decline in fair value from cost were as follows, including the length of time of such decline:

<i>(In millions)</i>	Fair Value	Amortized Cost	Unrealized Depreciation
Fixed Maturities:			
One year or less:			
Investment grade	\$ 1,083	\$ 1,101	\$ (18)
Below investment grade	\$ 150	\$ 152	\$ (2)
More than one year:			
Investment grade	\$ 1,411	\$ 1,452	\$ (41)
Below investment grade	\$ 52	\$ 54	\$ (2)

The unrealized depreciation of investment grade fixed maturities is primarily due to increases in interest rates since purchase. There were no equity securities with a material decline in fair value from cost as of September 30, 2006.



CIGNA recorded pre-tax impairments in fixed maturities of \$1 million for the third quarter and \$28 million for the nine months of 2006, compared with \$10 million for the nine months of 2005.

### **Mortgage Loans**

In connection with CIGNA's investment strategy to enhance investment yields by selling senior participations, mortgage loans includes \$125 million of mortgage loans originated with the intent to sell as of September 30, 2006. These mortgage loans held for sale are carried at the lower of cost or market with any resulting valuation allowance reported in realized investment gains and losses. Also in connection with this strategy, CIGNA entered into commitments to extend credit under commercial mortgage loans at a fixed rate of interest. As these mortgage loans will also be held for sale, these commitments are treated as derivatives and pre-tax decreases in their fair values of approximately \$2 million for the nine months of 2006 are reported in realized investment gains and losses.

### **Other Long-term Investments**

As of September 30, 2006, CIGNA had commitments to contribute:

- \$308 million to limited liability entities that hold either real estate or loans to real estate entities; and
- \$265 million to entities that hold securities.

### **NOTE 12 - DEBT**

In connection with the Star HRG acquisition in the third quarter of 2006, CIGNA issued to the seller a note payable of \$151 million due as follows:

- \$72 million at 5.40% due 11/1/06; and
- \$79 million at 6.37% due in 2021.

In August 2006, CIGNA filed a universal shelf registration statement on Form S-3ASR with the SEC to take advantage of its status as a "well known seasoned issuer" under the Securities Offering Reform Act. CIGNA may issue debt, equity or other securities from time to time, with amount, price, and terms to be determined at the time of sale.

In May 2006, CIGNA entered into a five year revolving credit and letter of credit agreement for \$1.75 billion which replaced its previous credit agreement. Of this amount, up to \$1.25 billion may be used for letters of credit. CIGNA entered into the agreement for general corporate purposes, including support for the issuance of commercial paper and to obtain statutory reserve credit for certain reinsurance arrangements. There were no amounts outstanding under the credit facility nor any letters of credit issued as of September 30, 2006.

### **NOTE 13 - ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

Accumulated other comprehensive income (loss) excludes:

- amounts required to adjust future policy benefits for certain annuities; and
- amounts required to adjust other liabilities under a modified coinsurance arrangement, which terminated on April 1, 2006.

Changes in accumulated other comprehensive income (loss) were as follows:

	Tax (Expense)	After-
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<i>(In millions)</i>	Pre-tax	Benefit	tax
<b>Three Months Ended September 30, 2006</b>			
<b>Net unrealized appreciation, securities:</b>			
Net unrealized appreciation on securities arising during the year	\$ 218	\$ (75)	\$ 143
Plus: reclassification adjustment for losses included in net income	19	(6)	13
Net unrealized appreciation, securities	\$ 237	\$ (81)	\$ 156
<b>Net unrealized appreciation, derivatives</b>	\$ 16	\$ (6)	\$ 10
<b>Net translation of foreign currencies</b>	\$ 21	\$ (8)	\$ 13
<b>2005</b>			
<b>Net unrealized depreciation, securities:</b>			
Net unrealized depreciation on securities arising during the year	\$ (183)	\$ 64	\$ (119)
Less: reclassification adjustment for gains included in net income	(12)	5	(7)
Net unrealized depreciation, securities	\$ (195)	\$ 69	\$ (126)
<b>Net unrealized depreciation, derivatives</b>	\$ (9)	\$ 4	\$ (5)
<b>Minimum pension liability adjustment</b>	\$ 1	\$ (1)	\$ -

