

AETNA INC /PA/  
Form 10-Q  
August 03, 2017

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, 2017  
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	23-2229683
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
151 Farmington Avenue, Hartford, CT	06156
(Address of principal executive offices)	(Zip Code)
Registrant's telephone number, including area 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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated

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filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)  Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 332.1 million shares of the registrant’s voting common stock with a par value of \$.01 per share outstanding at June 30, 2017.

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Aetna Inc.  
 Form 10-Q  
 For the Quarterly Period Ended June 30, 2017

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), refer to Aetna Inc. (a Pennsylvania corporation) (“Aetna”) and its subsidiaries (collectively, the “Company”).

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Item 1. Financial Statements

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## Consolidated Balance Sheets

(Millions)	(Unaudited)	
	June 30, 2017	December 31, 2016
Assets:		
Current assets:		
Cash and cash equivalents	\$ 3,574	\$ 17,996
Investments	2,934	3,046
Premiums receivable, net	3,447	2,356
Other receivables, net	2,476	2,224
Accrued investment income	228	232
Income taxes receivable	173	44
Other current assets	2,669	2,551
Total current assets	15,501	28,449
Long-term investments	21,953	21,833
Reinsurance recoverables	713	727
Goodwill	10,637	10,637
Other acquired intangible assets, net	1,324	1,442
Property and equipment, net	570	587
Other long-term assets	1,808	1,480
Separate Accounts assets	4,208	3,991
Total assets	\$ 56,714	\$ 69,146
Liabilities and shareholders' equity:		
Current liabilities:		
Health care costs payable	\$ 6,246	\$ 6,558
Future policy benefits	612	645
Unpaid claims	791	801
Unearned premiums	1,989	556
Policyholders' funds	2,788	2,772
Current portion of long-term debt	1,997	1,634
Accrued expenses and other current liabilities	5,317	5,728
Total current liabilities	19,740	18,694
Future policy benefits	5,786	5,929
Unpaid claims	1,705	1,703
Policyholders' funds	885	812
Long-term debt, less current portion	7,175	19,027
Deferred income taxes	106	4
Other long-term liabilities	1,534	1,043
Separate Accounts liabilities	4,208	3,991
Total liabilities	41,139	51,203
Commitments and contingencies (Note 15)		
Shareholders' equity:		
Common stock (\$.01 par value; 2.5 billion shares authorized and 332.1 million shares issued and outstanding in 2017; 2.5 billion shares authorized and 351.7 million shares issued and outstanding in 2016) and additional paid-in capital	4,016	4,716
Retained earnings	12,568	14,717
Accumulated other comprehensive loss	(1,180	) (1,552 )

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Total Aetna shareholders' equity	15,404	17,881
Non-controlling interests	171	62
Total equity	15,575	17,943
Total liabilities and equity	\$ 56,714	\$ 69,146

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

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Index to Consolidated Financial StatementsConsolidated Statements of Income  
(Unaudited)

(Millions, except per common share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenue:				
Health care premiums	\$13,223	\$13,629	\$26,442	\$27,098
Other premiums	552	547	1,096	1,087
Fees and other revenue <sup>(1)</sup>	1,486	1,474	2,961	2,941
Net investment income	237	251	497	469
Net realized capital gains (losses)	25	52	(308)	51
Total revenue	15,523	15,953	30,688	31,646
Benefits and expenses:				
Health care costs <sup>(2)</sup>	10,577	11,232	21,493	22,080
Current and future benefits	539	525	1,084	1,054
Operating expenses:				
Selling expenses	402	416	823	837
General and administrative expenses	2,150	2,368	5,582	4,810
Total operating expenses	2,552	2,784	6,405	5,647
Interest expense	86	123	259	225
Amortization of other acquired intangible assets	58	64	118	126
Loss on early extinguishment of long-term debt	—	—	246	—
Reduction of reserve for anticipated future losses on discontinued products	(109)	(128)	(109)	(128)
Total benefits and expenses	13,703	14,600	29,496	29,004
Income before income taxes	1,820	1,353	1,192	2,642
Income taxes:				
Current	492	554	485	1,117
Deferred	145	6	(96)	(6)
Total income tax expense	637	560	389	1,111
Net income including non-controlling interests	1,183	793	803	1,531
Less: Net (loss) income attributable to non-controlling interests	(20)	2	(19)	3
Net income attributable to Aetna	\$1,203	\$791	\$822	\$1,528
Earnings per common share:				
Basic	\$3.62	\$2.25	\$2.43	\$4.35
Diluted	\$3.60	\$2.23	\$2.42	\$4.32

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 \$37 million and \$69 million (net of <sup>(1)</sup> pharmaceutical and processing costs of \$349 million and \$689 million) for the three and six months ended June 30, 2017, respectively, and \$35 million and \$59 million (net of pharmaceutical and processing costs of \$333 million and \$641 million) for the three and six months ended June 30, 2016, respectively.

Health care costs have been reduced by Insured member co-payments related to our mail order and specialty <sup>(2)</sup> pharmacy operations of \$32 million and \$67 million for the three and six month periods ended June 30, 2017, respectively, and \$28 million and \$62 million for the three and six month periods ended June 30, 2016, respectively.

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

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(Unaudited)

(Millions)	Three Months		Six Months	
	Ended June 30, 2017	2016	Ended June 30, 2017	2016
Net income including non-controlling interests	\$1,183	\$793	\$803	\$1,531
Other comprehensive income, net of tax:				
Previously impaired debt securities	(1 )	—	(1 )	1
All other securities	80	165	124	386
Derivatives and foreign currency	6	(12 )	228	(169 )
Pension and other postretirement employee benefit (“OPEB”) plans	11	10	21	20
Other comprehensive income	96	163	372	238
Comprehensive income including non-controlling interests	1,279	956	1,175	1,769
Less: Comprehensive (loss) income attributable to non-controlling interests	(20 )	2	(19 )	3
Comprehensive income attributable to Aetna	\$1,299	\$954	\$1,194	\$1,766

Refer to accompanying Condensed Notes to Consolidated Financial Statements (Unaudited), including Note 12 for further information about other comprehensive (loss) income.

