

AETNA INC /PA/
Form 10-Q
July 29, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014
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: 1-16095

Aetna Inc.
(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of incorporation or organization)
151 Farmington Avenue, Hartford, CT
(Address of principal executive offices)
Registrant's telephone number, including area code:

23-2229683
(I.R.S. Employer Identification No.)
06156
(Zip Code)
(860) 273-0123

Former name, former address and former fiscal year, if changed since last report: N/A

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

There were 354.6 million shares of the registrant’s voting common stock with a par value of \$.01 per share outstanding at June 30, 2014.

Aetna Inc.
Form 10-Q
For the Quarterly Period Ended June 30, 2014

Unless the context otherwise requires, references to the terms “we”, “our” or “us” used throughout this Quarterly Report on Form 10-Q (except the Report of Independent Registered Public Accounting Firm on page 35), refer to Aetna Inc. (a Pennsylvania corporation) (“Aetna”) and its subsidiaries (collectively, the “Company”).

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Part I. Financial Information

Item 1. Financial Statements

Consolidated Statements of Income
(Unaudited)

(Millions, except per common share data)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Revenue:				
Health care premiums	\$12,416.1	\$9,701.3	\$24,327.8	\$17,487.1
Other premiums	551.7	514.3	1,113.3	1,035.6
Fees and other revenue ⁽¹⁾	1,289.5	1,126.6	2,538.3	2,093.0
Net investment income	228.3	225.0	472.5	460.1
Net realized capital gains (losses)	23.8	(29.8)	52.3	.5
Total revenue	14,509.4	11,537.4	28,504.2	21,076.3
Benefits and expenses:				
Health care costs ⁽²⁾	10,314.8	8,006.9	19,891.1	14,386.4
Current and future benefits	525.6	539.1	1,104.3	1,098.4
Operating expenses:				
Selling expenses	413.0	332.2	815.8	629.4
General and administrative expenses	2,188.2	1,762.2	4,235.8	3,204.2
Total operating expenses	2,601.2	2,094.4	5,051.6	3,833.6
Interest expense	81.3	83.5	166.9	161.3
Amortization of other acquired intangible assets	61.9	51.8	124.1	84.2
Loss on early extinguishment of long-term debt	—	—	91.9	—
Reduction of reserve for anticipated future losses on discontinued products	—	(86.0)	—	(86.0)
Total benefits and expenses	13,584.8	10,689.7	26,429.9	19,477.9
Income before income taxes	924.6	847.7	2,074.3	1,598.4
Income taxes:				
Current	350.5	275.7	769.0	542.5
Deferred	26.9	38.8	88.7	31.8
Total income taxes	377.4	314.5	857.7	574.3
Net income including non-controlling interests	547.2	533.2	1,216.6	1,024.1
Less: Net (loss) income attributable to non-controlling interests	(1.6)	(2.8)	2.3	(2.0)
Net income attributable to Aetna	\$548.8	\$536.0	\$1,214.3	\$1,026.1
Earnings per common share:				
Basic	\$1.54	\$1.50	\$3.38	\$3.00
Diluted	\$1.52	\$1.49	\$3.35	\$2.97

Fees and other revenue include administrative services contract member co-payments and plan sponsor reimbursements related to our mail order and specialty pharmacy operations of \$26.4 million and \$48.2 million

⁽¹⁾ (net of pharmaceutical and processing costs of \$315.5 million and \$590.9 million) for the three and six months ended June 30, 2014, respectively, and \$18.3 million and \$40.6 million (net of pharmaceutical and processing costs of \$278.8 million and \$547.7 million) for the three and six months ended June 30, 2013, respectively.

Health care costs have been reduced by Insured member co-payments related to our mail order and specialty

⁽²⁾ pharmacy operations of \$27.3 million and \$57.9 million for the three and six months ended June 30, 2014, respectively, and \$28.1 million and \$59.1 million for the three and six months ended June 30, 2013, respectively.

Refer to accompanying Condensed Notes to Consolidated Financial Statements (Unaudited).

Page 1

Consolidated Statements of Comprehensive Income
(Unaudited)

