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CI - Q2 2016 Cigna Corp Earnings Call

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OVERVIEW:

Co. reported 2Q16 consolidated revenue of $10b and adjusted income from operations of $515m or $1.98 per share. Expects 2016 consolidated YoverY revenue to grow mid-single-digit and consolidated adjusted EPS to be $7.75-8.10.

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CORPORATE PARTICIPANTS

Will McDowell *Cigna Corporation - VP, IR*

David Cordani *Cigna Corporation - President & CEO*

Tom McCarthy *Cigna Corporation - EVP & CFO*

CONFERENCE CALL PARTICIPANTS

Matthew Borsch *Goldman Sachs - Analyst*

Justin Lake *Wolfe Research - Analyst*

Josh Raskin *Barclays Capital - Analyst*

A.J. Rice *UBS - Analyst*

Gary Taylor *JPMorgan Chase - Analyst*

Kevin Fischbeck *Bank of America Merrill Lynch - Analyst*

Ralph Giacobbe *Citigroup - Analyst*

Andy Schenker *Morgan Stanley - Analyst*

Christine Arnold *Cowen and Company - Analyst*

Scott Fidel *Credit Suisse - Analyst*

Chris Rigg *Susquehanna Financial Group - Analyst*

Ana Gupte *Leerink Partners - Analyst*

Peter Costa *Wells Fargo Securities - Analyst*

Tom Carroll *Stifel Nicolaus - Analyst*

Sarah James *Wedbush Securities - Analyst*

Dave Windley *Jefferies & Co. - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by for Cigna's second-quarter 2016 results review. (Operator Instructions). As a reminder, ladies and gentlemen, this conference, including the question-and-answer session, is being recorded. We will begin by turning the conference over to Mr. Will McDowell. Please go ahead, Mr. McDowell.

Will McDowell - *Cigna Corporation - VP, IR*

Good morning everyone and thank you for joining today's call. I am Will McDowell, Vice President of Investor Relations. Joining me this morning are David Cordani, our President and Chief Executive Officer and Tom McCarthy, Cigna's Chief Financial Officer.

In our remarks today, David and Tom will cover a number of topics, including Cigna's second-quarter 2016 financial results as well as an update on our financial outlook for 2016. As noted in our earnings release, when describing our financial results, Cigna uses certain financial measures which are not determined in accordance with accounting principles generally accepted in the United States, otherwise known as GAAP.

Specifically, we use the terms labeled adjusted income from operations and earnings per share on this same basis as our principal measures of financial performance. A reconciliation of these measures to the most directly comparable GAAP measure is contained in today's earnings release which is posted in the Investor Relations section of Cigna.com.

In our remarks today, we will be making some forward-looking statements, including statements regarding our outlook for 2016 and future performance. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our current expectations. A description of these risks and uncertainties is contained in the cautionary note to today's earnings release and in our most recent reports filed with the SEC.

Before turning the call over to David, I will cover a few items pertaining to our financial results and disclosures. In the second quarter, we recorded an after-tax charge of $26 million, or $0.10 per share, for merger-related transaction costs and we reported this charge as a special item. As described in today's earnings release, special items are excluded from adjusted income from operations in our discussion of second-quarter 2016 results.

Also, consistent with past practices, when we make any prospective comments on earnings or EPS outlook, we will do so on a basis that excludes the impact of any future capital deployment or additional prior year development of medical costs. And with that, I will turn the call over to David.

David Cordani - *Cigna Corporation - President & CEO*

Thanks Will. Good morning everyone and thank you for joining us. It's been over a year since we've held a formal earnings call due to our pending combination and clearly much has happened. We wanted to take the opportunity to connect directly with you first to reaffirm our goals and how we are delivering on our strategy; second, to provide an update around this quarter's results and the actions we are taking to remedy the specific performance headwind that has caused us to miss our expectations; and third, to provide some perspective regarding the actions from the U.S. Department of Justice to block our proposed combination with Anthem.

After I share my remarks, Tom will briefly highlight our second-quarter financial results and updated outlook in more detail and we will take your questions. After that, I will leave you with a few closing thoughts following the Q&A portion of the call.

I'd like to begin by underscoring that over the past year our goals have been clear -- first and foremost to continue to effectively run and operate our businesses with a focus on our customers and clients and on delivering long-term value for you, our shareholders; second, to support and guide the proposed transaction through the regulatory process as Anthem leads that process and we support it; and third, to keep the Company well-positioned with optionality in a variety of scenarios given the uncertainty around the regulatory approval process.

We are delivering on our strategy. We have maintained focus and continue to grow and invest in our businesses while delivering differentiated value for our customers and clients and, until this quarter, deliver on our shareholder commitments.

While our results underperformed expectations in the second quarter, to be clear, our diversified businesses remain grounded in solid fundamentals and we continue to innovate and deliver a notable array of capabilities that are truly differentiated. Our relationships with employers, providers and partners continue to strengthen. We continue to add new customer relationships in addition to maintaining high retention levels for existing customers and clients.

We are maintaining a strong pipeline for future growth in all of our businesses and we continue to generate and warehouse historic levels of deployable capital and balance sheet capacity.

While this is our immediate backdrop, it is important to remember our long-term strategic goal of 10% to 13% compounded annual growth on average for earnings per share and, over the last six years, we have delivered 13%, which is at the high end of that range.

I will now turn to our results in the second quarter. Our Global Health Care and Global Supplemental Benefits businesses delivered strong 2016 second-quarter financial results for our portfolio, which were tempered by disappointing performance in our Group Disability and Life segment.

Our second-quarter 2016 consolidated revenue increased 5% to $10 billion over the second quarter of 2015. We reported adjusted income from operations for the second quarter of $515 million or $1.98 per share. Our revenue growth is fully aligned with our expectations; however, the earnings were pressured by temporary impacts on our Group Disability and Life segment.

Given that as a backdrop, let's discuss our Group operations, specifically performance, issues and actions. The quarterly results were significantly below our expectations in both Disability and Life businesses. The poor performance in Disability is a result of modifications made to the disability claim process coming into the first quarter this year where we are investing additional resources in the upfront medical review of claims to conduct further physical examinations, perform deeper medical history reviews and enhance documentation.

These modifications have resulted in longer claim cycles thereby increasing the disability durations and our claim inventory, which has contributed significantly to the unfavorable financial impact we have experienced in the first half of 2016 for this business. We are currently making the investments necessary to strengthen the operational processes in a manner that will provide an improved customer experience as we lower claim volatility and further improve the quality of decisions all at a lower operating cost.

While we have yet to realize the long-term benefits associated with these changes, it is important to recognize that they are both customer-friendly and aligned with regulatory best practices. As a result, our disability operating results are expected to improve over the balance of 2016 and into 2017 as these changes take hold. And Cigna's differentiated disability model with a unique focus on productivity and health continues to deliver value for our customers and clients as evidenced by our sustained growth and stable performance up to this point.

Now to round out Group Insurance and to add to the disability pressure in the second quarter, our Group Disability and Life earnings were significantly impacted by unfavorable life claims. While claims emerged unfavorably early in the quarter, claims in the last month of the quarter were more in line with our expectations. It is important to note for context we have had periods of life claim volatility in the past and expect life claims to run closer to historical levels over the balance of the year due in part by the rapid reversion of the short-term spike in claims to historical levels and some reserve strengthening and pricing actions that we are taking.

We understand the results in this business did not meet your expectations and to be clear, they did not meet ours. We are taking actions to ensure they will improve and they present an earnings trajectory opportunity for us as we look to the future.

Additionally and importantly, our client and customer performance has been strong despite the financial impact of these challenges in the second quarter. Overall, our Group Disability and Life business remains an important part of our portfolio.

As for the rest of our portfolio, we continue to post strength in our employer health care book and our Global Supplemental business. While our U.S. individual business has experienced softness similar to the rest of the industry, overall, our commercial book of business is performing well.