Index to Consolidated Financial StatementsConsolidated 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, 2017								
Balance at December 31, 2016	351.7	\$4,716	\$14,717	\$ (1,552 )	\$ 17,881	\$ 62	\$17,943	
Net income (loss)	—	—	822	—	822	(19 )	803	
Other increases in non-controlling interest	—	—	—	—	—	128	128	
Other comprehensive income (Note 12)	—	—	—	372	372	—	372	
Common shares issued for benefit plans, net of employee tax withholdings	1.3	(39 )	—	—	(39 )	—	(39 )	
Repurchases of common shares	(20.9 )	(661 )	(2,639 )	—	(3,300 )	—	(3,300 )	
Dividends declared	—	—	(332 )	—	(332 )	—	(332 )	
Balance at June 30, 2017	332.1	\$4,016	\$12,568	\$ (1,180 )	\$ 15,404	\$ 171	\$15,575	
Six Months Ended June 30, 2016								
Balance at December 31, 2015	349.5	\$4,647	\$12,797	\$ (1,330 )	\$ 16,114	\$ 65	\$16,179	
Net income	—	—	1,528	—	1,528	3	1,531	
Other decreases in non-controlling interest	—	—	—	—	—	(1 )	(1 )	
Other comprehensive income (Note 12)	—	—	—	238	238	—	238	
Common shares issued for benefit plans, net of employee tax withholdings	1.3	6	—	—	6	—	6	
Dividends declared	—	—	(175 )	—	(175 )	—	(175 )	
Balance at June 30, 2016	350.8	\$4,653	\$14,150	\$ (1,092 )	\$ 17,711	\$ 67	\$17,778	

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

Index to Consolidated Financial StatementsConsolidated Statements of Cash Flows  
(Unaudited)

(Millions)	Six Months Ended	
	June 30,	
	2017	2016
Cash flows from operating activities:		
Net income including non-controlling interests	\$ 803	\$ 1,531
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized capital losses (gains)	308	(51 )
Depreciation and amortization	339	343
Debt fair value amortization	(10 )	(15 )
Equity in earnings of affiliates, net	(60 )	(2 )
Stock-based compensation expense	94	101
Reduction of reserve for anticipated future losses on discontinued products	(109 )	(128 )
Amortization of net investment premium	37	39
Loss on early extinguishment of long-term debt	246	—
Changes in assets and liabilities:		
Premiums due and other receivables	(1,335 )	(1,215 )
Income taxes	(222 )	418
Other assets and other liabilities	(432 )	470
Health care and insurance liabilities	1,033	719
Net cash provided by operating activities	692	2,210
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	6,091	6,699
Cost of investments	(5,736 )	(6,534 )
Additions to property, equipment and software	(180 )	(129 )
Net cash provided by investing activities	175	36
Cash flows from financing activities:		
Issuance of long-term debt	—	12,886
Repayment of long-term debt	(11,734)	—
Common shares issued under benefit plans, net	(126 )	(88 )
Common shares repurchased	(3,300 )	—
Dividends paid to shareholders	(254 )	(175 )
Net payment on interest rate derivatives	—	(274 )
Contributions, non-controlling interests	125	—
Net cash (used for) provided by financing activities	(15,289)	12,349
Net (decrease) increase in cash and cash equivalents	(14,422)	14,595
Cash and cash equivalents, beginning of period	17,996	2,524
Cash and cash equivalents, end of period	\$ 3,574	\$ 17,119
Supplemental cash flow information:		
Interest paid	\$ 285	\$ 172
Income taxes paid	611	703

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 emerging business products and services that complement and enhance our medical products. 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 networks in select geographies.

Group Insurance primarily includes group life insurance and group disability products. Group life insurance products are offered on an Insured basis. Group disability products are offered to employers on both an Insured and an ASC basis. Group Insurance also includes long-term care products that were offered primarily on an Insured basis. 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 17 for additional information).

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial reporting. Accordingly, they do not include all of the information and footnotes required by GAAP for annual financial statements. We have omitted certain footnote disclosures that would substantially duplicate the disclosures in our 2016 Annual Report on Form 10-K (our “2016 Annual Report”), unless the information contained in those disclosures materially changed or is required by GAAP. The accompanying unaudited consolidated financial statements and related condensed notes should be read in conjunction with the consolidated financial statements and related notes presented in our 2016 Annual Report.

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 Company has evaluated subsequent events that occurred after June 30, 2017 through the date the financial statements were issued and determined there were no subsequent events to disclose.

Reclassifications

Certain reclassifications were made to 2016 financial information to conform with the 2017 presentation.

New Accounting Standards

Simplifying the Test for Goodwill Impairment

Effective January 1, 2017, we adopted, on a prospective basis, new accounting guidance which simplifies the accounting for goodwill impairment. The new guidance eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. A goodwill impairment charge would be recognized if the carrying amount of a reporting unit exceeds the estimated fair value of the reporting unit. The adoption of this new guidance is not expected to have a material impact on our financial position or operating results.

Classification of Certain Cash Receipts and Cash Payments in the Statement of Cash Flows

Effective January 1, 2017, we adopted, on a retrospective basis, new accounting guidance which clarifies the classification of certain cash receipts and cash payments in our Consolidated Statements of Cash Flows. As a result, certain cash distributions received from our equity method investments will now be classified as cash inflows from operating activities. These cash distributions previously were classified as cash inflows from investing activities. There were no material reclassifications in our Consolidated Statements of Cash Flows for the six months ended June 30, 2017 and June 30, 2016 as a result of the adoption of this new guidance.

#### Future Application of Accounting Standards

##### Revenue from Contracts with Customers

Effective January 1, 2018, we will adopt new accounting guidance related to revenue recognition from contracts with customers. While industry-specific guidance related to contracts with customers within the scope of Accounting Standards Codification (“ASC”) 944 Financial Services - Insurance remains unchanged, most other industry-specific revenue recognition requirements have been removed. The new guidance 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 those 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. We currently anticipate adopting the new guidance using the modified retrospective approach with a cumulative effect adjustment to retained earnings. While we are still evaluating the impact of this new guidance on our financial statements, we anticipate that any impact will only relate to contracts with customers outside the scope of ASC Topic 944. Adoption of this new guidance will result in reclassifications within our Consolidated Statements of Income; however, we do not anticipate any material changes in the timing of our recognition of revenue or net income.