(Millions)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Net income including non-controlling interests	\$547.2	\$533.2	\$1,216.6	\$1,024.1
Other comprehensive income (loss), net of tax:				
Previously impaired debt securities: ⁽¹⁾				
Net unrealized gains (losses)				
(\$3.4, \$(38.6), \$5.1 and \$(53.1) pretax)	2.2	(25.1)	3.3	(34.5)
Less: reclassification of gains (losses) to earnings				
(\$2.5, \$(22.9), \$3.1 and \$(28.6) pretax)	1.6	(14.9)	2.0	(18.6)
Total previously impaired debt securities ⁽¹⁾	.6	(10.2)	1.3	(15.9)
All other securities:				
Net unrealized gains (losses)				
(\$213.6, \$(607.4), \$424.6 and \$(728.1) pretax)	138.8	(394.8)	276.0	(473.3)
Less: reclassification of gains (losses) to earnings				
(\$6.9, \$(29.9), \$1.9 and \$(4.8) pretax)	4.5	(18.9)	1.2	(3.1)
Total all other securities	134.3	(375.9)	274.8	(470.2)
Foreign currency and derivatives:				
Net unrealized (losses) gains				
(\$19.3), \$18.8, \$(38.5) and \$29.1 pretax)	(12.5)	12.2	(25.0)	18.9
Less: reclassification of (losses) gains to earnings				
(\$1.4), \$(1.3), \$14.2 and \$(2.6) pretax)	(.9)	(.9)	9.2	(1.7)
Total foreign currency and derivatives	(11.6)	13.1	(34.2)	20.6
Pension and other postretirement benefit (“OPEB”) plans:				
Amortization of net actuarial losses				
(\$11.9), \$(19.3), \$(23.8) and \$(38.7) pretax)	7.7	12.6	15.4	25.2
Amortization of prior service credit				
(\$1.0, \$.9, \$2.0 and \$1.9 pretax)	(.7)	(.7)	(1.3)	(1.3)
Total pension and OPEB plans	7.0	11.9	14.1	23.9
Other comprehensive income (loss)	130.3	(361.1)	256.0	(441.6)
Comprehensive income including non-controlling interests	677.5	172.1	1,472.6	582.5
Less: Comprehensive (loss) income attributable to non-controlling interests	(1.6)	(2.8)	2.3	(2.0)
Comprehensive income attributable to Aetna	\$679.1	\$174.9	\$1,470.3	\$584.5

⁽¹⁾ Represents unrealized (losses) gains on the non-credit related component of impaired debt securities that we do not intend to sell and subsequent changes in the fair value of any previously impaired security.

Refer to accompanying Condensed Notes to Consolidated Financial Statements (Unaudited).

Consolidated Balance Sheets

(Millions)	(Unaudited) At June 30, 2014	At December 31, 2013
Assets:		
Current assets:		
Cash and cash equivalents	\$1,760.1	\$1,412.3
Investments	2,294.6	2,063.8
Premiums receivable, net	2,254.4	1,331.2
Other receivables, net	1,665.2	1,780.8
Accrued investment income	217.4	211.1
Collateral received under securities loan agreements	856.0	792.6
Income taxes receivable	—	69.2
Deferred income taxes	424.8	521.5
Other current assets	2,174.6	1,536.4
Total current assets	11,647.1	9,718.9
Long-term investments	21,860.1	20,935.0
Reinsurance recoverables	767.0	782.7
Goodwill	10,294.8	10,227.5
Other acquired intangible assets, net	1,993.6	2,094.1
Property and equipment, net	680.2	721.9
Other long-term assets	1,572.0	1,419.2
Separate Accounts assets	4,345.9	3,972.5
Total assets	\$53,160.7	\$49,871.8
Liabilities and shareholders' equity:		
Current liabilities:		
Health care costs payable	\$5,371.9	\$4,547.4
Future policy benefits	721.2	734.4
Unpaid claims	727.2	705.4
Unearned premiums	583.8	458.7
Policyholders' funds	1,879.5	1,727.3
Collateral payable under securities loan agreements	856.1	792.6
Current portion of long-term debt	612.4	387.3
Income taxes payable	96.5	—
Accrued expenses and other current liabilities	4,084.1	3,226.9
Total current liabilities	14,932.7	12,580.0
Future policy benefits	6,545.8	6,656.8
Unpaid claims	1,635.4	1,619.3
Policyholders' funds	1,244.3	1,188.0
Long-term debt, less current portion	7,612.4	7,865.3
Deferred income taxes	1,045.2	864.2
Other long-term liabilities	1,046.2	1,047.5
Separate Accounts liabilities	4,345.9	3,972.5
Total liabilities	38,407.9	35,793.6
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Common stock (\$.01 par value; 2.6 billion shares authorized and 354.6 million shares issued		

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and outstanding in 2014; 2.6 billion shares authorized and 362.2 million shares issued and

outstanding in 2013) and additional paid-in capital	4,462.5	4,382.2
Retained earnings	10,889.4	10,555.4
Accumulated other comprehensive loss	(656.1	) (912.1
Total Aetna shareholders' equity	14,695.8	14,025.5
Non-controlling interests	57.0	52.7
Total equity	14,752.8	14,078.2
Total liabilities and equity	\$53,160.7	\$49,871.8

Refer to accompanying Condensed Notes to Consolidated Financial Statements (Unaudited).