Additionally, our U.S. Medicare book continues to perform in line with our expectations recognizing we did incur increased temporary costs associated with our CMS audit issue.

Now turning briefly to our pending combination, as you've recently seen, the United States Department of Justice has sued to block the proposed combination with Anthem. Given the nature of the concerns raised by the DOJ and the overall status of the regulatory process, which, under the merger agreement, is led by Anthem, we stepped back briefly to evaluate our options, consistent with our obligations under the merger agreement.

As part of this evaluation, we obviously sought to deeply understand the various and significant concerns of the DOJ and the states that have joined on, as well as the path to possibly address their broad and specific concerns.

So to be clear, we have and will continue to fulfill our contractual obligations. If there is a successful combination to be completed, it is clearly our intent and commitment to continue to provide the support as we have, dedicating significant resources, time and effort to do so. If there is not a combination to be completed, we will seek to improve shareholder value by accelerating growth in our core strong performing businesses, improve the results of our underperforming businesses, seek to pursue additional growth opportunities and finally, seek to further create shareholder value with the tremendous capital flexibility we have created over the last several years.

Reflecting on all these challenges and the criticality of the work we do, which impacts more than 90 million customer relationships around the world, I'd also like to take a moment to thank the Cigna team and recognize their steadfast passion, resilience and focus on our customers and clients during the past year.

Now to summarize. Cigna's performance this quarter includes solid revenue and earnings contributions from our Global Health Care and Global Supplemental Benefits business and performance from our Group Disability and Life segment that did not meet our expectations. We believe these results will improve meaningfully over the remaining 2016 and 2017 timeframe.

Our highly engaged, passionate and extremely resilient team will continue to create value for our customers and clients by leveraging the strengths of our diversified businesses and our differentiated capabilities. We remain committed to our long-term objective to continue to deliver competitively attractive long-term EPS growth of 10% to 13% annually on average, all while continuing to invest in our Company's business portfolio. And with that, I will turn the call over to Tom.

Tom McCarthy - *Cigna Corporation - EVP & CFO*

Thanks David. Good morning everyone. In my remarks today, I will briefly review key aspects of Cigna's second-quarter 2016 results and discuss our outlook for the full year. Overall, key highlights in the quarter are: consolidated revenue growth of 5% to $10 billion; consolidated earnings of $515 million; quarterly earnings per share of $1.98; and continued strong capital efficiency and free cash flow in line with our full-year expectations.

Regarding the segments, I will first comment on our Global Health Care segment. Second-quarter premiums and fees grew to $6.9 billion. Second-quarter earnings were $486 million reflecting medical and specialty business growth and continued favorable medical costs and quality outcomes, particularly in our commercial employer group business. These drivers were partially offset by higher medical costs in our Individual business and increased costs related to our Medicare Advantage CMS audit response.

Turning to our Global Supplemental Benefits business, on a currency-adjusted basis, premiums and fees grew 12% and earnings grew 15% quarter-over-quarter to $83 million. This was another strong quarter for our Global Supplemental Benefits business.

Group Disability and Life reported a second-quarter loss of $12 million. Results in the second quarter reflect the continued impact of modifications to our disability claims process and poor experience in Group Life claims. While second-quarter results in our Disability business were better than results in the first quarter, the improvement was less than we had expected.

Results in the Group Life business were also below expectations. We experienced elevated claims early in the quarter while life claims were more in line with expectations later in the quarter. This quarter's results also included a $17 million after-tax unfavorable impact from a reserve study on our Life business, and for comparative purposes, the second quarter of 2015 results included a $37 million after-tax favorable impact from a reserve study on our Group Disability business, resulting in a $54 million after-tax unfavorable variance from reserve studies quarter-over-quarter.

Over the balance of the year, we expect life claims experience to run closer to historical levels and we continue to expect disability results to improve, though at a slower pace than previously expected, as the process modifications implemented in the first quarter take time to mature and long-term benefits begin to emerge.

Overall, our second-quarter results reflect solid revenue and earnings contributions from our Global Health Care and Global Supplemental Benefits businesses and continuing pressure in the Group Disability and Life results. We also continue to generate strong free cash flow from our businesses and have significant financial flexibility.

Now I will discuss our outlook for 2016. We continue to expect consolidated revenues to grow in the mid-single digit range over 2015 results. Our outlook for full-year 2016 consolidated adjusted income from operations is now in the range of approximately $2.02 billion to $2.11 billion or $7.75 to $8.10 per share. This represents a reduction of $1.23 per share at the midpoint from previous expectations and is driven by an approximate $0.30 per share reduction due to higher than previously anticipated costs associated with our CMS audit response and higher medical costs in our Individual business and an approximate $0.90 per share reduction due to higher claim costs in our Group Disability and Life business.

To provide greater transparency within our outlook, we are introducing segment level guidance for full-year 2016. We expect full-year Global Health Care earnings in the range of approximately $1.9 billion to $1.93 billion. Key assumptions reflected in our Global Health Care earnings outlook for 2016 include the following:

Regarding global medical customers, we continue to expect 2016 customer growth in the low single digit percentage range.

Turning to medical costs, our 2016 outlook continues to assume some increase in medical utilization, which has been reflected in our pricing. For our total U.S. commercial business, we expect full-year medical cost trend to be in the range of 4.5% to 5.5%. We continue to deliver medical costs that reflect better health outcomes and strong clinical excellence for our customers and clients as a result of our deep collaborative relationships with physicians and our focus on personalization of care.

Now turning to our medical care ratio outlook, for our total commercial book of business, we expect a 2016 medical care ratio to be in the range of 78.5% to 79.5%. The MCR outlook reflects continued strong performance in our commercial employer business and some continued pressure in Individual medical costs. For our total Government book of business, we expect the 2016 medical care ratio to be in the range of 84% to 85% reflecting the continued benefits of our physician engagement model within our seniors business.

Regarding operating expenses, we expect our 2016 Global Health Care operating expense ratio to be in the range of 21% to 22%, which includes the impact of spending on our CMS audit response.

For our Global Supplemental Benefits business, we continue to expect strong top-line growth on a currency-adjusted basis and earnings in the range of $255 million to $275 million.

Regarding the Group Disability and Life business, we now expect full-year earnings in 2016 in the range of $40 million to $80 million. Group Disability and Life earnings are well below our previous expectations and reflect results to date and continuing pressure over the balance of the year.

Regarding our remaining operations, that is Other Operations and Corporate, we expect a loss of $175 million for 2016.

So all in for full-year 2016, we now expect consolidated adjusted income from operations of $2.02 billion to $2.11 billion or $7.75 to $8.10 per share. I would also highlight that we expect earnings and EPS between the third and fourth quarter to be more evenly distributed than historical patterns, and I would also remind you that our outlook continues to exclude the impact of additional prior-year reserve development or any future capital deployment.

Regarding free cash flow, year-to-date, we have repurchased 785,000 shares of common stock for approximately $110 million. We ended the quarter with parent company cash of approximately $2 billion. After considering all sources and uses of parent company cash, we expect to have approximately $2.75 billion in parent cash available during the balance of the year, including $250 million held for liquidity purposes. Our balance sheet and free cash flow outlook are strong and remain in line with our expectations.

Now to recap, the fundamentals of our Global Health Care and Global Supplemental Benefits businesses remain strong. We are also taking the appropriate steps to address the challenges we are facing in Group Disability and Life. We are confident in our ability to achieve our revised full-year 2016 earnings outlook, and with that, we will turn it over to the operator for the Q&A portion of the call.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Matthew Borsch, Goldman Sachs.

Matthew Borsch - *Goldman Sachs - Analyst*

Thank you for your decision to hold the call. I think it makes sense in light of where we are and also the volatility in results. Would you mind just stepping into a little more detail on Group Disability and Life and help us understand the $0.90 lower outlook, how much of that is life? And I gather on the life side, that's just pure variability. There really isn't any causation that you can point to there, nor any reason why we should expect that to repeat.