##### Recognition and Measurement of Financial Assets and Financial Liabilities

Effective January 1, 2018, we will adopt new accounting guidance related to the recognition and measurement of financial assets and financial liabilities. Under the new guidance, all equity investments in unconsolidated entities will be measured at fair value with changes in fair value recognized in net income. A reporting entity may elect to report equity investments without a readily determinable fair value at cost. The new guidance also revises certain disclosures regarding financial assets and liabilities. The adoption of this new guidance is not expected to have a material impact on our financial position or operating results.

##### Leases

Effective January 1, 2019, we will adopt new accounting guidance related to the recognition, measurement and disclosure requirements for leases. Under the new guidance, lessees will be required to recognize a right-of-use asset and corresponding lease liability on their balance sheets for all leases other than those that meet the definition of a short-term lease. The new guidance also revises certain disclosure requirements regarding leases. While we are still evaluating the impact of adoption of this new guidance, we anticipate that we will be required to record an asset and corresponding liability related to our operating leases (as described in Note 17 in our 2016 Annual Report) on our Consolidated Balance Sheets.

##### Accounting for Interest Associated with the Purchase of Callable Debt Securities

Effective January 1, 2019, we will adopt new accounting guidance related to the amortization of purchased callable debt securities held at a premium. Under the new guidance, premiums on callable debt securities are amortized to the earliest call date rather than to the contractual maturity date. Callable debt securities held at a discount will continue to be amortized to the contractual maturity date. We are still evaluating the impact of the adoption of this new guidance on our financial position and operating results.

##### Measurement of Credit Losses on Financial Instruments

Effective January 1, 2020, we will adopt new accounting guidance related to the measurement of credit losses on financial assets and certain other instruments. The new guidance requires the use of a new forward-looking expected loss impairment model for trade and other receivables, held-to-maturity debt securities, loans and other instruments. The new guidance also requires impairments and recoveries for available-for-sale debt securities to be recorded through an allowance account and revises certain disclosure requirements. We are still evaluating the impact of the adoption of this new guidance on our financial position and operating results.

### 3. Terminated Acquisition and Terminated Divestiture

Terminated Acquisition of Humana

On July 2, 2015, we entered into a definitive agreement (the “Merger Agreement”) to acquire Humana Inc. (“Humana”). On July 21, 2016, the U.S. Department of Justice (the “DOJ”) and certain state attorneys general filed a civil complaint in the U.S. District Court for the District of Columbia (the “District Court”) against us and Humana charging that our acquisition of Humana (the “Humana Transaction”) would violate Section 7 of the Clayton Antitrust Act, and seeking a permanent injunction to prevent Aetna from acquiring Humana. On January 23, 2017, the District Court granted the DOJ’s request to enjoin the Humana Transaction.

On February 14, 2017, Aetna and Humana entered into a mutual termination agreement (the “Termination Agreement”) pursuant to which the parties thereto (collectively the “Parties”) agreed to terminate the Merger Agreement, including all schedules and exhibits thereto, and all ancillary agreements contemplated thereby, entered pursuant thereto or entered in connection therewith (other than certain confidentiality agreements) (collectively with the Merger Agreement, the “Transaction Documents”), effective immediately as of February 14, 2017 (the “Termination Date”). Under the Termination Agreement, Aetna agreed to pay Humana the Regulatory Termination Fee (as defined in the Merger Agreement) of \$1.0 billion in cash in full satisfaction of any amounts required to be paid by Aetna under the Merger Agreement. The Parties also agreed to release each other from any and all liability, claims, rights, actions, causes of action, suits, liens, obligations, accounts, debts, demands, agreements, promises, liabilities, controversies, costs, charges, damages, expenses and fees, however arising, in connection with, arising out of or related to the Transaction Documents, the transactions contemplated therein or thereby or certain related matters. We paid Humana the Regulatory Termination Fee on February 16, 2017 and recorded the expense in general and administrative expenses. We funded that payment with the proceeds of the 2016 senior notes (as defined below).

In June 2016, we issued \$13.0 billion of senior notes to partially fund the Humana Transaction (collectively, the “2016 senior notes”). In accordance with the terms of the 2016 senior notes, on February 14, 2017, we issued a notice of redemption for \$10.2 billion aggregate principal amount of certain of the 2016 senior notes (collectively, the “Special Mandatory Redemption Notes”) at a redemption price equal to 101% of the aggregate principal amount of those notes plus accrued and unpaid interest. We redeemed the Special Mandatory Redemption Notes on March 16, 2017, and we funded the redemption with the proceeds of the 2016 senior notes. As a result of the redemption of the Special Mandatory Redemption Notes, we recognized certain costs in our net income during the six months ended June 30, 2017. Refer to Note 9 for additional information.

#### Terminated Divestiture to Molina

In order to address the DOJ’s perceived competitive concerns regarding Medicare Advantage relating to the Humana Transaction, on August 2, 2016, we entered into a definitive agreement (the “Aetna APA”) to sell for cash to Molina Healthcare, Inc. (“Molina”) certain of our Medicare Advantage assets. On February 14, 2017, Aetna and Molina entered into a Termination Agreement (the “APA Termination Agreement”) pursuant to which Aetna terminated the Aetna APA, including all schedules and exhibits thereto, and all ancillary agreements contemplated thereby or entered pursuant thereto. Under the APA Termination Agreement, Aetna agreed to pay Molina in cash (a) a termination fee of \$53 million and (b) approximately 70% of Molina’s transaction costs. We paid Molina the termination fee on February 16, 2017 and the applicable transaction costs of \$7 million on February 27, 2017 and recorded the expense in general and administrative expenses. The payments were funded with the proceeds of the 2016 senior notes.