Page 3

Consolidated Statements of Shareholders' Equity
(Unaudited)

(Millions)	Number of Common Shares Outstanding	Attributable to Aetna Common			Accumulated Other Comprehensive Loss	Total Aetna Shareholders' Equity	Non-Controlling Interests	Total Equity
		Stock and Additional Paid-in Capital	Retained Earnings					
Six Months Ended June 30, 2014								
Balance at December 31, 2013	362.2	\$4,382.2	\$10,555.4	\$ (912.1)	\$14,025.5	\$ 52.7	\$14,078.2	
Net income	—	—	1,214.3	—	1,214.3	2.3	1,216.6	
Other increases in non-controlling interest	—	—	—	—	—	2.0	2.0	
Other comprehensive income (Note 7)	—	—	—	256.0	256.0	—	256.0	
Common shares issued for benefit plans, including tax benefits	2.2	80.4	—	—	80.4	—	80.4	
Repurchases of common shares	(9.8)	(.1)	(720.0)	—	(720.1)	—	(720.1)	
Dividends declared	—	—	(160.3)	—	(160.3)	—	(160.3)	
Balance at June 30, 2014	354.6	\$4,462.5	\$10,889.4	\$ (656.1)	\$14,695.8	\$ 57.0	\$14,752.8	
Six Months Ended June 30, 2013								
Balance at December 31, 2012	327.6	\$1,095.3	\$10,343.9	\$ (1,033.4)	\$10,405.8	\$ 23.4	\$10,429.2	
Net income	—	—	1,026.1	—	1,026.1	(2.0)	1,024.1	
Other increases in non-controlling interest	—	—	—	—	—	29.5	29.5	
Other comprehensive loss (Note 7)	—	—	—	(441.6)	(441.6)	—	(441.6)	
Common shares issued to acquire Coventry	52.2	3,064.6	—	—	3,064.6	—	3,064.6	
Common shares issued for benefit plans, including tax benefits	3.3	159.8	—	—	159.8	—	159.8	
Repurchases of common shares	(11.0)	(.1)	(624.6)	—	(624.7)	—	(624.7)	
Dividends declared	—	—	(139.7)	—	(139.7)	—	(139.7)	
Balance at June 30, 2013	372.1	\$4,319.6	\$10,605.7	\$ (1,475.0)	\$13,450.3	\$ 50.9	\$13,501.2	

Refer to accompanying Condensed Notes to Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Cash Flows
(Unaudited)

(Millions)	Six Months Ended	
	June 30,	
	2014	2013
Cash flows from operating activities:		
Net income including non-controlling interests	\$1,216.6	\$1,024.1
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized capital gains	(52.3	) (.5
Depreciation and amortization	311.2	247.9
Debt fair value amortization	(30.3	) (8.9
Equity in earnings of affiliates, net	(20.4	) (23.4
Stock-based compensation expense	80.8	55.5
Reduction of reserve for anticipated future losses on discontinued products	—	(86.0
Reversal of allowance and gain on sale of reinsurance recoverable	—	(49.4
Amortization of net investment premium	35.8	25.7
Loss on early extinguishment of long-term debt	91.9	—
Changes in assets and liabilities:		
Accrued investment income	(6.3	) 5.4
Premiums due and other receivables	(864.6	) (520.8
Income taxes	254.7	56.0
Other assets and other liabilities	365.7	(102.9
Health care and insurance liabilities	706.8	(36.3
Other, net	1.7	(2.9
Net cash provided by operating activities	2,091.3	583.5
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	3,980.4	8,070.6
Cost of investments	(4,445.4	) (7,100.8
Additions to property, equipment and software	(189.3	) (188.2
Cash used for acquisitions, net of cash acquired	(70.7	) (1,635.9
Other, net	—	2.5
Net cash used for investing activities	(725.0	) (851.8
Cash flows from financing activities:		
Repayment of long-term debt	(839.7) —
Issuance of long-term debt	741.9	—
Net issuance of short-term debt	—	545.8
Deposits and interest credited for investment contracts	2.3	2.3
Withdrawals of investment contracts	(1.9	) (6.7
Common shares issued under benefit plans, net	(25.7	) 44.5
Stock-based compensation tax benefits	20.2	55.5
Common shares repurchased	(720.1	) (624.7
Dividends paid to shareholders	(162.0	) (130.8
Collateral on interest rate swaps	(36.1	) 30.5
Contributions, non-controlling interests	2.6	29.5
Net cash used for financing activities	(1,018.5	) (54.1
Net increase (decrease) in cash and cash equivalents	347.8	(322.4
Cash and cash equivalents, beginning of period	1,412.3	2,579.2
Cash and cash equivalents, end of period	\$1,760.1	\$2,256.8
Supplemental cash flow information:		

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Interest paid	\$184.9	\$160.7
Income taxes paid	582.8	463.8

Refer to accompanying Condensed Notes to Consolidated Financial Statements (Unaudited).