And on the disability side, how much of it is because you put in this new systems process that you missed some of the claims expense from earlier periods, or maybe I am misunderstanding what it is?

David Cordani - *Cigna Corporation - President & CEO*

Let me try to paint the picture on your various questions for both the disability and life pieces. First, just to frame. Our Group insurance business has been a strong and consistent performer. We recognize we are having an out-of-pattern year. We understand that and as I noted in my prepared remarks, we are taking specific steps to improve that. Let me talk about disability first and then life, and I think I will put all your questions into that context.

From the disability standpoint, first, we made operating changes to our business processes. Very importantly, these are not systemic changes or changes in technology. These are business process changes, starting with the first quarter this year, with the goal of improving our customer service, driving further efficiency and effectiveness over the long term, all while complying with emerging regulatory best practices.

It's clear that the operational disruption is more significant and prolonged than we had planned for. Importantly, our customers continue to see good, strong service. However, as we noted, the financials have suffered. We are already seeing improvement in the patterns as we go through the second quarter, so we see the pattern improving and expect to continue to see that improve throughout 2016 and as we step into 2017.

These are not catchups for prior-year claims. Don't think about it that way. It's operational process changes of meaningful magnitude, we are already seeing improvements to the pattern, and we will see improvements throughout 2016 and into 2017.

Relative to the life book, your basic hypothesis is right. We have a meaningful book that over time has performed very well. Unfortunately, from time to time, our life book of business has a temporary dislocation or spike. The second quarter this year was one of those years. Order of magnitude, operating-wise in the quarter, about $45 million after tax. It's important to note that the claims did settle back, generally speaking, within historical patterns by the end of the second quarter.

Additionally, as you'd expect, we conducted a variety of detailed analyses to see if there were any other unique causes to the pattern we saw spike and we found none. Also, as we noted, we completed a reserve study in the second quarter. That resulted in a reserve strengthening of about $17 million after tax. So when you think about life taken together from an operating standpoint and from the reserve standpoint altogether, a little more than $60 million after tax.

So net-net, clearly not happy with the results. We clearly believe they are temporary. Life will recover more quickly for the reasons you stated and disability will continue to recover throughout the remaining portion of 2016 and into 2017.

As to the latter part of your question, you can think about the current year change in the outlook as split roughly 50/50 between the two lines of business.

Matthew Borsch - *Goldman Sachs - Analyst*

Okay. Thank you for all that. Just so I understand though, as you made these process changes, did that result in a lower level of catching disability claims that should have been remediated differently, and so in seeking to improve things, it's gotten temporarily worse? Is that the right way to think about it?

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David Cordani - *Cigna Corporation - President & CEO*

Matthew, the way to think about that is, as you change the processes and, as I noted in my prepared remarks, more upfront and broader medical reviews, what you have is essentially we've triggered a temporary environment of longer claim durations and higher inventory, which we will work down throughout the residual part of this year, as I noted. And we are already starting to see improvement relative to that.

Matthew Borsch - *Goldman Sachs - Analyst*

And last question if I could on the Medicare sanctions. Any outlook there? Are you hopeful that you'll get them resolved? Are you optimistic you will get them resolved before open enrollment?

David Cordani - *Cigna Corporation - President & CEO*

Matthew, relative to the CMS audit, our team continues to work to resolve the issues and to drive the sustainable operational improvements that are necessary. As for timing, as you might frame, there's three varieties of alternatives here. We can get it remediated and validated before AEP, annual enrollment period. We could get it remediated and validated during the cycle. Or thirdly, we could get it remediated and validated after the cycle.

Our team clearly understands the importance of that, but our broader objective here is to ensure that we successfully remediate all the issues and create a sustainable environment on a go-forward basis. And we will manage the next several months to make sure we are in the right position.

Matthew Borsch - *Goldman Sachs - Analyst*

Okay. Thank you.

Operator

Justin Lake, Wolfe Research.

Justin Lake - *Wolfe Research - Analyst*

Just want to follow up first on the disability and life business. David, you talked to this segment creating an earnings trajectory opportunity going forward. So looking for some more color here. What's a reasonable expectation in terms of the trajectory back to historical margins and earnings power in this business and how does that happen? Is it simply, like you said, fixing the claims processing issue and life reverting to normal, or do we have to do some meaningful repricing here?

David Cordani - *Cigna Corporation - President & CEO*

Your former conclusion is proper. We believe that the life results will return to historical patterns and the disability results, we continue to start seeing improvement throughout the second quarter and it will continue throughout the course of the year. Long term, we believe both the growth and earnings and margin profile of the business remain intact. We have work to do to reestablish that and we will do that in the second half of this year with a positive trajectory and continue that trajectory into 2017.

Justin Lake - *Wolfe Research - Analyst*

So, David, on the margins, your margin is going to be 1% to 2% this year on a business that's historically been closer to 8%, let's call it. So can you just give us some color in terms of how should we think about that trajectory back to 8%? Can you get halfway there, 4% to 5%, next year on the way back to 7% to 8% in 2018? Do you expect to get all the way back there next year? Can you help us with some visibility there?

David Cordani - *Cigna Corporation - President & CEO*

Yes, Justin, first and foremost, just to make sure we are clear on your first part of your initial question, I want to underscore this is an operational problem in disability, not fundamentally a pricing problem for us relative to the book of business. Hence, as you bring it across to your margin question, I think the way to think about it is this arguably presents the single largest earnings step-up opportunity for us as we step from 2016 to 2017. So if you think about the headwinds/tailwinds, this is our number one tailwind.

We expect to see meaningful improvement. We are not going to give you 2017 guidance at this point in time, but a way to punctuate that is, as I noted in my prepared remarks, we expect to see the life business recover more rapidly. We expect to see the disability business continue to improve its performance throughout 2016 and into 2017. So for that, I'd ask you to think about an ongoing improvement trajectory for the disability portfolio both through the second half of this year, as well as into 2017 giving us a good run rate as we step out of 2017 into 2018.

Justin Lake - *Wolfe Research - Analyst*

Great. And then just my follow-up is on capital deployment. I think investors would love to hear anything you could share with us on Plan B if this deal doesn't go through. I know the focus is on getting the deal done, but if not, you are going to have -- with a breakup fee -- something like $4 billion of cash to deploy and an under-levered balance sheet. Can you share with us any thoughts there?

David Cordani - *Cigna Corporation - President & CEO*

Sure. So first and foremost, we have a long and clear track record of strong capital deployment and capital management, and as part of that, we understand the importance of not letting surplus capital lie idle for any length of time. Our priorities remain clear and the same -- first, supporting our business; second, strategic M&A; and third, returning excess capital to shareholders.

To your point, we fully recognize the tremendous capital -- as in free cash flow -- as well as capital through balance sheet leverage flexibility we've built over the last several years. In the event, taking your statement that the DOJ process is not successful, our view is that, as we look toward the second half and latter part of 2017, we'd have $5 billion -- a bit more than $5 billion -- of deployable cash on the balance sheet. In the current situation, it sits at about 27% leverage. Our view is that normal course of business, we could add 10 points to that leverage. For strategic M&A, you could add 15 points to that leverage.

So taken together, a truly tremendous value creation opportunity for shareholders in the event the DOJ process is not successful. We fully understand that and would expect to responsibly deploy that.

Justin Lake - *Wolfe Research - Analyst*

Great. Thanks for the color.

Operator

Josh Raskin, Barclays.

Josh Raskin - *Barclays Capital - Analyst*

I guess I'm just a little confused as to why this is all so temporary? It sounded like last quarter -- maybe let's start with disability and life -- it sounded like that was considered a timing issue. It sounds like it's gotten materially worse. And so I guess I'm just confused as to why a process change would increase your actual incidence, or is it not incidence, it's just the inability to manage down these claims quickly? And I guess I'm just curious why that disappears so fast. And then on the life business, it doesn't sound like we know the driver of the spike, so I'm curious why you are confident it will get better.