#### 4. Investments

Total investments at June 30, 2017 and December 31, 2016 were as follows:

(Millions)	June 30, 2017			December 31, 2016		
	Current	Long-term	Total	Current	Long-term	Total
Debt and equity securities available for sale	\$2,757	\$ 18,880	\$21,637	\$2,876	\$ 18,866	\$21,742
Mortgage loans	177	1,392	1,569	170	1,341	1,511
Other investments	—	1,681	1,681	—	1,626	1,626
Total investments	\$2,934	\$ 21,953	\$24,887	\$3,046	\$ 21,833	\$24,879

## Debt and Equity Securities

Debt and equity securities available for sale at June 30, 2017 and December 31, 2016 were as follows:

(Millions)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2017				
Debt securities:				
U.S. government securities	\$ 1,678	\$ 58	\$ (1 )	\$ 1,735
States, municipalities and political subdivisions	4,689	204	(20 )	4,873
U.S. corporate securities	8,191	441	(27 )	8,605
Foreign securities	3,014	196	(11 )	3,199
Residential mortgage-backed securities	713	9	(5 )	717
Commercial mortgage-backed securities	1,292	7	(24 )	1,275
Other asset-backed securities	1,122	9	(4 )	1,127
Redeemable preferred securities	20	5	—	25
Total debt securities	20,719	929	(92 )	21,556
Equity securities	70	14	(3 )	81
Total debt and equity securities <sup>(1)(2)</sup>	\$ 20,789	\$ 943	\$ (95 )	\$ 21,637
December 31, 2016				
Debt securities:				
U.S. government securities	\$ 1,643	\$ 51	\$ —	\$ 1,694
States, municipalities and political subdivisions	5,047	152	(61 )	5,138
U.S. corporate securities	8,145	385	(55 )	8,475
Foreign securities	2,958	163	(33 )	3,088
Residential mortgage-backed securities	793	11	(9 )	795
Commercial mortgage-backed securities	1,382	5	(39 )	1,348
Other asset-backed securities	1,077	7	(9 )	1,075
Redeemable preferred securities	22	5	—	27
Total debt securities	21,067	779	(206 )	21,640
Equity securities	84	20	(2 )	102
Total debt and equity securities <sup>(1)(2)</sup>	\$ 21,151	\$ 799	\$ (208 )	\$ 21,742

At both June 30, 2017 and December 31, 2016, we held securities for which we previously recognized an

(1) immaterial amount of non-credit related impairments in accumulated other comprehensive loss. These securities each had an immaterial amount of net unrealized capital gains at both June 30, 2017 and December 31, 2016. Investment risks associated with our experience-rated and discontinued products generally do not impact our operating results (refer to Note 17 for additional information on our accounting for discontinued products). At June 30, 2017, debt and equity securities with a fair value of approximately \$2.9 billion, gross unrealized capital gains of \$218 million and gross unrealized capital losses of \$17 million and, at December 31, 2016, debt and

(2) equity securities with a fair value of approximately \$2.9 billion, gross unrealized capital gains of \$195 million and gross unrealized capital losses of \$35 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, 2017 is shown below by contractual maturity. Actual maturities may differ from contractual maturities because securities may be restructured, called or prepaid, or we intend to sell a security prior to maturity.

(Millions)	Amortized Cost	Fair Value
Due to mature:		
Less than one year	\$ 1,350	\$ 1,363
One year through five years	6,772	6,941
After five years through ten years	4,742	4,921
Greater than ten years	4,728	5,212
Residential mortgage-backed securities	713	717
Commercial mortgage-backed securities	1,292	1,275
Other asset-backed securities	1,122	1,127
Total	\$ 20,719	\$ 21,556

#### Mortgage-Backed and Other Asset-Backed Securities

All of our residential mortgage-backed securities at June 30, 2017 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, 2017, our residential mortgage-backed securities had an average credit quality rating of AAA and a weighted average duration of 4.3 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 loss severity and probability of default. At June 30, 2017, these securities had an average credit quality rating of AAA and a weighted average duration of 6.8 years.

Our other asset-backed securities have a variety of underlying collateral (e.g., automobile loans, credit card receivables, home equity loans and commercial loans). Significant market observable inputs used to value these securities include the unemployment rate, loss severity and probability of default. At June 30, 2017, these securities had an average credit quality rating of AA- and a weighted average duration of 1.2 years.

Summarized below are the debt and equity securities we held at June 30, 2017 and December 31, 2016 that were in an unrealized capital loss position, aggregated by the length of time the investments have been in that position:

(Millions, except number of securities)	Less than 12 months			Greater than 12 months			Total <sup>(1)</sup>		
	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
June 30, 2017									
Debt securities:									
U.S. government securities	84	\$345	\$ 1	—	\$—	\$ —	84	\$345	\$ 1
States, municipalities and political subdivisions	338	1,064	17	43	83	3	381	1,147	20
U.S. corporate securities	899	1,488	19	62	66	8	961	1,554	27
Foreign securities	364	632	10	29	40	1	393	672	11
Residential mortgage-backed securities	178	343	4	96	16	1	274	359	5
Commercial mortgage-backed securities	211	786	24	—	—	—	211	786	24
Other asset-backed securities	229	420	3	62	65	1	291	485	4
Total debt securities	2,303	5,078	78	292	270	14	2,595	5,348	92
Equity securities	1	4	—	8	3	3	9	7	3
Total debt and equity securities <sup>(1)</sup>	2,304	\$5,082	\$ 78	300	\$273	\$ 17	2,604	\$5,355	\$ 95
December 31, 2016									
Debt securities:									
U.S. government securities	26	\$39	\$ —	1	\$1	\$ —	27	\$40	\$ —
States, municipalities and political subdivisions	865	2,228	58	37	75	3	902	2,303	61
U.S. corporate securities	1,428	2,277	44	114	101	11	1,542	2,378	55
Foreign securities	649	970	27	62	76	6	711	1,046	33
Residential mortgage-backed securities	188	455	8	104	17	1	292	472	9
Commercial mortgage-backed securities	285	1,038	39	3	3	—	288	1,041	39
Other asset-backed securities	226	403	4	208	177	5	434	580	9
Total debt securities	3,667	7,410	180	529	450	26	4,196	7,860	206
Equity securities	2	3	—	8	3	2	10	6	2
Total debt and equity securities <sup>(1)</sup>	3,669	\$7,413	\$ 180	537	\$453	\$ 28	4,206	\$7,866	\$ 208

(1)

At June 30, 2017 and December 31, 2016, debt and equity securities in an unrealized capital loss position of \$17 million and \$35 million, respectively, and with related fair value of \$592 million and \$890 million, respectively, related to experience-rated and discontinued products.

We reviewed the securities in the tables above and concluded that these are performing assets generating investment income to support the needs of our business. In performing this review, we considered factors such as the quality of the investment security based on research performed by our internal credit analysts and external rating agencies and the prospects of realizing the carrying value of the security based on the investment's current prospects for recovery. At June 30, 2017, we did not intend to sell these securities, and we did not believe it was more likely than not that we would be required to sell these securities prior to anticipated recovery of their amortized cost basis.