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Condensed Notes to Consolidated Financial Statements
(Unaudited)

1. Organization

We conduct our operations in three business segments:

Health Care consists of medical, pharmacy benefit management services, dental, behavioral health and vision plans offered on both an Insured basis (where we assume all or a majority of the risk for medical and dental care costs) and an employer-funded basis (where the plan sponsor under an administrative services contract (“ASC”) assumes all or a majority of this risk) and products and services, such as Accountable Care Solutions (“ACS”), that complement and enhance our medical products. Medical products include point-of-service (“POS”), preferred provider organization (“PPO”), health maintenance organization (“HMO”) and indemnity benefit plans. Medical products also include health savings accounts (“HSAs”) and Aetna HealthFund consumer-directed health plans that combine traditional POS or PPO and/or dental coverage, subject to a deductible, with an accumulating benefit account (which may be funded by the plan sponsor and/or the member in the case of HSAs). We also offer Medicare and Medicaid products and services and other medical products, such as medical management and data analytics services, medical stop loss insurance, workers’ compensation administrative services and products that provide access to our provider network in select geographies.

Group Insurance primarily includes group life insurance and group disability products. Group life insurance products are offered on an Insured basis, and include basic and supplemental group term life, group universal life, supplemental or voluntary programs and accidental death and dismemberment coverage. Group disability products consist primarily of short-term and long-term disability products (and products which combine both), which are offered to employers on both an Insured and an ASC basis, and absence management services offered to employers, which include short-term and long-term disability administration and leave management. Group Insurance also includes long-term care products that were offered primarily on an Insured basis, which provide benefits covering the cost of care in private home settings, adult day care, assisted living or nursing facilities. We no longer solicit or accept new long-term care customers.

Large Case Pensions manages a variety of retirement products (including pension and annuity products) primarily for tax-qualified pension plans. These products provide a variety of funding and benefit payment distribution options and other services. Large Case Pensions also includes certain discontinued products (refer to Note 16 beginning on page 33 for additional information).

On May 7, 2013 (the “Acquisition Date”), we completed the acquisition of Coventry Health Care, Inc. (“Coventry”) in a transaction valued at approximately \$8.7 billion, including the fair value of Coventry’s outstanding debt. Refer to Note 3 beginning on page 9 for additional information.

2. Summary of Significant Accounting Policies

Interim Financial Statements

These interim financial statements necessarily rely on estimates, including assumptions as to annualized tax rates. In the opinion of management, all adjustments necessary for a fair statement of results for the interim periods have been made. All such adjustments are of a normal, recurring nature. The accompanying unaudited consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and related notes presented in our 2013 Annual Report on Form 10-K (our “2013 Annual Report”). Certain financial information that is normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”), but that is not required for interim reporting purposes, has been condensed or omitted. We have

omitted certain footnote disclosures that would

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substantially duplicate the disclosures in our 2013 Annual Report, unless the information contained in those disclosures materially changed and is required by GAAP. We evaluated subsequent events that occurred after June 30, 2014 through the date the financial statements were issued and determined there were no other items to disclose other than as disclosed in Note 11 beginning on page 26.

Reclassifications

Certain reclassifications were made to 2013 financial information to conform with the 2014 presentation.

Principles of Consolidation

The accompanying unaudited consolidated financial statements have been prepared in accordance with GAAP and include the accounts of Aetna and the subsidiaries we control. All significant intercompany balances have been eliminated in consolidation.

Accounting for certain provisions of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively, "Health Care Reform" or "ACA")

We are participating in certain public health insurance exchanges established pursuant to Health Care Reform. Under regulations established by the U.S. Department of Health and Human Services ("HHS"), HHS pays us a portion of the premium ("Premium Subsidy") and/or a portion of the health care costs ("Cost Sharing Subsidy") for low-income individual members. In addition, HHS administers certain risk management programs as described below.

We recognize monthly premiums received from members and the Premium Subsidy as premium revenue ratably over the contract period. The Cost Sharing Subsidy offsets health care costs when incurred. We record a liability if the Cost Sharing Subsidy is paid in advance or a receivable if incurred health care costs exceed the Cost Sharing Subsidy received to date.

Accounting for Health Care Reform's Reinsurance, Risk Adjustment and Risk Corridor (the "3Rs")

Reinsurance

Health Care Reform established a temporary three-year reinsurance program, whereby all issuers of major medical commercial insurance products and self-insured plan sponsors are required to contribute funding in amounts set by HHS. Funds collected will be utilized to reimburse issuers' high claims costs incurred for qualified individual members. The expense related to this required funding is reflected in general and administrative expenses for all of our insurance products with the exception of products associated with qualified individual members; this expense for qualified individual members is reflected as a reduction of premium revenue. When annual claim costs incurred by our qualified individual members exceed a specified attachment point, we are entitled to certain reimbursements from this program. We record a receivable and offset health care costs to reflect our estimate of these recoveries.

Risk Adjustment

Health Care Reform established a permanent risk adjustment program to transfer funds from qualified individual and small group insurance plans with below average risk scores to those respective plans with above average risk scores. Based on the risk of our qualified plan members relative to the average risk of members of other qualified plans in comparable markets, we estimate our ultimate 2014 risk adjustment receivable or payable and reflect the pro-rata year-to-date impact as an adjustment to our premium revenue.