David Cordani - *Cigna Corporation - President & CEO*

Very fair. So let's take it in reverse order. Let's take life first. If you look at the life industry, players in the life industry, unfortunately it's the nature of the book of business, will experience short-term temporary spikes or dislocations in cost. It transpires. Ideally, we'd like that not to happen because we want a consistent, predictable environment.

So to add to your point, as we noted, that spike took place in the early portion of the second quarter and, as I noted in my prepared remarks and my comments, we saw a reversion of the life pattern within historical ranges toward the latter part of the quarter.

Secondly, we did significant analysis to try to determine whether or not there were any unique drivers of that as you'd expect, and we didn't find any. And thirdly, there was a reserve study, which, while it triggered a $17 million after-tax strengthening, a way of looking at it otherwise, it only triggered a $17 million after-tax strengthening.

Specific to disability, you are right. We flagged this last quarter. There are operating changes that we've put in place, as we noted. The results stepped down meaningfully in the first quarter. As I noted in my prepared remarks, we've already seen progress in the second quarter relative to the improvement, albeit at a slower pace than we would like or projected. And we expect to continue to see that progress going forward and that offsets ultimately the longer claim durations and the incurrence rates that we are incurring currently, as well as the elevated claim inventory.

So important to note, we are seeing improvement in the disability results through the second quarter and expect that pattern to continue throughout the remaining portion of this year and into 2017.

Josh Raskin - *Barclays Capital - Analyst*

David, did you say it's a 50/50 split on the $0.90 reduction to guidance between life and disability?

David Cordani - *Cigna Corporation - President & CEO*

Yes, let me try to -- I did say that, but I was looking at where we are intra-year versus a full year. When you look at the full-year pattern, I think it's a little safer to look at that as a two-third/one-third because of the recovery pattern of life being more rapid versus the disability pattern. What we have intra-quarter is a good $60 million delta intra-quarter, but you have the two-thirds on the disability side and the one-third on the life over the course of the full year.

Josh Raskin - *Barclays Capital - Analyst*

Okay. That makes more sense. And then follow up just on the healthcare business. Could you parse out -- I guess, one, I'm a little surprised on the CMS cost. You guys knew about those sanctions before last quarter was announced, so is the process more onerous? Is it going to take a little bit longer? What's causing the CMS sanction response cost to be higher? And then how big is your Individual book and maybe what's the size of the -- how much of the $0.30 is Individual versus CMS?

David Cordani - *Cigna Corporation - President & CEO*

I will start on the CMS piece and I will frame a little bit of the Individual and then ask Tom to enhance that piece. First and foremost, relative to our MA book of business, the fundamentals of the MA book of business continue to perform well. Very important, and we are pleased with the performance, both the service performance, as well as the overall earnings performance of the book.

You are correct; our cost of remediation has grown. We are seeking to ensure that the remediation is both completed as rapidly as possible, but also as comprehensively as possible. And as unfortunately is the case when you are doing a variety of complex bodies of work, sometimes they are more complicated. Our number one priority though is to get this issue fully remediated and create the sustainable platform for the growth and the ongoing performance we expect for many years to come.

So ultimately what transpired is more complexity to the work necessary to build the sustainability that we want for the growth profile we see over the long term, but the operations and the day-to-day fundamentals of the earnings performance of the base book of business continues to be strong.

As it relates to the Individual book of business, I will ask Tom to talk about the financials, but as you recall, we've continued to take a very focused and disciplined view of the marketplace primarily because we viewed from day one that 2014, 2015 and 2016 would be, as we call it, version 1.0 of the marketplace - underscored by a smaller aggregate size than was initially projected. We called it a little bit of a choppy operating environment for the new marketplace, as well as we projected for the industry to have more losses than not. And in hindsight, that's demonstrating itself. So I will ask Tom to describe a little bit about the financial impact for us.

Tom McCarthy - *Cigna Corporation - EVP & CFO*

Josh, you are right, Individual is a small component of our business. Unfortunately, sometimes it has more impact than we'd like. Particularly just thinking about the MCR impact this year, quarter-over-quarter, it explains most of the variability in our commercial MCR, so it's a small business, but shows up in some metrics that we don't like. And if we think about the revised outlook for the year, I'm not going to give specifics, but let's say there's big chunks of both driving that, maybe 50-50, somewhere in that range.

Josh Raskin - *Barclays Capital - Analyst*

Okay. So the Individual -- Tom, do you have what the premium level or just a revenue number on the Individual book is? I thought you guys were somewhere around 100,000 lives or something?

Tom McCarthy - *Cigna Corporation - EVP & CFO*

A little more than that. All those details are disclosed in the stat supplement. Now if you are suggesting that, how can it have that much of an impact, if you do the math, it actually can have that much of an impact.

Josh Raskin - *Barclays Capital - Analyst*

Okay, all right. Maybe I will follow up with the math off-line. Thanks.

Operator

A.J. Rice, UBS.

A.J. Rice - *UBS - Analyst*

I know you hadn't given your medical cost trend for the Commercial before, but I think you came out and said 4.5% to 5.5%. Can you just comment on, away from the Individual business, what are you seeing there? Any buckets that are running hot or any that are particularly positive? That cost trend obviously is lower than what others are saying they are seeing.

Tom McCarthy - *Cigna Corporation - EVP & CFO*

A.J., thank you. Yes, we are really pleased with our medical trend results and we continue to build on very strong trend results we reported for several years as you pointed out with industry-leading medical cost trends. Since most of our commercial customers are in self-funded arrangements, and you recall they directly benefit from this well-managed medical trend, our outlook has remained consistent this year with a full-year trend outlook in that 4.5% to 5.5% range that we cited. And that is in line with the 5% trend we reported in 2015, so consistent results.

So, overall, we are expecting to deliver another year of competitively strong medical trends that reflects our focus on engaging customers and healthcare professionals to improve quality and affordability of care. And I really wouldn't call out any specific major changes in the underlying components.

A.J. Rice - *UBS - Analyst*

Okay. And then, just as my follow-up, appreciate the comments, David, you offered about the DOJ process and so forth, and it makes sense that they came out with a decision to challenge the deal and you wanted to evaluate your options. Am I hearing you right to assume that that evaluation process, whatever it entailed, has happened and that now Cigna's basic view is we are going to play out the litigation and the interaction with the DOJ through to its conclusion as whatever evaluation was done has concluded? Is that the way to think about it?

David Cordani - *Cigna Corporation - President & CEO*

A.J., yes and a "but." So you are absolutely correct. In my prepared remarks, I indicated we briefly stepped back. We wanted to make sure we understood the fact statements from the DOJ and the states quite well and deeply, and understand that. The "but" aspect of it means we are fully engaged and continue to be fully engaged in the process with full support of all contractual obligations as we have provided.

But to continue on that dialogue, to be clear, as we noted, Anthem has been running the regulatory process, which is consistent with the contract. Anthem independently decided to pursue the lawsuit with the DOJ. As such, we are a party of that suit. We will take the appropriate steps obviously to protect the interests of our shareholders, which includes ongoing evaluation and monitoring of all options as they unfold, but we are fully engaged in the process, as you noted. And we should think about that.

The "but" is it's a dynamic process, right? There's no static processes in life and this is not a static process, but we are fully engaged.

A.J. Rice - *UBS - Analyst*

Okay. All right. Thanks a lot.

Operator

Gary Taylor, JPMorgan.

Gary Taylor - *JPMorgan Chase - Analyst*

A few questions. First, just going back to the Disability segment. On Disability itself, how much of the quarterly or annual premiums are short-term versus long-term disability, ballpark?

Tom McCarthy - *Cigna Corporation - EVP & CFO*

I will follow up with that. Much of our short-term disability business is ASO-oriented, but we will follow up with the exact split.