<i>(In millions)</i>	Pre-tax	Tax (Expense) Benefit	After- tax
<b>Nine Months Ended September 30, 2006</b>			
<b>Net unrealized depreciation, securities:</b>			
Net unrealized depreciation on securities arising during the year	\$ (57)	\$ 21	\$ (36)
Plus: reclassification adjustment for losses included in net income	38	(13)	25
Net unrealized depreciation, securities	\$ (19)	\$ 8	\$ (11)
<b>Net unrealized appreciation, derivatives</b>	\$ 1	\$ -	\$ 1
<b>Net translation of foreign currencies</b>	\$ 39	\$ (14)	\$ 25
<b>Minimum pension liability adjustment</b>	\$ (13)	\$ 4	\$ (9)
<b>2005</b>			
<b>Net unrealized depreciation, securities:</b>			
Net unrealized depreciation on securities arising during the year	\$ (208)	\$ 73	\$ (135)
Less: reclassification adjustment for gains included in net income	(27)	10	(17)
Net unrealized depreciation, securities	\$ (235)	\$ 83	\$ (152)
<b>Net unrealized appreciation, derivatives</b>	\$ 3	\$ (1)	\$ 2
<b>Net translation of foreign currencies</b>	\$ (6)	\$ 1	\$ (5)
<b>Minimum pension liability adjustment</b>	\$ (45)	\$ 15	\$ (30)

**NOTE 14 - SEGMENT INFORMATION**

Operating segments generally reflect groups of related products, but the International segment is generally based on geography. In accordance with accounting principles generally accepted in the United States of America, operating segments that do not require separate disclosure may be combined. CIGNA measures the financial results of its segments using "segment earnings (loss)" which is defined as income (loss) from continuing operations excluding after-tax realized investment gains (losses).

Summarized segment financial information was as follows:

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
<b>Premiums and fees and other revenues</b>				
Health Care	\$ 2,815	\$ 2,783	\$ 8,288	\$ 8,352
Disability and Life	566	557	1,691	1,667

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International		388		316		1,118		920
Run-off Retirement		5		13		18		338
Run-off Reinsurance		(16)		(25)		(7)		37
Other Operations		47		47		149		165
Corporate		(12)		(12)		(37)		(28)
Total	\$	3,793	\$	3,679	\$	11,220	\$	11,451
<b>Income (loss) from continuing operations</b>								
Health Care	\$	177	\$	164	\$	492	\$	528
Disability and Life		58		57		180		175
International		31		24		104		86
Run-off Retirement		5		2		10		200
Run-off Reinsurance		(6)		(3)		(22)		(29)
Other Operations		25		25		71		95
Corporate		(22)		(16)		(39)		(7)
Segment earnings		268		253		796		1,048
Realized investment gains, net of taxes		34		6		131		18
Income from continuing operations	\$	302	\$	259	\$	927	\$	1,066

**NOTE 15 - CONTINGENCIES AND OTHER MATTERS**

CIGNA, 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, primarily associated with the sold retirement benefits business, are contractholder funds maintained in accounts with specific investment objectives. CIGNA records separate account liabilities equal to separate account assets. In certain cases, CIGNA guarantees a minimum level of benefits for retirement and insurance contracts written in separate accounts. CIGNA establishes an additional liability if management believes that CIGNA will be required to make a payment under these guarantees. Except as noted below, these guarantees are fully reinsured

by an affiliate of the buyer of the retirement benefits business:

- CIGNA 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, CIGNA 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, 2006, employers maintained assets that exceeded the benefit obligations. Benefit obligations under these arrangements were \$2.0 billion as of September 30, 2006. As of September 30, 2006, approximately 80% of these guarantees are reinsured by an affiliate of the buyer of the retirement benefits business. There were no additional liabilities required for these guarantees as of September 30, 2006.
- CIGNA guarantees that separate account assets, primarily fixed income investments, will be sufficient to pay retiree benefits for participants under a certain group annuity contract. These guarantees are fully reinsured by an affiliate of the buyer of the retirement benefits business. These guaranteed benefit obligations were \$31 million as of September 30, 2006. CIGNA had no additional liabilities for these guarantees as of September 30, 2006.

#### **Other Financial Guarantees**

CIGNA had indemnification obligations to lenders up to \$273 million as of September 30, 2006 related to borrowings by certain real estate joint ventures which CIGNA either records as an investment or consolidates. These borrowings, which are nonrecourse to CIGNA, 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 the fourth quarter of 2006 through 2017. CIGNA's indemnification obligations would require payment to lenders for any 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, CIGNA 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, CIGNA 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, 2006.

As of September 30, 2006, CIGNA guaranteed that it would compensate the lessor for a shortfall of up to \$49 million in the market value of leased equipment at the end of the lease. Guarantees of \$21 million expire at the end of 2006 and \$28 million expire in 2012. CIGNA had additional liabilities for these guarantees of \$2 million as of September 30, 2006.

CIGNA guaranteed construction loans of \$21 million as of September 30, 2006 related to real estate joint venture investments. The loans are secured by joint venture real estate property with fair values in excess of the loan amounts and mature by 2008, including extension options. CIGNA would be required to repay the construction loans if permanent financing could not be obtained. There were no liabilities required for these guarantees as of September 30, 2006.

CIGNA had indemnification obligations as of September 30, 2006 in connection with acquisition and disposition transactions. These indemnification obligations are triggered by the breach of representations or covenants provided by CIGNA, 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. CIGNA does not believe that it is possible to determine

the maximum potential amount due under these obligations, since

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not all amounts due under these indemnification obligations are subject to limitation. There were no liabilities required for these guarantees as of September 30, 2006.

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

**Guaranteed minimum income benefit contracts.** CIGNA's reinsurance operations, which were discontinued in 2000 and are now an inactive business in run-off mode, reinsured variable annuity contracts that provide annuitants with certain guarantees related to minimum income benefits. When annuitants elect to receive these minimum income benefits, CIGNA may be required to make payments based on changes in underlying mutual fund values and interest rates.

CIGNA estimates the fair value of the assets and liabilities associated with these contracts using assumptions as to market returns, volatility of the underlying equity and bond mutual fund investments, interest rates, mortality, lapse, credit risk and annuity election rates.

CIGNA regularly evaluates the assumptions used in establishing these assets and liabilities and changes its estimates if actual experience or other evidence suggests that earlier assumptions should be revised. CIGNA describes these assumptions and provides an estimate of the effects of the hypothetical changes in those assumptions on page 27 of CIGNA's 2005 Annual Report to Shareholders. If actual experience differs from the assumptions used in estimating these assets and liabilities, the resulting change could have a material adverse effect on CIGNA's consolidated results of operations, and in certain situations, could have a material adverse effect on CIGNA's financial condition.

The following provides information about the assumptions used in calculating the assets and liabilities for guaranteed minimum income benefits:

- These liabilities represent estimates of the present value of net amounts expected to be paid, less the present value of net future premiums expected to be received. Included in net amounts expected to be paid is the excess of the expected value of the income benefits over the values of the annuitant's accounts at the time of annuitization. The assets associated with these contracts represent receivables in connection with reinsurance that CIGNA has purchased from third parties (see below).
- The market return assumption is 8-12% varying by equity fund type; 6-9% varying by bond fund type; and 5-6% for money market funds.
- The volatility assumption is 14-24%, varying by equity fund type; 6-7%, varying by bond fund type; and 2-3% for money market funds.
  - The discount rate is 5.75%.
- The projected interest rate used to calculate the reinsured income benefits at the time of annuitization varies by economic scenario, reflects interest rates as of the valuation date, and has a long-term mean rate of 5-6% and a standard deviation of 12-13%.
- The mortality assumption is 70% of the 1994 Group Annuity Mortality table, with 1% annual improvement beginning January 1, 2000.
  - The lapse rate assumption is 3-12%, depending on policy duration.
- The annuity election rate assumption is that no more than 5% of the policies eligible to annuitize their variable annuity contracts will do so each year.

CIGNA is required to disclose the maximum potential undiscounted future payments for guarantees related to minimum income benefits using hypothetical adverse assumptions, defined as follows:

- No annuitants surrendered their accounts; and
- All annuitants lived to elect their benefit; and

- All annuitants elected to receive their benefit on the next available date (2006 through 2014); and
- All underlying mutual fund investment values remained at the September 30, 2006 value of \$3.2 billion, with no future returns.



The maximum potential undiscounted payments that CIGNA would make under those assumptions would aggregate \$1.0 billion before reinsurance recoveries. CIGNA believes the likelihood of such payment is remote and expects the amount of actual payments to be significantly less than this hypothetical undiscounted aggregate amount. CIGNA has purchased reinsurance from third parties which covers 55% of the exposures on these contracts.

As of September 30, 2006, CIGNA had liabilities of \$98 million related to these contracts and net amounts recoverable from reinsurers of \$55 million. CIGNA had an additional liability of \$47 million associated with the cost of reinsurance as of September 30, 2006. As of December 31, 2005, CIGNA had liabilities of \$88 million related to these contracts and net amounts recoverable from reinsurers of \$48 million. CIGNA had an additional liability of \$49 million associated with the cost of reinsurance as of December 31, 2005. Management believes the current assumptions used to estimate reserves for these liabilities are appropriate.

### **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 and judicial decisions have resulted in changes to industry and CIGNA's business practices and will continue to do so in the future. In addition, CIGNA'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 in its various forms could have an adverse effect on CIGNA's health care operations if it inhibits CIGNA's ability to respond to market demands or results in increased medical or administrative costs without improving the quality of care or services.

Other possible regulatory changes that could have an adverse effect on CIGNA'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 ERISA regulations resulting in increased administrative burdens and costs;
- additional restrictions on the use of prescription drug formularies and pending purported class action litigation, which could result in adjustments to or the elimination of the average wholesale price or "AWP" of pharmaceutical products as a benchmark in establishing certain rates, charges, discounts, guarantees and fees for various prescription drugs;
- 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.

***Tax benefits for corporate life insurance.*** Federal legislation in 1996 eliminated on a prospective basis the tax deductibility of policy loan interest for most leveraged corporate life insurance products, and an IRS initiative in 2001 encouraged policyholders to settle tax disputes regarding these products. As a result, some customers have surrendered their policies and management expects earnings associated with these products to continue to decline.



**Concentration of risk.** CIGNA's products in its International segment include coverages for employees and individuals who may be exposed to acts of terrorism, the events of a war zone or natural disasters. These risks could result in a concentration of loss if a single adverse event affected many covered individuals and, in certain situations, could lead to losses that could be material to earnings for the International segment and to CIGNA's consolidated results.

South Korea represents the single largest geographic market for CIGNA's international businesses. South Korea generated 29% of International revenues for the third quarter and nine months of 2006. South Korea generated 34% of segment earnings for the third quarter and 39% for the nine months of 2006. International's business in South Korea would be vulnerable to adverse consumer credit and geopolitical conditions in that country.

### **Litigation and Other Legal Matters**

In 2004, a Florida federal court handling multi-district health care litigation against CIGNA and several health care industry competitors approved a settlement agreement between the physician class and CIGNA. A dispute over disallowed claims under the settlement submitted by a representative of certain class member physicians is proceeding to arbitration. In April 2005, the court approved a settlement between CIGNA and the remaining plaintiffs, a class of non-physician health care professionals.