The maturity dates for debt securities in an unrealized capital loss position at June 30, 2017 were as follows:

(Millions)	Supporting discontinued and experience-rated products		Supporting remaining products		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Due to mature:						
Less than one year	\$ 5	\$ —	\$291	\$ —	\$296	\$ —
One year through five years	43	1	1,455	16	1,498	17
After five years through ten years	176	4	783	13	959	17
Greater than ten years	183	7	782	18	965	25
Residential mortgage-backed securities	12	—	347	5	359	5
Commercial mortgage-backed securities	153	4	633	20	786	24
Other asset-backed securities	18	—	467	4	485	4
Total	\$ 590	\$ 16	\$4,758	\$ 76	\$5,348	\$ 92

#### Mortgage Loans

Our mortgage loans are collateralized by commercial real estate. During the three and six months ended June 30, 2017 and 2016 we had the following activity in our mortgage loan portfolio:

(Millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
New mortgage loans	\$127	\$77	\$181	\$89
Mortgage loans fully repaid	52	38	100	86

We assess our mortgage loans on a regular basis for credit impairments, and annually assign a credit quality indicator to each loan. Our credit quality indicator is internally developed and categorizes our portfolio on a scale from 1 to 7. These indicators are based upon several factors, including current loan to value ratios, property condition, market trends, creditworthiness of the borrower and deal structure. The vast majority of our mortgage loans fall into categories 2 to 4.

Category 1 - Represents loans of superior quality.

Categories 2 to 4 - Represents loans where credit risk is minimal to acceptable; however, these loans may display some susceptibility to economic changes.

Categories 5 and 6 - Represents loans where credit risk is not substantial, but these loans warrant management's close attention.

Category 7 - Represents loans where collections are potentially at risk and, if necessary, an impairment is recorded.

Based upon our most recent assessments at June 30, 2017 and December 31, 2016, our mortgage loans were given the following credit quality indicators:

(In Millions, except credit ratings indicator)	June 30, 2017	December 31, 2016
1	\$43	\$45
2 to 4	1,516	1,449
5 and 6	10	17
7	—	—

Total

\$ 1,569 \$ 1,511

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## Net Investment Income

Sources of net investment income for the three and six months ended June 30, 2017 and 2016 were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Millions)	2017	2016	2017	2016
Debt securities	\$ 190	\$ 196	\$ 380	\$ 391
Mortgage loans	21	21	43	50
Other investments	37	43	95	47
Gross investment income	248	260	518	488
Investment expenses	(11 )	(9 )	(21 )	(19 )
Net investment income <sup>(1)</sup>	\$ 237	\$ 251	\$ 497	\$ 469

Net investment income includes \$59 million and \$125 million for the three and six months ended June 30, 2017, <sup>(1)</sup> respectively, and \$66 million and \$111 million for the three and six months ended June 30, 2016, respectively, related to investments supporting our experience-rated and discontinued products.

## Realized Capital Gains/Losses

Net realized capital gains and losses for the three and six months ended June 30, 2017 and 2016, excluding amounts related to experience-rated contract holders and discontinued products, were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Millions)	2017	2016	2017	2016
Other-than-temporary impairment (“OTTI”) losses on debt securities recognized in earnings	\$(1 )	\$ —	\$(3 )	\$(10)
Other net realized capital gains (losses)	26	52	(305 )	61
Net realized capital gains (losses)	\$ 25	\$ 52	\$(308)	\$ 51

The net realized capital gains for the three months ended June 30, 2017 were primarily attributable to sales of debt securities and investment real estate. The net realized capital losses for the six months ended June 30, 2017 were primarily attributable to the recognition into earnings of the entire unamortized effective portion of the related hedge losses upon the mandatory redemption of \$10.2 billion aggregate principal amount of the Special Mandatory Redemption Notes and the redemption of \$750 million aggregate principal amount of senior notes due 2020. The net realized capital gains for the three and six months ended June 30, 2016 were primarily attributable to gains from the sale of debt securities, partially offset by losses on other investments.

We had no individually material realized capital losses on debt or equity securities that impacted our operating results during three or six months ended June 30, 2017 or 2016.

Excluding amounts related to experience-rated and discontinued products, proceeds from the sale of available for sale debt and equity securities and the related gross realized capital gains and losses for the three and six months ended June 30, 2017 and 2016 were as follows<sup>(1)</sup>:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Millions)	2017	2016	2017	2016
Proceeds on sales	\$ 1,562	\$ 1,770	\$ 2,672	\$ 3,315

Gross realized capital gains	30	68	51	100
Gross realized capital losses	13	4	27	35

(1) The proceeds on sales and gross realized capital gains and losses exclude the impact of the sales of short-term debt securities which primarily relate to our investments in mutual funds. These investments were excluded from the disclosed amounts because they represent an immaterial amount of aggregate gross realized capital gains or losses and have a high volume of sales activity.

#### Variable Interest Entities

We have investments in certain hedge fund and private equity investments and real estate partnerships that are considered Variable Interest Entities (“VIE’s”). We do not have a future obligation to fund losses or debts on behalf of these investments; however, we may voluntarily contribute funds. In evaluating whether we are the primary beneficiary of a VIE, we considered

several factors, including whether we (a) have the power to direct the activities that most significantly impact the VIE's economic performance and (b) the obligation to absorb losses and the right to receive benefits that could potentially be significant to the VIE.

#### Variable Interest Entities - Primary Beneficiary

We have one majority owned hedge fund investment where we are the investment manager and have the power to direct the activities that most significantly impact the VIE's economic performance, including determining the hedge fund's investment strategy. Accordingly, we are the primary beneficiary and consolidate the investment in our operating results. The fund invests in additional hedge funds that are VIEs; however, we are not the primary beneficiary of these underlying funds as discussed in further detail below.

Substantially all of the assets of the VIE hedge fund are comprised of hedge fund investments reported as long-term investments on our Consolidated Balance Sheets. The VIE hedge fund had no material liabilities at June 30, 2017 or December 31, 2016. The total amount of the VIE hedge fund's assets included in long term investments on our Consolidated Balance Sheets at June 30, 2017 and December 31, 2016 were \$483 million and \$472 million, respectively.