Gary Taylor - *JPMorgan Chase - Analyst*

Okay. And you talked about an improvement in the segment, particularly in the life in the near term and obviously the implied guidance for the second-half year in the segment is much better than the first half and you talked about improvement into 2017. Is it fair to say that if we take I believe the implied guidance for disability and life for the second half of the year as $37 million to $77 million -- if we annualized that, is it fair to say that would be the low end of what 2017 should be given that you think there's an improving trajectory?

David Cordani - *Cigna Corporation - President & CEO*

It's David. Again, we are not providing 2017 guidance. We have expectations for ourselves to dramatically improve the results as we step into 2017. We think we have the opportunity obviously to see the life results revert to historical patterns more rapidly and the disability pattern will continue to improve over time.

I don't want to validate your numbers again because we are not providing 2017 guidance, but as I mentioned to Justin, this represents the largest contributor or largest tailwind as we step from 2016 to 2017. And we will hold ourselves to the higher expectation to achieve those numbers or better.

Gary Taylor - *JPMorgan Chase - Analyst*

Two more quick ones if I could. Could we just go back to, you keep saying this disability issue is an operational issue driven by these medical claims reviews. Are you saying that you are doing more detailed, longer duration reviews and it's causing you to pay out more days of disability than you believe you will be on these claims in the future?

David Cordani - *Cigna Corporation - President & CEO*

Gary, at a macro level the picture you carry is, I think, directionally correct. Just stepping back and adding to that, so more resources, clinical resources, specialists and otherwise, added to the front end of the processes to enable more comprehensive reviews than even was being done before, which over the long-term further enhances our customer experience, further enhances the efficiency of the overall process and is aligned with emerging regulatory best practices for the space.

Over the immediate term, the disruption is some of the effects that you made reference to. And we are rapidly working to improve those results day in, week in, month in, month out.

Gary Taylor - *JPMorgan Chase - Analyst*

So these are self-inflicted delays, basically, you are trying to fix.

David Cordani - *Cigna Corporation - President & CEO*

That is absolutely correct.

Gary Taylor - *JPMorgan Chase - Analyst*

And last question. I think in response to Justin, you talked about taking leverage potentially into the mid-30s if the Anthem deal doesn't move forward on possibly other strategic M&A, or just conceptually willing to do that. What about for share repurchase? How much would we be willing to move debt-to-cap for accelerated share repurchase, or is the same ballpark in the scope of possibilities?

Tom McCarthy - *Cigna Corporation - EVP & CFO*

Gary, we don't parse in terms of which of the deployment components we would prioritize moving leverage up or down for, other than as I noted in the prior comments, strategic M&A enables you from our point of view to temporarily expand leverage yet even further. I think to your broader point and to reiterate, we recognize that if there is an unsuccessful DOJ process as you go into the latter part of 2017, we would have order of magnitude $5 billion or $5 billion plus of deployable cash. A current environment of a leverage situation of approximately 27%, and the ability to add at least 10 points of that in the various scenarios we identified.

And share repurchase would be a part of the calculus we would be looking to. Net-net under a variety of scenarios, the opportunity to create significant shareholder value off of both the cash on hand and leverage capabilities.

Gary Taylor - *JPMorgan Chase - Analyst*

Okay. Thank you very much.

Operator

Kevin Fischbeck, Bank of America.

Kevin Fischbeck - *Bank of America Merrill Lynch - Analyst*

Just wanted to clarify a question earlier when you were saying the breakout in Group and Life being one-third, two-thirds for the year. That's on the $0.90 you are saying, basically, that $0.30 is life and $0.60 is disability. Is that what you were saying?

David Cordani - *Cigna Corporation - President & CEO*

Correct.

Kevin Fischbeck - *Bank of America Merrill Lynch - Analyst*

Okay. And then I guess just wondering if you've seen -- obviously you've had the deal out there for a year now. Wondering if you've seen any impact to the core business at all from the customer perspective, either on retention or as you go out to bid? Is this creating an overhang as far as your ability to retain or to win new business?

David Cordani - *Cigna Corporation - President & CEO*

So broadly speaking, our team has done an outstanding job of ensuring we first and foremost are delivering on our promises to our existing customers, which is job one. Hence, our client and customer retention levels have been very strong and we are pleased and proud about that.

Second, we expected as we announced this deal that given the long regulatory time frame, we anticipated that over that time frame as it continued to extend, it may cause a bit lower traction on new-new business. And I say new-new on purpose because in between that is new business off of existing relationships. So point one is our retention has been strong and outstanding due to great service delivery by the franchise, and high attention and support from our customers and clients, and we obviously work very hard for that every day.

Two, we have been able to successfully expand relationships throughout our various lines of business. And three, we have been able to grow new relationships. Net-net, our covered lives are up and our portfolio penetration is up. We have seen some impact of a little lower close ratio in some situations where some clients want to wait it out, but I would say that's the smallest portion of the overall equation. When you put a bow around the whole package, we are pleased to have achieved our revenue outlook thus far for the year and that is aided by that very strong retention rate and the strong expansion of relationships.

Kevin Fischbeck - *Bank of America Merrill Lynch - Analyst*

Okay. And then just I guess on the MA side of things, I guess we've obviously seen how the MA membership has gone from an attrition perspective from quarter to quarter with the sanctions. If we assume a negative outcome, and you are not able to get this fixed by the open enrollment period, would that transition from Q4 to Q1 be a similar drop in your view? Is that the way to think about it, or would you think that would be a more disruptive time period around membership?

David Cordani - *Cigna Corporation - President & CEO*

Kevin, let me just make sure I understood your hypothesis for starters. A way to think about 2016 is we started the year with good covered life growth for MA, mid to upper single digits, and we expect that to flatten out throughout the course of the year due to the non-ongoing enrollment and disenrollment pattern that would unfold. Therefore, under your hypothesis, if we were not active in any dimensions of the annual enrollment period, obviously we wouldn't be picking up the new lives and you'd have attrition throughout the course of the year. And I would actually think about it as that -- attrition throughout the course of the year, not attrition in any one month -- obviously the annual enrollment period is an important marker that would manifest itself.

So we've seen continued attrition throughout the course of the year coming more to a flat result at the end of 2016 in terms of net life growth, and there would be arguably stated a similar pattern overall for 2017 in the event of your scenario, but we wouldn't be starting with the step-up point that we started at for 1/1/16.

Kevin Fischbeck - *Bank of America Merrill Lynch - Analyst*

The question is, if you have to go through an open enrollment period where you can't get new lives and there's going to be theoretically some shopping, I was just trying to understand how persistent you think your core business would be in that scenario over the next year. Is it just a situation that we always lose, I don't know, 5%, but you always gain 15%, so you are growing 10%? Now you would be entering an open enrollment period where you lose 5% and there's no ability to pick something up. I just wasn't sure if that Q4 to Q1 was going to be a more disruptive drop point or if that membership is just more sticky?

David Cordani - *Cigna Corporation - President & CEO*

I think first and foremost your normal pattern of assumptions is more correct. Secondly, our retention rate in this portfolio tends to be quite strong, especially when we have relationships that are onboard for over one year in our MA book of business. Those relationships become very well-established with our physician collaborative model and have a high retention rate, and we would expect to carry a very strong retention rate in, but your notion relative to not having the new business would be an offset. I wouldn't view any unique event would transpire beyond that.

Kevin Fischbeck - *Bank of America Merrill Lynch - Analyst*

Okay, great. Thanks.

Operator

Ralph Giacobbe, Citi.

Ralph Giacobbe - *Citigroup - Analyst*

Just wanted to clarify. Last quarter, in the release, it was cited that the timing of the reserve review on the disability and life would move from second to third quarter and I think I heard you say you did do the review this quarter? Is that fair, so there shouldn't be risk of further adjustment? And then a couple of times, David, you've cited emerging regulatory processes. Just hoping maybe you can provide some color on exactly what that is.