Risk Corridor

Health Care Reform established a temporary three-year risk sharing program for qualified individual and small group insurance plans. Under this program we make (or receive) a payment to (or from) HHS based on the ratio of allowable costs to target costs (as defined by Health Care Reform). We record a risk corridor receivable or payable as an adjustment to premium revenue on a pro-rata year-to-date basis based on our estimate of the ultimate 2014 risk sharing amount.

We will perform a final reconciliation and settlement with HHS of the 2014 Cost Sharing Subsidy and 3Rs in the second half of 2015.

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New Accounting Standards

Fees Paid to the Federal Government by Health Insurers

Effective January 1, 2014, we adopted new accounting guidance relating to the recognition and income statement reporting of the mandated fee to be paid to the federal government by health insurers. This guidance applies to the new health insurer fee (“HIF”) included in Health Care Reform. This new accounting guidance resulted in the establishment on January 1, 2014, of a liability for our portion of the entire estimated 2014 annual HIF. This amount is reflected in accrued expenses and other liabilities with a corresponding amount reflected in other current assets. The estimated annual HIF is amortized into general and administrative expenses on a straight-line basis with a corresponding reduction in other current assets. The HIF for 2014 is expected to be paid no later than September 30, 2014 and is not tax deductible.

Amendments to the Scope, Measurement and Disclosure Requirements of Investment Companies

Effective January 1, 2014, we adopted new accounting guidance relating to the approach for determining whether an entity is considered an investment company for accounting purposes. This guidance clarified the characteristics and set measurement and disclosure requirements for an investment company for accounting purposes. The adoption of this new guidance did not have an impact on our financial position or operating results.

Future Application of Accounting Standards

Accounting for Investments in Qualified Affordable Housing Projects

Effective January 1, 2015, we will be permitted to make an accounting policy election to adopt new accounting guidance relating to the recognition of amortization of investments in qualified affordable housing projects. The guidance sets forth a new method of measurement, referred to as the proportional amortization method, under which income and expense items related to qualified affordable housing projects would be recorded in the income taxes line item. If we elect to adopt this new guidance, it is not expected to have a material impact on our financial position or operating results.

Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity

Effective January 1, 2015, we will adopt amended accounting guidance related to when an entity reports a discontinued operation in its financial position and operating results. The guidance clarifies that a discontinued operation is required to be reported if the disposal represents a significant shift that has (or will have) a major effect on an entity’s operations and financial results when a component of an entity or a group of components of an entity are either classified as held for sale or are disposed of by sale. The amendments also require additional disclosures about discontinued operations. If we have a discontinued operation after the effective date, these changes could result in increased reporting and disclosure requirements in our financial statements.

Revenue from Contracts with Customers

Effective January 1, 2017, we will adopt new accounting guidance related to revenue recognition from contracts with customers. This new guidance removes most industry-specific revenue recognition requirements (insurance contracts are not covered by this guidance) and requires that an entity recognize revenue for the transfer of goods or services to a customer at an amount that reflects the consideration to which an entity expects to be entitled in exchange for the goods or services. The new guidance also requires additional disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. The new guidance allows an entity to adopt the standard either through a full retrospective approach or a modified retrospective approach with a cumulative effect adjustment to retained earnings. We are still assessing the impact of this standard on our financial position and operating results in addition to evaluating the transition method we will use when we adopt this standard.

Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures

Effective January 1, 2015, we will adopt new accounting guidance related to the accounting for repurchase-to-maturity transactions and repurchase financing arrangements. This guidance aligns the accounting for

repurchase-to-maturity transactions and repurchase agreements executed as repurchase financings with other typical repurchase agreements, resulting in these transactions generally being accounted for as secured borrowings. The guidance also

requires additional disclosures about repurchase agreements and other similar transactions. The adoption of this new guidance is not expected to have a material impact on our financial position or operating results.

Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period

Effective January 1, 2016, we will adopt new accounting guidance related to the accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. This guidance clarifies that awards with these provisions should be treated as performance conditions that affect vesting, and do not impact the award's estimated grant-date fair value. Early adoption for this new guidance is permitted. The adoption of this new guidance will not have an impact on our financial position or operating results.

3. Acquisitions; Completed Disposition

Acquisition of the InterGlobal Group

In April 2014, we acquired the InterGlobal group ("InterGlobal"), a company that specializes in international private medical insurance for groups and individuals in the Middle East, Asia, Africa and Europe. The purchase price was not material, and the goodwill related to this acquisition was assigned to our Health Care segment.

Acquisition of Coventry

On August 19, 2012, we entered into a definitive agreement to acquire Coventry. On the Acquisition Date, we acquired Coventry in a transaction (the "Merger") valued at approximately \$8.7 billion, including the \$1.8 billion fair value of Coventry's outstanding long-term debt.