Various regulators, including the New York and Connecticut Attorneys General and the Florida Office of Insurance Regulation, have been investigating insurance broker compensation. Some regulators have brought suit against certain insurance brokers, including Universal Life Resources (ULR), alleging, among other things, that these brokers sought rigged bids from, and steered business to, insurers with whom they had contingent compensation arrangements. Some of CIGNA's subsidiaries are included in one such lawsuit seeking injunctive relief against these contingent compensation practices. CIGNA is also providing information about ULR in connection with investigations by the U.S. Attorney's Office for the Southern District of California and the San Diego District Attorney. In addition, CIGNA is providing information about another broker to the U.S. Department of Labor. CIGNA is cooperating with the inquiries and investigations by regulators and the U.S. Attorney's Office.

Separately, several purported class action lawsuits have been filed against brokers and insurance companies, including certain of CIGNA's subsidiaries, asserting that contingent commissions are unlawful. These suits are now procedurally consolidated in a multi-district litigation proceeding in federal court in New Jersey. Additionally, a separate action brought by individual plaintiffs on their own behalf has been conditionally transferred into that litigation. CIGNA denies the allegations and will vigorously defend itself in these cases. The parties are currently engaged in discovery.

A purported class action lawsuit and a shareholder derivative lawsuit, both originating in 2002, against CIGNA and certain of its senior officers and directors allege securities law violations and breach of fiduciary duty. The judge handling these cases has ordered the parties to participate in mediation, which is scheduled to occur on November 14-15, 2006. Currently the parties are concluding expert discovery. If mediation is unsuccessful, and the case is not otherwise resolved, the case is expected to enter the trial pool no sooner than March 1, 2007.

Plaintiffs representing CIGNA Pension Plan participants affected by the 1998 conversion to a cash balance formula filed a class action lawsuit against CIGNA and the CIGNA Pension Plan in December 2001. 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 (during which the pre-conversion accrued benefit exceeded the post-conversion benefit); and these conditions are not adequately disclosed in the Plan. A non-jury trial began on September 11-15, 2006. Due to the court's schedule, the proceedings were adjourned until January 24-30, 2007, when the trial is expected to reconvene.

See “Unicover and other run-off reinsurance” in Note 8 for a description of legal matters arising out of the run-off reinsurance operations.

CIGNA 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 the business of administering

and insuring employee benefit programs. An increasing number of claims are being made for substantial non-economic, extra-contractual or punitive damages. The outcome of litigation and other legal matters is always uncertain, and outcomes that are not justified by the evidence can occur. CIGNA believes that it has valid defenses to the legal matters pending against it and is defending itself vigorously. Nevertheless, it is possible that resolution of one or more of the legal matters currently pending or threatened could result in losses material to CIGNA's consolidated results of operations, liquidity or financial condition.

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

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**INTRODUCTION**

In this filing and in other marketplace communications, CIGNA makes certain forward-looking statements relating to its financial condition and results of operations, as well as to trends and assumptions that may affect CIGNA. Generally, forward-looking statements can be identified through the use of predictive words (e.g., “Outlook for 2006”). Actual results may differ from CIGNA’s predictions. Some factors that could cause results to differ are discussed throughout Management’s Discussion and Analysis, including in the Cautionary Statement on page 49.

The following discussion addresses the financial condition of CIGNA as of September 30, 2006, compared with December 31, 2005, and its results of operations for the third quarter and nine months ended September 30, 2006, compared with the same periods last year. This discussion should be read in conjunction with Management’s Discussion and Analysis included in CIGNA’s 2005 Annual Report to Shareholders and Form 10-K, to which the reader is directed for additional information.