Tom McCarthy - *Cigna Corporation - EVP & CFO*

I will address the reserve study dynamics first. So what we completed this quarter was a life reserve study and that study covers impacts to claim development factors, interest rate assumptions, all the normal things you look at in life businesses. What we highlighted last quarter was that we were deferring a disability claims study to later in the year given the changes in the disability claims process and in fact, we haven't completed that study yet. We still are completing it -- expecting to complete it in the last half of the year. And of course, we won't know the results of that study until it's completed, but I would just observe to maybe get to the heart of your question, that given the current environment, any significant impact from that study one way or the other seems unlikely.

David Cordani - *Cigna Corporation - President & CEO*

Relative to the regulatory question, first, we have a very differentiated disability model despite the earnings issues we are confronting in 2016. Like all of our businesses, they all come under a variety of regulatory forces. Relative to the disability space, specifically, emerging best practices are pointing toward more... While we always have had upfront medical resources, for example, emerging best practices are pointing toward more upfront resources, more use of specialists, more comprehensive physical examinations upfront for a broader variety of scenarios. And those are illustrative of the types of changes we are putting in place as we see where the regulatory direction is going and we want to ensure that we continue to position this book of business as an industry leader as it relates to the disability management process and the disability productivity management process. So those are illustrative of some of the types of emerging regulatory patterns.

Ralph Giacobbe - *Citigroup - Analyst*

Okay, all right. Fair enough. And then just in terms of the financial flexibility that you cited, I think commentary last quarter in the release that it was unlikely that you'd make further repurchase above and beyond what you had done through May and I know you are not making any incremental this quarter. But that language wasn't in the release this time around. I guess I'm just wondering if you are open to -- or maybe remind us of what you can do in terms of share repurchase at this time and how we should think about capital deployment if there is a challenge that goes into next year. Thanks.

David Cordani - *Cigna Corporation - President & CEO*

Sure. Ralph, so we carry the flexibility -- you asked a broader question on capital deployment, you asked relative to share repurchase. Let me take the other dimension of it. Under the merger agreement, we have the ability to be active from an M&A standpoint. There are mutual limits going in both directions. The mutual limits point toward in aggregate over the life of the contract $600 million and a transaction cap of $200 million. So transactions up to $200 million and cumulative transactions up to $600 million. That's mutual going in both directions.

Relative to share repurchase, there are also limits in both directions. Specific to us, we have about $725 million of capacity left under those contractual obligations. At this point in time, again, with the transaction pending, we view it as less likely that there would be significant share repurchase over the immediate term horizon, but we do have the capacity to do so under the merger agreement. And as I noted, approximately $725 million of remaining capacity.

Ralph Giacobbe - *Citigroup - Analyst*

Okay. That's helpful. Thank you.

Operator

(Operator Instructions). Andy Schenker, Morgan Stanley.

Andy Schenker - *Morgan Stanley - Analyst*

Just wondered if you could just help us maybe try to quantify in total the CMS audit costs incorporated in 2016 earnings, including the new assumptions you highlighted today and then just how we should be thinking about some of those costs? How much of them are one-time, just preparing for the audits versus what are really actually now ongoing costs that you needed to strengthen your MA systems to help your positioning there? And then how does that reflect at all in your bids for next year, assuming the sanctions are lifted? Thank you.

Tom McCarthy - *Cigna Corporation - EVP & CFO*

So you've got a couple dynamics going in there. First, we are spending more than we expected on CMS audit remediation costs and the total spend in the second quarter was about -- or year-to-date -- was about $30 million. Second quarter was about $30 million after tax. So that gives you an order of magnitude of the size of the total spend we are talking about.

We haven't mentioned exactly the overall outlook for the year, but, based on that spend, you can expect it's a sizable amount. Some of that probably does end up back in the run rate at least in the near term as we institute more robust processes, but much of that is one-time spend to get us through the remediation period and I don't think we'd see any significant impact on our bid related to that dynamic.

Andy Schenker - *Morgan Stanley - Analyst*

Okay. For Individual, once again always with the caveat that I understand it's a small portion of your business, but a volatile one, can you maybe talk about how you did position that book for next year? It looks like you are maybe actually entering a few new markets. So do you think total costs or profitability for Individual is actually going to possibly decline next year given new market entrants, or given any repositioning in existing markets? Could we see overall profitability for Individual actually go up next year? Thank you.

David Cordani - *Cigna Corporation - President & CEO*

So as for the results just for context, as we noted, we continue to experience losses with an elevated impact in certain markets. It's important to note, we have seen the performance of what we look at as our newest offerings as being markedly better than the traditional offerings that we had placed in the market and many have in the market. So those newer offerings are aided or driven by very focused and aligned collaborative delivery system models and those are performing better.

As it relates to 2017, you are right. First and foremost, at this point, we plan for and expect to continue to participate. We've taken a posture to position ourselves in a limited number of new markets where we have the ability to put in place those aligned collaborative delivery system models. But also relative to the disruption we are seeing from a results standpoint, we continue to have active engagement and dialogue with both CMS and state agencies to ensure that we are mutually enabled to be focused on those areas and programs where we can address the sustained value, which really are pivoting off those collaborative delivery system models. We would expect to improve our performance year-over-year, but this is a volatile marketplace, which is why we've kept it as a relatively speaking small portion of our portfolio.

Andy Schenker - *Morgan Stanley - Analyst*

Okay. Thank you.

Operator

Christine Arnold, Cowen.

Christine Arnold - *Cowen and Company - Analyst*

I'm still confused on the disability situation. I'm just not a disability expert. I would think that if you are doing more upfront examinations and medical specialist intervention, you'd find people who really aren't qualified for the disability benefit, maybe the fakers and the frauds, so I don't understand how the upfront medical management improvement is actually resulting in an increase in disability claims.

David Cordani - *Cigna Corporation - President & CEO*

So, as I indicated, as we put these process changes in place, to be clear, and obviously we expect the net result of it to be an improved outcome off of a book of business that has generally and consistently delivered industry-leading productivity and financial performance in part for some of the hypothesis you make reference to make sure we are more pinpointed, even more sharply pinpointed in terms of the disability events.

The result though of changing the processes, the staffing, the workflows, etc., has resulted in the temporary disruption, not one that we like and that is more prolonged than we had planned for, but the outcome and result will be an improved customer experience and improved overall efficiency and effectiveness and that's what your comments point toward, so we are fully aligned with that.

Christine Arnold - *Cowen and Company - Analyst*

So the fact that we have all these specialists reviewing means that for those that are legitimate they are on disability longer because we are spending more time with them, but I don't see how that reverses.

David Cordani - *Cigna Corporation - President & CEO*

Christine, a different way of thinking about it is, if you think about a multi-location significant workflow change, staffing model change, operating protocol change, what's transpiring is, in your question, your base hypothesis of where the endgame and destination is right. But in the interim what's happening is actually in some cases more people on disability or longer duration disability events, which are temporary until we work through and finalize the process enhancements.

And as I noted, we are already seeing improvements in those patterns in the second quarter, albeit not at the rate and pace we would like them to be and expect to continue to see that improvement pattern Q3, Q4, Q1 as we go forward.

Christine Arnold - *Cowen and Company - Analyst*

Okay. And then the government loss ratio was up year-over-year more than consensus and certainly what we expected. Is that because of the sanctions? Are we experiencing maybe a higher loss ratio because we are not getting in the healthier MA numbers? How do I think about that, what appears to be an elevated government loss ratio? Thank you.

Tom McCarthy - *Cigna Corporation - EVP & CFO*

Christine, that isn't a factor at all. So to underline the MCR, our focus on physician engagement continues to deliver exactly the results we'd expect -- quality and affordable care to Medicare Advantage customers. So the sanctions have not had an impact.

The quarter-over-quarter impact is two major factors. First, there's less favorable impact from favorable prior-year development, so we had significant favorable prior-year development last year, de minimis amount of prior-year development this year. Second, we are seeing some impact from the growth in the recent market expansions, and those markets, when we first did launch a market, tend to run at a higher MCR than our established markets, so that's somewhat shown up as a little bit of an increase in the quarter-over-quarter comparison. But underlying the results, so excluding the prior year, our Medicare Advantage business results and the MCR are very consistent with our expectations.