#### Variable Interest Entities - Other Variable Interest Holder

Our involvement with VIEs where we are not determined to be the primary beneficiary consists of the following:

Hedge fund and private equity investments - We invest in hedge fund and private equity investments in order to generate investment returns for our investment portfolio supporting our businesses.

Real estate partnerships - We invest in various real estate partnerships, including those that construct, own and manage low-income housing developments. For the low income housing development investments, substantially all of the projected benefits to us are from tax credits and other tax benefits.

We are not the primary beneficiary of these investments because the nature of our involvement with the activities of these VIEs does not give us the power to direct the activities that most significantly impact their economic performance. We record the amount of our investment in these VIEs as long-term investments on our Consolidated Balance Sheets and recognize our share of each VIE's income or losses in earnings. Our maximum exposure to loss from these VIEs is limited to our investment balances as disclosed below and the risk of recapture of previously recognized tax credits related to the real estate partnerships, which we do not consider significant.

The total amount of other variable interest holder VIE assets included in long term investments on our Consolidated Balance Sheets at June 30, 2017 and December 31, 2016 were as follows:

(Millions)	June 30, December 31,	
	2017	2016
Hedge fund investments	\$ 364	\$ 384
Private equity investments	501	454
Real estate partnerships	261	278
Total	\$ 1,126	\$ 1,116

The carrying value of the total assets and liabilities of our other variable interest holder VIE investments at June 30, 2017 and December 31, 2016 were as follows:

(Millions)	June 30, December 31,	
	2017	2016

Assets:

Hedge fund investments	\$47,923	\$ 32,926
Private equity investments	27,983	25,368
Real estate partnerships	6,822	6,743
Total	\$82,728	\$ 65,037

Liabilities:

Hedge fund investments	\$9,116	\$ 2,819
Private equity investments	5,075	2,354
Real estate partnerships	4,955	4,938
Total	\$19,146	\$ 10,111

Non-controlling (Minority) Interests

At June 30, 2017 and December 31, 2016, continuing business non-controlling interests were \$171 million and \$62 million, respectively, primarily related to third party interests in our investment holdings as well as third party interests in certain of our operating entities. The non-controlling entities' share was included in total equity. Net loss attributable to non-controlling interests was \$20 million and \$19 million for the three and six months ended June 30, 2017, respectively. Net income attributable to non-controlling interests was \$2 million and \$3 million for the three and six months ended June 30, 2016, respectively. These non-controlling interests did not have a material impact on our financial position or operating results.

## 5. Fair Value

The preparation of our consolidated financial statements in accordance with GAAP requires certain of our assets and liabilities to be reflected at their fair value, and others on another basis, such as an adjusted historical cost basis. In this note, we provide details on the fair value of financial assets and liabilities and how we determine those fair values. We present this information for those financial instruments that are measured at fair value for which the change in fair value impacts net income attributable to Aetna or other comprehensive income separately from other financial assets and liabilities.

### Financial Instruments Measured at Fair Value in our Balance Sheets

Certain of our financial instruments are measured at fair value in our Consolidated Balance Sheets. The fair values of these instruments are based on valuations that include inputs that can be classified within one of three levels of a hierarchy established by GAAP. The following are the levels of the hierarchy and a brief description of the type of valuation information ("inputs") that qualifies a financial asset or liability for each level:

Level 1 – Unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 – Inputs other than Level 1 that are based on observable market data. These include: quoted prices for similar assets in active markets, quoted prices for identical assets in inactive markets, inputs that are observable that are not prices (such as interest rates and credit risks) and inputs that are derived from or corroborated by observable markets.

Level 3 – Developed from unobservable data, reflecting our own assumptions.

Financial assets and liabilities are classified based upon the lowest level of input that is significant to the valuation. When quoted prices in active markets for identical assets and liabilities are available, we use these quoted market prices to determine the fair value of financial assets and liabilities and classify these assets and liabilities in Level 1. In other cases where a quoted market price for identical assets and liabilities in an active market is either not

available or not observable, we estimate fair value using valuation methodologies based on available and observable market information or by using a matrix pricing model. These financial assets and liabilities would then be classified in Level 2. If quoted market prices are not available, we determine fair value using broker quotes or an internal analysis of each investment's financial performance and cash flow projections. Thus, financial assets and liabilities may be classified in Level 3 even though there may be some significant inputs that may be observable.

The following is a description of the valuation methodologies used for our financial assets and liabilities that are measured at fair value, including the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Debt Securities – Where quoted prices are available in an active market, our debt securities are classified in Level 1 of the fair value hierarchy. Our Level 1 debt securities are comprised primarily of U.S. Treasury securities.

The fair values of our Level 2 debt securities are obtained using models, such as matrix pricing, which use quoted market prices of debt securities with similar characteristics, or discounted cash flows to estimate fair value. We review these prices to ensure they are based on observable market inputs that include, but are not limited to, quoted prices for similar assets in active markets, quoted prices for identical assets in inactive markets and inputs that are observable but not prices (for example, interest rates and credit risks). We also review the methodologies and the assumptions used to calculate prices from these observable inputs. On a quarterly basis, we select a sample of our Level 2 debt securities' prices and compare them to prices provided by a secondary source. Variances over a specified threshold are identified and reviewed to confirm the price provided by the primary source represents an appropriate estimate of fair value. In addition, our internal investment team consistently compares the prices obtained for select Level 2 debt securities to the team's own independent estimates of fair value for those securities. We obtained one price for each of our Level 2 debt securities and did not adjust any of these prices at June 30, 2017 or December 31, 2016.

We also value certain debt securities using Level 3 inputs. For Level 3 debt securities, fair values are determined by outside brokers or, in the case of certain private placement securities, are priced internally. Outside brokers determine the value of these debt securities through a combination of their knowledge of the current pricing environment and market flows. We obtained one non-binding broker quote for each of these Level 3 debt securities and did not adjust any of these quotes at June 30, 2017 or December 31, 2016. The total fair value of our broker quoted debt securities was \$98 million at June 30, 2017 and \$80 million at December 31, 2016. Examples of these broker quoted Level 3 debt securities include certain U.S. and foreign corporate securities and certain of our commercial mortgage-backed securities as well as other asset-backed securities. For some of our private placement securities, our internal staff determines the value of these debt securities by analyzing spreads of corporate and sector indices as well as interest spreads of comparable public bonds. Examples of these private placement Level 3 debt securities include certain U.S. and foreign securities and certain tax-exempt municipal securities.