Pro Forma Impact of Acquisition

The following table presents supplemental pro forma information for the three and six months ended June 30, 2013, as if the Merger had occurred on January 1, 2012. The unaudited pro forma consolidated results are not necessarily indicative of what our consolidated results would have been had the Merger been completed on January 1, 2012. In addition, the unaudited pro forma consolidated results do not purport to project the future results of the combined company nor do they reflect the expected realization of any cost savings associated with the Merger.

(Millions, except per common share data)	Three Months Ended June 30, 2013	Six Months Ended June 30, 2013
Total revenue	\$12,926.3	\$25,871.0
Net income attributable to Aetna	640.7	1,280.8
Earnings per share:		
Basic	\$1.70	\$3.39
Diluted	1.68	3.36

The unaudited pro forma consolidated results for the three and six months ended June 30, 2013 reflect the following pro forma adjustments:

- Elimination of intercompany transactions between Aetna and Coventry, primarily related to network rental fees.
- Foregone interest income associated with cash and cash equivalents and investments assumed to have been used to partially fund the Merger.
- Foregone interest income associated with adjusting the amortized cost of Coventry's investment portfolio to fair value as of the completion of the Merger.
- Elimination of historical Coventry intangible asset amortization expense and capitalized internal-use software amortization expense and addition of intangible asset amortization expense relating to intangibles valued as part of the acquisition.

Interest expense was reduced for the amortization of the fair value adjustment to long-term debt.
Elimination of transaction-related costs incurred by Aetna and Coventry during 2013.

• Adjustment of the above pro forma adjustments for the applicable tax impact.

• Conforming adjustments to align Coventry's presentation to Aetna's accounting policies.

• Elimination of revenue and directly identifiable costs related to the sale of Aetna's Missouri Medicaid business, Missouri Care, Incorporated ("Missouri Care"), to WellCare Health Plans, Inc. on March 31, 2013.

Completed Disposition

In connection with the acquisition of Coventry, on March 31, 2013, we completed the sale of Missouri Care to WellCare Health Plans, Inc. The sale price was not material, and the transaction did not have a material impact on our financial position or operating results.

4. Earnings Per Common Share

Basic earnings per share ("EPS") is computed by dividing net income attributable to Aetna by the weighted average number of common shares outstanding during the reporting period. Diluted EPS is computed in a similar manner, except that the weighted average number of common shares outstanding is adjusted for the dilutive effects of our outstanding stock-based compensation awards, but only if the effect is dilutive.

The computations of basic and diluted EPS for the three and six months ended June 30, 2014 and 2013 are as follows:

(Millions, except per common share data)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Net income attributable to Aetna	\$548.8	\$536.0	\$1,214.3	\$1,026.1
Weighted average shares used to compute basic EPS	356.8	356.2	359.2	342.1
Dilutive effect of outstanding stock-based compensation awards	3.5	3.9	3.4	3.5
Weighted average shares used to compute diluted EPS	360.3	360.1	362.6	345.6
Basic EPS	\$1.54	\$1.50	\$3.38	\$3.00
Diluted EPS	\$1.52	\$1.49	\$3.35	\$2.97

The stock-based compensation awards excluded from the calculation of diluted EPS for the three and six months ended June 30, 2014 and 2013 are as follows:

(Millions)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Stock appreciation rights ("SARs" ⁽¹⁾)	—	—	.7	3.4
Market stock units ("MSUs" ⁽²⁾)	—	.4	.2	.4
Performance stock units ("PSUs" ⁽²⁾)	.8	.8	.8	.8
Performance stock appreciation rights ("PSARs" ⁽²⁾)	.3	—	.3	—

(1) SARs are excluded from the calculation of diluted EPS if the exercise price is greater than the average market price of Aetna common shares during the period (i.e., the awards are anti-dilutive).

(2) PSUs, certain MSUs with performance conditions and PSARs are excluded from the calculation of diluted EPS if all necessary performance conditions have not been satisfied at the end of the reporting period.

All outstanding stock options were included in the calculation of diluted EPS for the three and six months ended June 30, 2014 and 2013.

In connection with the May 7, 2013 acquisition of Coventry, we issued approximately 52.2 million Aetna common shares in exchange for all the outstanding shares of Coventry common stock. Those Aetna common shares were outstanding, net of any subsequent share repurchases, and included in the calculation of weighted average shares

used to compute basic EPS for the entire three and six months ended June 30, 2014 and from the Acquisition Date through June 30, 2013, and weighted accordingly.

5. Operating Expenses

For the three and six months ended June 30, 2014 and 2013, selling expenses (which include broker commissions, the variable component of our internal sales force compensation and premium taxes) and general and administrative expenses were as follows:

(Millions)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Selling expenses	\$413.0	\$332.2	\$815.8	\$629.4
General and administrative expenses:				
Salaries and related benefits	1,108.9	992.6	2,219.6	1,795.1
Other general and administrative expenses ^{(1) (2) (3)}	1,079.3	769.6	2,016.2	1,409.1
Total general and administrative expenses ⁽⁴⁾	2,188.2	1,762.2	4,235.8	3,204.2
Total operating expenses	\$2,601.2	\$2,094.4	\$5,051.6	\$3,833.6

(1) The three and six months ended June 30, 2014 include estimated ACA mandated fees comprised primarily of the HIF of \$147.7 million and \$302.5 million, respectively, and our contribution to the funding of the reinsurance program of \$86.2 million and \$171.1 million, respectively. Refer to Note 2 beginning on page 6 for additional information on ACA mandated fees.