Christine Arnold - *Cowen and Company - Analyst*

Thank you.

Operator

Scott Fidel, Credit Suisse.

Scott Fidel - *Credit Suisse - Analyst*

I had a question just on the CMS review and the interplay in terms of M&A, and David, saw you highlighted that you have the ability under the agreement to do some acquisitions. So just interested in terms of on the Medicare side, are there restrictions on whether you can participate in doing acquisitions while you have a sanction in place, or is that a separate dynamic?

David Cordani - *Cigna Corporation - President & CEO*

We expect to see M&A opportunities as we go forward in the marketplace. So as you recall, first, broadly, one of our priorities for M&A has been and continues to be seniors and MA in a broader sense of the word. We are not aware of any impediment in any way, shape or form correlating the sanctions to our ability to be active from an M&A standpoint even in the current period.

Scott Fidel - *Credit Suisse - Analyst*

Okay. Then just a follow-up question. Just on Individual, can you give us an update, Tom, on where you are expecting the Individual margin to be for 2016 in the guidance now?

Tom McCarthy - *Cigna Corporation - EVP & CFO*

Scott, I don't think we are going to give specific details, but you can rest assured it's going to have a negative sign in front of it.

Scott Fidel - *Credit Suisse - Analyst*

Okay, all right. Thanks.

Operator

Chris Rigg, Susquehanna.

Chris Rigg - *Susquehanna Financial Group - Analyst*

Just wanted to come back to disability quickly here. Historically, you would guide by segment and I guess because of Anthem you just threw out a blanket number. Clearly, you substantially overhauled the business. Can you give us a sense for what was in the original baseline, how much earnings pressure you were expecting versus the $0.60-ish we are seeing now? Thanks. (technical difficulty)

David Cordani - *Cigna Corporation - President & CEO*

I apologize. It sounds like we temporarily had a line issue. If you don't mind starting over with your question; unfortunately, the line blanked out for a period.

Chris Rigg - *Susquehanna Financial Group - Analyst*

Okay, yes, I just asked what was in the original baseline for disability and life given you didn't provide guidance by segment. How much pressure were you expecting because of the overhaul of the disability business in the original outlook versus the $0.60-ish of additional pressure we are seeing now? Thanks.

David Cordani - *Cigna Corporation - President & CEO*

Chris, I don't think it's helpful to reconcile in detail, but a way to think about it is, and we tried to be very clear both in the press release and in our comments today, you could think about, as we step from the first-quarter results to this quarter, taking everything into consideration for the impact of the disability business and the life business, we noted a $0.90 change for the full year to our EPS outlook. And to the prior comments, we indicated you can think about that as approximately driven by two-thirds of the disability portfolio and one-third by the life portfolio.

Chris Rigg - *Susquehanna Financial Group - Analyst*

Okay. Sorry to come back to this, but were you originally expecting earnings in the disability segment to decline in 2016 relative to 2015?

David Cordani - *Cigna Corporation - President & CEO*

We had not provided a segment outlook for you, but as we stepped into the year, our expectations stepped down from start of the year through the first quarter. We knew we had operational changes and, as I noted in my prepared remarks, it is clear that the magnitude of the impact and the timeframe to remediate is longer. So we understood we were putting those processes in place. We believe we made provisions for that, but the impact is order of magnitude significant relative to that.

But I think the, A, understanding we knew we were making the process changes; B, put some provisions forward for that, but, at the end of the day, the most important part for you to think about is that $0.90 impact for the year as we sit today with the majority of that, or two-thirds of that, more specifically being driven by disability.

Chris Rigg - *Susquehanna Financial Group - Analyst*

Okay. I'll leave it there. Thank you.

Operator

Ana Gupte, Leerink Partners.

Ana Gupte - *Leerink Partners - Analyst*

So I was trying to figure out your normalized margins and your outlook for some of your segments and on the Medicare segment, I think you said that the development issue or the lack thereof is not because of the sanctions. I think you are running at fairly low single-digit margins now after a huge amount of margin compression post the HealthSpring acquisition. Might we still think of your ability to expand margins into next year, or have these sanctions and the claims audit process or anything there, CMS is asking likely to put some more pressure there, or at least leave your margins flat from where they are right now?

David Cordani - *Cigna Corporation - President & CEO*

So, first and foremost, the core MA business absent the step-up in costs for the MA sanctions activity is performing well. Two, as we look to 2017, to the core of your question, we would expect to improve margins in part driven by the runoff or absence of the sanction costs. And three, maybe broadly inferred in your question, we continue to look at this as an attractive both growth and earnings segment from the ability to both grow it and have attractive margins over time as we leverage the proven physician engagement models we have.

Ana Gupte - *Leerink Partners - Analyst*

Okay, great. Then the other segment that's really a big growth segment is your select segment with the stop loss and there was a change in the national definition originally to 100. They then backed from that. Certain states still do it, but maybe they are putting some restrictions on small groups that are trying to do ASO plus stop loss. How do you see this playing out and might you still see double-digit growth in that segment from a membership perspective on an ongoing basis?

David Cordani - *Cigna Corporation - President & CEO*

First, just to define for everybody's benefit, when we talk select segment for our Company, this is for employers with 51 to 250 employees, so the over 50 marketplace. We have focused on bringing innovative, transparent both engagement and incentive-based models and over time our results here have been tremendous not just from a growth standpoint or earnings standpoint, but from the value we deliver back to those employers and employees by having those aligned models.

As for results, we have grown again this year. Our customer base in a pattern at least on a year-to-date basis is similar to last year's pattern. And to the core of your question, we continue to see this as an attractive growth market as employers in that space continue to look more aggressively toward alternatives that again are transparent and aligned and these programs are performing well and we are excited and optimistic about the future for this business.

Ana Gupte - *Leerink Partners - Analyst*

And then finally just one follow-up on Individual, if I may. What's the pressure on continued on off-exchange? I recall you had something in the first year of Obamacare, or is this now on-exchange business so the claims experience is coming in ahead of your expectations?

David Cordani - *Cigna Corporation - President & CEO*

Well, we are seeing pressure both in the on-exchange ACA compliant and the off-exchange ACA compliant.

Ana Gupte - *Leerink Partners - Analyst*

And you expect both?

David Cordani - *Cigna Corporation - President & CEO*

Expect both? Meaning our assumption for the remaining part of the year, yes. And as we noted before, those programs that have the more advanced models with the physician-aligned collaboratives are performing better, and our expectation is to position as many markets as we are going to be in with those models into 2017.

Operator

Peter Costa, Wells Fargo Securities.

Peter Costa - *Wells Fargo Securities - Analyst*

Help me out with my math here a little bit. I think you talked about the life business having $62 million in charges in the quarter, so call that $0.24, and then disability you said $0.60 for the year. So if it's going to be improving through the year, it's at least $0.21 this quarter and then CMS you described as about a $0.12 problem. So all told a little over $0.60 in pressure this quarter. You only missed consensus by about $0.40. Was there some business that outperformed in the quarter, or did we just have the seasonal pattern wrong and so we missed your expectations by a much bigger amount? And I'm not even counting the Individual business, which would have also impacted the quarter.

David Cordani - *Cigna Corporation - President & CEO*

As we noted, our employer health care business and our Global Supplemental or Global Individual business continues to perform very well. Obviously, that performance was eclipsed by the items you made reference to. So as you are looking for offsets or the positive forces, the positive forces come out of those two large well-performing businesses with the offsets that you made reference to.

Peter Costa - *Wells Fargo Securities - Analyst*

And then that would imply that there's some further negatives going on in the back half of the year in those businesses or something unless the numbers were wrong relative to before as well.

David Cordani - *Cigna Corporation - President & CEO*

Peter, I would ask you to think about every business has seasonality patterns that are attached to them. So for example, in the employer health care business, we always have an uptick in spending in the latter part of the year to prepare for 1/1 activities and enrollment activities, etc. That's an illustration of movement of seasonal patterns in the book of business. The MLRs tend to perform differently because of the high deductibility plans, etc.