Equity Securities – We currently have two classifications of equity securities: those that are publicly traded and those that are privately placed. Our publicly-traded equity securities are classified in Level 1 because quoted prices are available for these securities in an active market. For privately-placed equity securities, there is no active market; therefore, we classify these securities in Level 3 because we price these securities through an internal analysis of each investment's financial statements and cash flow projections. Significant unobservable inputs consist of earnings and revenue multiples, discount for lack of marketability and comparability adjustments. An increase or decrease in any of these unobservable inputs would result in a change in the fair value measurement, which may be significant.

Derivatives – Where quoted prices are available in an active market, our derivatives are classified in Level 1. Certain of our derivative instruments are valued using models that primarily use market observable inputs and therefore are classified in Level 2 because they are traded in markets where quoted market prices are not readily available.

There were no financial liabilities measured at fair value on a recurring basis in our Consolidated Balance Sheets at June 30, 2017 or December 31, 2016. Financial assets measured at fair value on a recurring basis in our Consolidated Balance Sheets at June 30, 2017 and December 31, 2016 were as follows:

(Millions)	Level 1	Level 2	Level 3	Total
June 30, 2017				
Assets:				
Debt securities:				
U.S. government securities	\$1,582	\$153	\$—	\$1,735
States, municipalities and political subdivisions	—	4,873	—	4,873
U.S. corporate securities	—	8,519	86	8,605
Foreign securities	—	3,183	16	3,199
Residential mortgage-backed securities	—	717	—	717
Commercial mortgage-backed securities	—	1,275	—	1,275
Other asset-backed securities	—	1,127	—	1,127
Redeemable preferred securities	—	24	1	25
Total debt securities	1,582	19,871	103	21,556
Equity securities	48	—	33	81
Total	\$1,630	\$19,871	\$136	\$21,637
December 31, 2016				
Assets:				
Debt securities:				
U.S. government securities	\$1,514	\$180	\$—	\$1,694
States, municipalities and political subdivisions	—	5,137	1	5,138
U.S. corporate securities	—	8,395	80	8,475
Foreign securities	—	3,067	21	3,088
Residential mortgage-backed securities	—	795	—	795
Commercial mortgage-backed securities	—	1,348	—	1,348
Other asset-backed securities	—	1,075	—	1,075
Redeemable preferred securities	—	26	1	27
Total debt securities	1,514	20,023	103	21,640
Equity securities	59	—	43	102
Total	\$1,573	\$20,023	\$146	\$21,742

There were no transfers between Levels 1 and 2 during the three or six months ended June 30, 2017 or 2016. During the three and six months ended June 30, 2017, we had gross transfers out of Level 3 of \$42 million primarily related to commercial mortgage-backed securities for which observable market data was subsequently received. During the three and six months ended June 30, 2016, we had an immaterial amount of gross transfers out of Level 3. During the three and six months ended June 30, 2017 and 2016 we had an immaterial amount of gross transfers into Level 3.

Financial Instruments Not Measured at Fair Value in our Balance Sheets

The following is a description of the valuation methodologies used for estimating the fair value of our financial assets and liabilities that are carried on our Consolidated Balance Sheets at adjusted cost or contract value.

**Mortgage loans:** Fair values are estimated by discounting expected mortgage loan cash flows at market rates that reflect the rates at which similar loans would be made to similar borrowers. These rates reflect our assessment of the creditworthiness of the borrower and the remaining duration of the loans. The fair value estimates of mortgage loans of lower credit quality, including problem and restructured loans, are based on the estimated fair value of the underlying collateral.

**Bank loans:** Where fair value is determined by quoted market prices of bank loans with similar characteristics, our bank loans are classified in Level 2. For bank loans classified in Level 3, fair value is determined by outside brokers using their internal analyses through a combination of their knowledge of the current pricing environment and market flows.

**Equity securities:** Certain of our equity securities are carried at cost. The fair values of our cost-method investments are not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment.

**Investment contract liabilities:**

**With a fixed maturity:** Fair value is estimated by discounting cash flows at interest rates currently being offered by, or available to, us for similar contracts.

**Without a fixed maturity:** Fair value is estimated as the amount payable to the contract holder upon demand. However, we have the right under such contracts to delay payment of withdrawals that may ultimately result in paying an amount different than that determined to be payable on demand.

**Long-term debt:** Fair values are based on quoted market prices for the same or similar issued debt or, if no quoted market prices are available, on the current rates estimated to be available to us for debt of similar terms and remaining maturities.

The carrying value and estimated fair value classified by level of fair value hierarchy for our financial instruments carried on our Consolidated Balance Sheets at adjusted cost or contract value at June 30, 2017 and December 31, 2016 were as follows:

(Millions)	Carrying Value	Estimated Fair Value			Total
		Level 1	Level 2	Level 3	
June 30, 2017					
Assets:					
Mortgage loans	\$ 1,569	\$—		—\$1,613	\$1,613
Bank loans	8	—	7		7
Equity securities <sup>(1)</sup>	45	N/A	N/A	N/A	N/A
Liabilities:					
Investment contract liabilities:					
With a fixed maturity	8	—	8		8
Without a fixed maturity	383	—	371		371
Long-term debt	9,172	—	—	—9,926	9,926

(Millions)	December 31, 2016				
Assets:					
Mortgage loans	\$1,511	\$—		—\$1,540	\$1,540
Bank loans	8	—	—	8	8
Equity securities <sup>(1)</sup>	35	N/A	N/A	N/A	N/A
Liabilities:					
Investment contract liabilities:					
With a fixed maturity	8	—	—	8	8
Without a fixed maturity	378	—	—	364	364
Long-term debt	20,661	—	21,468	—	21,468

(1) It was not practical to estimate the fair value of these cost-method investments as it represents shares of unlisted companies.