In the fourth quarter of 2012, we recorded a charge of \$120.0 million pretax related to the settlement of purported class action litigation regarding Aetna's payment practices related to out-of-network health care providers. That charge included the estimated cost of legal fees of plaintiffs' counsel and the costs of administering the settlement.

(2) In the first quarter of 2014, we exercised our right to terminate the settlement agreement. As a result, we released the reserve established in connection with the settlement agreement, net of amounts due to the settlement administrator, which reduced first quarter 2014 other general and administrative expenses by \$103.0 million pretax. Refer to Note 13 beginning on page 28 for additional information on the termination of the settlement agreement.

In 2008, as a result of the liquidation proceedings of Lehman Re Ltd. ("Lehman Re"), a subsidiary of Lehman Brothers Holdings Inc., we recorded an allowance against our reinsurance recoverable from Lehman Re of \$42.2 million pretax. This reinsurance was placed in 1999 and was on a closed book of paid-up group whole life insurance business. In the second quarter of 2013, we sold our claim against Lehman Re to an unrelated third party (including the reinsurance recoverable) and terminated the reinsurance arrangement. Upon the sale of the claim and termination of the arrangement, we released the related allowance thereby reducing second quarter 2013 other general and administrative expenses by \$42.2 million pretax.

(4) The three and six months ended June 30, 2014 include \$55.8 million and \$119.5 million, respectively, of transaction and integration-related costs related to the acquisitions of Coventry and InterGlobal. The three and six months ended June 30, 2013 include \$95.9 million and \$120.2 million, respectively, of transaction and integration-related costs related to the acquisition of Coventry, including advisory, legal and other professional services fees and transaction-related payments.

Refer to the reconciliation of operating earnings to net income attributable to Aetna in Note 14 beginning on page 31 for additional information.

6. Investments

Total investments at June 30, 2014 and December 31, 2013 were as follows:

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(Millions)	June 30, 2014			December 31, 2013		
	Current	Long-term	Total	Current	Long-term	Total
Debt and equity securities available for sale	\$2,170.5	\$18,607.6	\$20,778.1	\$1,977.4	\$17,753.0	\$19,730.4
Mortgage loans	120.3	1,484.8	1,605.1	84.9	1,464.7	1,549.6
Other investments	3.8	1,767.7	1,771.5	1.5	1,717.3	1,718.8
Total investments	\$2,294.6	\$21,860.1	\$24,154.7	\$2,063.8	\$20,935.0	\$22,998.8

At June 30, 2014 and December 31, 2013, approximately \$827 million and \$766 million, respectively, of investments were pledged under securities loan agreements.

Debt and Equity Securities

Debt and equity securities available for sale at June 30, 2014 and December 31, 2013 were as follows:

(Millions)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2014				
Debt securities:				
U.S. government securities	\$1,448.2	\$91.4	\$(.7)	\$1,538.9
States, municipalities and political subdivisions	4,097.4	238.8	(16.8)	4,319.4
U.S. corporate securities	7,827.8	665.8	(24.2)	8,469.4
Foreign securities	3,323.5	297.4	(8.9)	3,612.0
Residential mortgage-backed securities	956.4	26.9	(7.5)	975.8
Commercial mortgage-backed securities	1,351.8	78.0	(1.6) ⁽¹⁾	1,428.2
Other asset-backed securities	320.4	8.2	(.6) ⁽¹⁾	328.0
Redeemable preferred securities	56.8	11.3	—	68.1
Total debt securities	19,382.3	1,417.8	(60.3)	20,739.8
Equity securities	42.9	.4	(5.0)	38.3
Total debt and equity securities ⁽²⁾	\$19,425.2	\$1,418.2	\$(65.3)	\$20,778.1
December 31, 2013				
Debt securities:				
U.S. government securities	\$1,396.8	\$68.7	\$(3.0)	\$1,462.5
States, municipalities and political subdivisions	4,118.5	126.6	(82.8)	4,162.3
U.S. corporate securities	7,559.0	493.7	(110.1)	7,942.6
Foreign securities	3,209.6	198.9	(53.0)	3,355.5
Residential mortgage-backed securities	928.4	16.9	(21.1)	924.2
Commercial mortgage-backed securities	1,323.5	88.2	(4.7) ⁽¹⁾	1,407.0
Other asset-backed securities	343.4	8.3	(2.1) ⁽¹⁾	349.6
Redeemable preferred securities	56.8	8.6	—	65.4
Total debt securities	18,936.0	1,009.9	(276.8)	19,669.1
Equity securities	38.5	26.5	(3.7)	61.3
Total debt and equity securities ⁽²⁾	\$18,974.5	\$1,036.4	\$(280.5)	\$19,730.4

At June 30, 2014 and December 31, 2013, we held securities for which we previously recognized \$18.6 million and \$22.8 million, respectively, of non-credit related impairments in accumulated other comprehensive loss. These securities had a net unrealized capital gain at June 30, 2014 and December 31, 2013 of \$4.9 million and \$6.6 million, respectively.