Peter Costa - *Wells Fargo Securities - Analyst*

Which theoretically was already accounted for; I understand that, but I'm trying to figure out if there's something incrementally negative in the back part of the year in those other businesses that wasn't laid out.

David Cordani - *Cigna Corporation - President & CEO*

Simple answer is no.

Peter Costa - *Wells Fargo Securities - Analyst*

Okay. And then just as part of that, if you don't mind, relative to the CMS audit, have you started to change your marketing plans at this point? If you are not yet approved, there's going to be a point where you have to start marketing and we are getting towards that. So is there any impact at this point in terms of your marketing plans for seniors?

David Cordani - *Cigna Corporation - President & CEO*

Peter, obviously, a very important point you raise. We are quite cognizant of the timing, the decision criteria, etc., and our team is poised to be able to dynamically manage that as the next 30-day window unfolds in front of us and we are prepared to make whatever trade-off decisions we need to make as our final judgment around the enrollment cycle unfolds.

Peter Costa - *Wells Fargo Securities - Analyst*

Do you believe you will have a ruling from CMS before certainly the minimum amount of time for you to still be able to market for next year as we approach (multiple speakers)?

David Cordani - *Cigna Corporation - President & CEO*

I'm not going to comment or speculate on CMS's conclusion. The most important piece is we are 100% focused on fully remediating and getting the validation as quickly as possible so we can put ourselves in a sustainable position. Obviously, we will update you as soon as we have clarity and conclusion to the final steps there.

Peter Costa - *Wells Fargo Securities - Analyst*

If you don't market, what would be the earnings impact? And that's my last question.

David Cordani - *Cigna Corporation - President & CEO*

I'm not disclosing at this point in time. As we noted, we expect as we look forward for 2017 we have margin improvement opportunities in the Medicare book of business in part driven by the removal of the remediation costs, and then we will talk further as the year unfolds relative to 2017 guidance more comprehensively.

Operator

Tom Carroll, Stifel.

Tom Carroll - *Stifel Nicolaus - Analyst*

Just a follow-up on the disability side of things. Will the changes being made take you back to your 7% or 8% margin level, or will the process hopefully improvements being done create a longer-term perhaps higher level of margins in this business than we have seen?

David Cordani - *Cigna Corporation - President & CEO*

A couple of comments, David. Broadly speaking, we've been quite pleased over an elongated period of time for both the intersection of the service and productivity service delivery we provide to clients and customers. The ongoing growth of that portfolio of businesses in very difficult economic times, low interest rates, low employment, growth rates, etc., and a tremendous margin level. Our strategic objective has been to maintain margins in line with our historic performance and continue to grow that book and that portfolio.

These investments will put us in position to continue to further improve the customer experience, as I noted before, be aligned with emerging regulatory best practices and be in position to again exceed those margins on a long-term basis.

Tom Carroll - *Stifel Nicolaus - Analyst*

Okay -- or make better the infrastructure but not necessarily move you to a different margin level it sounds like I'm hearing?

David Cordani - *Cigna Corporation - President & CEO*

I think that's a good way of thinking about it, and as we think about infrastructure, as I noted before, this is not a technology problem; it's a workflow and human capital program.

Tom Carroll - *Stifel Nicolaus - Analyst*

Right. And then just one administrative follow-up. Did you say you'd be willing to raise your debt to total cap level higher than the 10 percentage points that you mentioned for a strategic opportunity that was compelling?

David Cordani - *Cigna Corporation - President & CEO*

So to be clear, we operate at about 27% today, which is low based on historical levels, low based on our goals and objectives. We see the ability to raise that 10 points for, I will call it ordinary course of business, and illustratively 15 points for strategic M&A.

Operator

Sarah James, Wedbush Securities.

Sarah James - *Wedbush Securities - Analyst*

Can you help us understand what portion of the MA annual sell-in costs are variable? Something you could scale back on if sanctions weren't lifted in time for the normal marketing and selling season? And what's the timeline of when you have to commit to things like outside call center contracting, ad buys, print marketing materials?

David Cordani - *Cigna Corporation - President & CEO*

Broadly speaking, you should think about the vast majority of the costs and the resources for purposes of annual enrollment period as largely being variable. So if you are putting them in buckets, nothing is ever at 100%, but you should think about them as largely variable.

Two, as noted by prior callers, the timeframe is rapidly coming upon us to make final decisions relative to ramping and staging. That's both beneficial. That is not a cliff decision in terms of your cost structure, the variability allows you to dial up and dial down, and we would expect to be confronting some focused decisions over the near-term 30-plus day window and we are highly focused on that.

Sarah James - *Wedbush Securities - Analyst*

Got it. Can you remind us how you are thinking about Medicaid? Is that an attractive business in your opinion and is there a portion of that market that you are more inclined towards?

David Cordani - *Cigna Corporation - President & CEO*

Sarah, historically, we've prioritized Medicaid below certain other segments, so seniors or Medicare, expanding our global footprint, expanding our retail capabilities as examples. We have viewed that over time that the Medicaid marketplace would continue to move more toward, we will use the broad term, managed Medicaid, programs within states to focus on high risk populations where we believe we have the opportunity to create differentiated value through physician collaboratives or clinical models, etc. And we believe over time that will continue to present opportunities be it organically or inorganically. So it's a subset of the Medicaid world as it allows where we believe we could actually create differentiated value through either clinical engagement, physician engagement or both.

Operator

Dave Windley, Jefferies.

Dave Windley - *Jefferies & Co. - Analyst*

So if I read a couple comments in the press release correctly, you talk about lack of meaningful prior-year reserve development in the current quarter and you say a relatively small amount or less than last year in Medicare. Does that imply that the commercial PYD was actually negative or was it just a very small number, small positive number?

Tom McCarthy - *Cigna Corporation - EVP & CFO*

I would think about prior-year this way. So in the quarter, we had about the same level of favorable prior-year department in our commercial employer business this year as last year, but we had reductions in both Individual and Medicare and that resulted in an overall de minimis amount for the entire Company.

Dave Windley - *Jefferies & Co. - Analyst*

Okay, okay. My follow-up was going to be, as it relates to trend, and, Tom, I think you commented on this earlier, that it's consistent with where you started the year, and I don't think you really commented on individual buckets, but maybe you could comment on any bias within the range? Is the commercial part of the group part of that trend? I don't think you include Individual in trend, but how is that biased within the range, perhaps?

Tom McCarthy - *Cigna Corporation - EVP & CFO*

Actually Individual is included, but so is our broader employer business. So in the overall scheme of things, Individual is a smaller contribution to the trend result and, as I said when this came up earlier, we really don't see any significant changes in the underlying trend factors in the components.

Dave Windley - *Jefferies & Co. - Analyst*

Okay. Thank you.

Operator

Thank you, Dave. At this time, I would like to hand the call back to Mr. David Cordani for closing remarks.

David Cordani - *Cigna Corporation - President & CEO*

Thank you. So just briefly to conclude our call, I'd like to highlight some key points. Cigna's second-quarter results reflected solid revenue and earnings contributions from our Global Health Care and Global Supplemental Benefits business and a disappointing financial performance in our Group Disability and Life segment, reflective of short-term challenges that will improve.

The 40,000 outstanding members of the Cigna team around the globe work diligently every day to fulfill our mission of improving the health, well-being and sense of security of the people we serve, and we will seek to continue to effectively operate our business guided by our strategic framework to create sustained value for customers, clients and shareholders. Again, we thank you for joining our call today.

Operator

Ladies and gentlemen, this concludes Cigna's second-quarter 2016 results review. Cigna Investor Relations will be available to respond to additional questions shortly. A recording of this conference will be available for 10 business days following this call. You may access the recorded conference by dialing 1-866-421-5864 or 1-203-369-0809. No passcode is required. Thank you for participating and we will now disconnect.