#### Separate Accounts Measured at Fair Value in our Balance Sheets

Separate Accounts assets in our Large Case Pensions segment represent funds maintained to meet specific objectives of contract holders. Since contract holders bear the investment risk of these assets, a corresponding Separate Accounts liability has been established equal to the assets. These assets and liabilities are carried at fair value. Net investment income and capital gains and losses accrue directly to such contract holders. The assets of each account are legally segregated and are not subject to claims arising from our other businesses. Deposits, withdrawals, net investment income and realized and unrealized capital gains and losses on Separate Accounts assets are not reflected in our Consolidated Statements of Income, Shareholders' Equity or Cash Flows.

Separate Accounts assets include debt and equity securities and derivative instruments. The valuation methodologies used for these assets are similar to the methodologies described above in this Note 5. Separate Accounts assets also include investments in common/collective trusts that are carried at fair value. Common/collective trusts invest in other investment funds otherwise known as the underlying funds. The Separate Accounts' interests in the common/collective trust funds are based on the fair values of the investments of the underlying funds and therefore are classified in Level 2. The assets in the underlying funds primarily consist of equity securities. Investments in common/collective trust funds are valued at their respective net asset value per share/unit on the valuation date.



Separate Accounts financial assets at June 30, 2017 and December 31, 2016 were as follows:

(Millions)	June 30, 2017				December 31, 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Debt securities	\$952	\$2,563	\$ 2	\$3,517	\$766	\$2,378	\$ —	—\$3,144
Equity securities	—	6	—	6	166	6	—	172
Common/collective trusts	—	439	—	439	—	582	—	582
Total <sup>(1)</sup>	\$952	\$3,008	\$ 2	\$3,962	\$932	\$2,966	\$ —	—\$3,898

<sup>(1)</sup> Excludes \$246 million and \$93 million of cash and cash equivalents and other receivables at June 30, 2017 and December 31, 2016, respectively.

During the three and six months ended June 30, 2017 and 2016, we had an immaterial amount of Level 3 Separate Accounts financial assets.

#### Offsetting Financial Assets and Liabilities

Certain financial assets and liabilities are offset in our Consolidated Balance Sheets or are subject to master netting arrangements or similar agreements with the applicable counterparty. Financial assets, including derivative assets, subject to offsetting and enforceable master netting arrangements at June 30, 2017 and December 31, 2016 were as follows:

(Millions)	Gross Amounts of Recognized Assets <sup>(1)</sup>	Gross Amounts Not Offset in the Balance Sheets		Cash Collateral Received	Net Amount
		Financial Instruments			
June 30, 2017					
Derivatives	\$ —	\$ 14	\$ —	\$ —	\$ 14
Total	\$ —	\$ 14	\$ —	\$ —	\$ 14
December 31, 2016					
Derivatives	\$ —	\$ 17	\$ —	\$ —	\$ 17
Total	\$ —	\$ 17	\$ —	\$ —	\$ 17

<sup>(1)</sup> There were no amounts offset in our Consolidated Balance Sheets at June 30, 2017 or December 31, 2016.

There were no financial liabilities, including derivative liabilities, subject to offsetting and enforceable master netting arrangements at June 30, 2017 or December 31, 2016.

#### 6. Premiums and Fees Receivable

The State of Illinois has experienced budget difficulties which have contributed to the state being delinquent in paying certain of our premiums and fees. At June 30, 2017, the total amount due to Aetna was approximately \$750 million. In July 2017, the State of Illinois passed a budget. Given the state's progress towards obtaining funding, a federal judge's ruling that prioritizes Medicaid payments and the federal government's match of a percentage of payments made by the state to managed care organizations under the state's Medicaid program, we continue to believe the amounts due to us are collectible.



## 7. Health Care and Other Insurance Liabilities

Our insurance liabilities in this Note 7 were disaggregated by reportable segment. Health care costs payable relate to our Health Care segment, and unpaid claims relates to our Group Insurance segment.

## Health Care Costs Payable

The following table shows the components of the change in health care costs payable during the six months ended June 30, 2017 and 2016:

(Millions)	Six Months Ended June 30,	
	2017	2016
Health care costs payable, beginning of the period	\$6,558	\$6,306
Less: Reinsurance recoverables	5	4
Health care costs payable, beginning of the period, net	6,553	6,302
Add: Components of incurred health care costs		
Current year	22,123	22,725
Prior years	(750 )	(709 )
Total incurred health care costs <sup>(1)</sup>	21,373	22,016
Less: Claims paid		
Current year	16,580	16,601
Prior years	5,224	4,841
Total claims paid	21,804	21,442
Health care costs payable, end of period, net	6,122	6,876
Add: Premium deficiency reserve	120	64
Add: Reinsurance recoverables	4	3
Health care costs payable, end of period	\$6,246	\$6,943

Total incurred health care costs exclude from the table above \$120 million and \$64 million, respectively, related to <sup>(1)</sup> the premium deficiency reserve recorded during the six months ended June 30, 2017 and 2016 for the 2017 and 2016 coverage years on our individual Commercial products.

Our estimates of prior years' health care costs payable decreased by \$750 million and \$709 million in the six months ended June 30, 2017 and 2016, respectively, resulting from claims settled for amounts less than originally estimated (i.e., the amount of claims incurred was lower than we originally estimated), primarily due to lower health care cost trends as well as the actual claim submission time being faster than we originally assumed (i.e., our completion factors were higher than we originally assumed) in establishing our health care costs payable in the prior year. This development does not directly correspond to an increase in our current year operating results as these reductions were offset by estimated current period health care costs when we established our estimate of the current year health care costs payable.

At June 30, 2017, total Health Care liabilities for (i) services rendered to our medical members but not yet reported to us and (ii) medical claims reported to us but not yet paid (collectively, "IBNR") plus expected development on reported claims totaled approximately \$5.3 billion. Substantially all of the total Health Care IBNR liabilities plus expected development on reported claims at June 30, 2017 related to the current year.



## Long-Term Disability Unpaid Claims

The following table shows the components of the change in unpaid long-term disability claims during the six months ended June 30, 2017 and 2016:

(Millions)	Six Months Ended June 30,	
	2017	2016
Long-term disability unpaid claims beginning of the period	\$1,904	\$1,819
Less: Reinsurance recoverables	26	27
Long-term disability unpaid claims, beginning of the period, net	1,878	1,792
Add: Components of incurred claims		
Current year	265	267
Prior years	8	12
Total incurred claims	273	279
Less: Claims paid		
Current year	5	5
Prior years	265	231
Total claims paid	270	236