Investment risks associated with our experience-rated and discontinued products generally do not impact our operating results (refer to Note 16 beginning on page 33 for additional information on our accounting for discontinued products). At June 30, 2014, debt and equity securities with a fair value of approximately \$3.7 billion, gross unrealized capital gains of \$410.6 million and gross unrealized capital losses of \$13.7 million and, at December 31, 2013, debt and equity securities with a fair value of approximately \$3.7 billion, gross unrealized capital gains of \$291.3 million and gross unrealized capital losses of \$60.3 million were included in total debt and equity securities, but support our experience-rated and discontinued products. Changes in net unrealized capital gains (losses) on these securities are not reflected in accumulated other comprehensive income.

The fair value of debt securities at June 30, 2014 is shown below by contractual maturity. Actual maturities may differ from contractual maturities because securities may be restructured, called or prepaid.

(Millions)	Fair Value
Due to mature:	
Less than one year	\$1,045.4
One year through five years	5,681.6
After five years through ten years	5,791.2
Greater than ten years	5,489.6
Residential mortgage-backed securities	975.8
Commercial mortgage-backed securities	1,428.2
Other asset-backed securities	328.0
Total	\$20,739.8

Mortgage-Backed and Other Asset-Backed Securities

All of our residential mortgage-backed securities at June 30, 2014 were issued by the Government National Mortgage Association, the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation and carry agency guarantees and explicit or implicit guarantees by the U.S. Government. At June 30, 2014, our residential mortgage-backed securities had an average credit quality rating of AAA and a weighted average duration of 4.2 years.

Our commercial mortgage-backed securities have underlying loans that are dispersed throughout the United States. Significant market observable inputs used to value these securities include probability of default and loss severity. At June 30, 2014, these securities had an average credit quality rating of AA+ and a weighted average duration of 2.3 years.

Our other asset-backed securities have a variety of underlying collateral (e.g., automobile loans, credit card receivables and home equity loans). Significant market observable inputs used to value these securities include the unemployment rate, loss severity and probability of default. At June 30, 2014, these securities had an average credit quality rating of AA+ and a weighted average duration of 2.7 years.

Unrealized Capital Losses and Net Realized Capital Gains (Losses)

When a debt or equity security is in an unrealized capital loss position, we monitor the duration and severity of the loss to determine if sufficient market recovery can occur within a reasonable period of time. We recognize an other-than-temporary impairment (“OTTI”) when we intend to sell a debt security that is in an unrealized capital loss position or if we determine a credit-related loss on a debt or equity security has occurred.

Summarized below are the debt and equity securities we held at June 30, 2014 and December 31, 2013 that were in an unrealized capital loss position, aggregated by the length of time the investments have been in that position:

(Millions)	Less than 12 months		Greater than 12 months		Total ⁽¹⁾	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2014						
Debt securities:						
U.S. government securities	\$11.5	\$—	\$26.8	\$.7	\$38.3	\$.7
States, municipalities and political subdivisions	209.4	1.2	756.2	15.6	965.6	16.8
U.S. corporate securities	273.5	2.4	707.4	21.8	980.9	24.2
Foreign securities	107.5	.5	262.0	8.4	369.5	8.9
Residential mortgage-backed securities	13.9	.1	216.6	7.4	230.5	7.5
Commercial mortgage-backed securities	7.8	.1	78.9	1.5	86.7	1.6
Other asset-backed securities	6.6	.1	32.3	.5	38.9	.6
Redeemable preferred securities	3.0	—	—	—	3.0	—
Total debt securities	633.2	4.4	2,080.2	55.9	2,713.4	60.3
Equity securities	—	—	14.7	5.0	14.7	5.0
Total debt and equity securities ⁽¹⁾	\$633.2	\$4.4	\$2,094.9	\$60.9	\$2,728.1	\$65.3
December 31, 2013						
Debt securities:						
U.S. government securities	\$555.9	\$2.7	\$13.4	\$.3	\$569.3	\$3.0
States, municipalities and political subdivisions	1,779.9	73.1	132.4	9.7	1,912.3	82.8
U.S. corporate securities	2,196.8	88.0	170.0	22.1	2,366.8	110.1
Foreign securities	875.2	43.5	90.9	9.5	966.1	53.0
Residential mortgage-backed securities	541.1	17.3	35.0	3.8	576.1	21.1
Commercial mortgage-backed securities	162.4	4.2	25.0	.5	187.4	4.7
Other asset-backed securities	87.8	1.9				