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

**OVERVIEW**

CIGNA Corporation’s subsidiaries provide health care and related benefits offered through the workplace. Key product lines include medical coverages and related specialty health care products and services such as pharmacy, behavioral health, dental benefits, and disease management as well as group disability, life and accident insurance, and disability and workers’ compensation case management and related services. In addition, CIGNA has an international operation that offers products (that are generally similar to those offered domestically) to businesses and individuals in selected markets, and has certain inactive businesses, including a run-off retirement operation and a run-off reinsurance operation.

CIGNA's results are influenced by a range of economic and other factors, including:

- cost trends and inflation levels for medical and related services;
- patterns of utilization of medical and other services;
  - employment levels;
  - the tort liability system;
  - interest rates and equity market returns;
- regulations and tax rules related to the provision and administration of employee benefit plans; and
  - initiatives to increase health care regulation.

CIGNA generates revenues, net income and cash flow from operations by maintaining and growing its relationships with employers and consumers, charging prices that reflect emerging experience and

investing available cash at attractive rates of return for appropriate durations. CIGNA's ability to increase operating results in terms of growth in revenues, net income and cash flow from operations is directly related to its ability to execute plans that address broad economic factors as well as company-specific drivers.

Key company-specific drivers affecting CIGNA's results include:

- competitiveness of CIGNA's product design and service quality;
  - the absolute level of and trends in benefit costs;
- the volume of customers served and the mix of products and services purchased by those customers;
- the ability to price products and services competitively at levels that appropriately account for underlying cost inflation and utilization patterns;
  - the relationship between administrative costs and revenue; and
- the ability to execute on key technology initiatives, including successfully managing outsourcing arrangements with vendors, including International Business Machines Corporation (IBM) (see [page 46](#)).

CIGNA regularly monitors trends in the above mentioned economic and other factors and the company-specific drivers of operating results. CIGNA develops strategic and tactical plans designed to improve performance and maximize its competitive position in the markets served. CIGNA's ability to achieve its financial objectives is dependent upon its ability to effectively execute these plans and to appropriately respond to emerging economic and company-specific trends.

CIGNA is focused, in particular, on continuing to improve the performance of the health care operations, profitably growing the disability and life insurance and international businesses and managing the risks associated with the run-off reinsurance operations. In the health care operations, CIGNA has initiatives in place to (1) offer products that meet emerging consumer and market trends; (2) strengthen underwriting and pricing effectiveness; (3) improve medical membership results; (4) improve medical cost trends; (5) deliver quality member service; and (6) lower administrative expenses (see pages [35](#) and [36](#) for further discussion).

CIGNA believes that the health care business model is changing to one that focuses more directly on the consumer. CIGNA has developed product designs, educational resources and customer support tools with a goal of enabling consumers to make informed choices about their health care, to ultimately improve health outcomes and to reduce costs. These changes in the business model are in the early stages, and CIGNA believes that its capabilities in consumerism, health advocacy and the delivery of useful information position it to meet the emerging trend.

CIGNA's disability and life insurance operations continue to focus on profitable growth with a particular emphasis on middle market disability business. The international business is focused on profitable growth particularly in the life, accident and health insurance and expatriate benefits businesses. In the run-off reinsurance operations, CIGNA maintains a program to reduce the equity market risk associated with its guaranteed minimum death benefit reinsurance exposures. CIGNA is also pursuing the resolution of disputes associated with workers' compensation and other reinsurance contracts through audits of claims from assumed business and managing collections from retrocessionaires (see page [40](#) for further discussion).



**CONSOLIDATED RESULTS OF OPERATIONS****FINANCIAL SUMMARY**

	Three Months Ended September 30,		Nine Months Ended September 30,	
<i>(In millions)</i>	2006	2005	2006	2005
Premiums and fees	\$ 3,433	\$ 3,381	\$ 10,070	\$ 10,151
Net investment income	296	334	924	995
Other revenues	360	298	1,150	1,300
Realized investment gains				