Co. reported 3Q16 consolidated revenue of $9.9b and adjusted income from operations of $503m or $1.94 per share. Expects 2016 consolidated YoverY revenue to grow in mid-single-digit percentage range and consolidated adjusted EPS to be $7.80-8.05.
Will McDowell - Cigna Corporation - VP of 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 third-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 term 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, shareholders’ net income 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. Regarding our results, I note that in the third quarter, we recorded two charges to shareholders' net income, which we reported as special items. The first special item was an after-tax charge of $46 million or $0.18 per share, for merger-related transaction costs. The second special item was an after-tax charge of $25 million or $0.10 per share, related to a litigation matter.

As described in today's earnings release, special items are excluded from adjusted income from operations in our discussion of third-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. With that, I will turn the call over to David.

David Cordani - Cigna Corporation - President and CEO

Thanks, Will, and good morning, everyone. In my remarks today, I'll begin with a review of highlights from the third quarter.

I'll also discuss how our ability to anticipate and meet customer and client needs through innovation, engagement and value-based programs continues to drive our business performance. Then I'll discuss how our well-positioned businesses continue to deliver strong results for the benefit of our shareholders, and how we are driving improvements for our businesses that are currently underperforming their potential.

We are doing all this while we continue to prepare for the future by investing in capabilities that meet customers’ needs, and while we continue to support the litigation process with our proposed Anthem combination. Next, Tom will provide more detail around our third-quarter financial performance and our full-year outlook, and following your questions, I'll conclude our conversation with just a few closing remarks.

Let's begin with some highlights from the quarter. Our third-quarter 2016 consolidated revenue increased 5% to $9.9 billion over the third quarter of 2015. We reported adjusted income from operations for the third quarter of $503 million, or $1.94 per share, reflecting strong performance in our commercial healthcare and global supplemental benefits businesses, and improving results in our group disability and life segment.

Our actions continue to be guided by our proven strategy of go deep, go global, go individual, with a focus on anticipating and meeting the needs of our customers and clients through ongoing innovation, and a commitment to being a trusted partner, as well as continuing investments for future growth and capabilities, which deliver affordable, personalized solutions, and further expand our geographic reach.

Around the world, individuals are seeking access to quality healthcare and sense of security programs that are both of high quality and affordable. At the same time, employers of all sizes and across all industries and geographies increasingly recognize that healthier, more engaged and productive work forces are essential to driving their businesses forward, while they continue to seek solutions that are affordable and sustainable. Amid this backdrop, many individuals and employers are concerned that they must accept either constrained access or diminished quality or both, in order to achieve affordability of care.

At Cigna, we see it differently. We have demonstrated that quality and affordability can be achieved by designing personally-tailored access and high-quality care delivery, with engagement, alignment and support for individuals, and healthcare professionals. We deliver this through personalized and localized benefits, as well as services for our customers, which empower and support their actions and decision making and enable them to find the right balance of access, quality and affordability.

At the same time, we support healthcare professionals with actionable insights and further expanded care resources, all while ensuring alignment with them to deliver superior quality and improve affordability. To further innovate for our customers and clients, we are accelerating investments...
in value-based care programs and incentive payment models with our provider partners that continue to drive enhancements in both care quality and affordability.

For example, today we have 160 collaborative accountable care arrangements, which span 29 states, and we serve well over 2 million customers in these value-based programs. Our success in driving increased affordability is reflected in our continued delivery of industry-leading medical cost trend. In support of that, 82% of our more mature collaborative relationships with large physician groups have outperformed the market in total medical costs.

This leadership in physician partnership was also most recently validated through Cigna's first-place ranking amongst 214 companies in Athena Health's provider satisfaction survey. Our ability to anticipate, identify and help satisfy these needs continues to resonate with our customers and clients, as well as our provider partners. Importantly, across all of our businesses, our customer and client experience remains at high levels.

As a result, retention remains strong, and this presents ongoing opportunities for further expansion of our customer and client relationships. Importantly, these long-term relationships allow us to support individuals more meaningfully across their life and health stages. Now, relative to our businesses where we have an opportunity to improve performance, throughout the third quarter, we made solid progress in our efforts to improve the financial results of our group disability and life segment.

As the model begins to mature, this will lead to a further differentiated customer experience. Relative to Cigna-HealthSpring, we continue to make progress in the CMS audit remediation work. Our focus remains on completing this work, and growing our business with industry-leading collaborative relationships, all to drive positive outcomes for the benefit of seniors. We expect to emerge from this work with a stronger, more sustainable model that ensures seniors will continue to receive the highest quality service experience and clinical outcomes.

So to summarize, our well-performing businesses continue to deliver strong results, and we are driving improvements where needed. This, combined with our ongoing investments for the future, and our tremendous capital resources, positions us with strength and flexibility to deliver sustained value for our customers and clients, and differentiated results for our shareholders.

Now as we look forward to 2017, we expect to deliver attractive financial performance and growth. We see a number of earnings tailwinds, including continued strong performance of our global healthcare and global supplemental benefits businesses, with high customer retention levels, and solid revenue and earnings growth.

Second, more meaningful improvement in the margin for our disability and life business. And, third, meaningful margin improvement for our seniors business, with the ramp down of remediation costs, will more than offset the headwind caused by the revenue reductions that we expect for 2017 in this business.

As always, there may be variability in 2017 in the rate and pace of both medical utilization, as well as the pace of our strategic investments. When we take the tailwinds and headwinds as a whole, and consider our significant capital position, and ongoing strong free cash flow generation, we are well-positioned for an attractive 2017.

Before I turn the call over to Tom, I'd like to reiterate some of the key points from my remarks this morning. Cigna is operating a well-positioned diversified portfolio of businesses, dedicated to meeting our customers’ needs, and delivering value through engagement, incentive alignment and support services. As we look ahead to 2017, we will continue our momentum in our well-performing businesses, and improve the results in some of our historical strong businesses.

Our long-term objective remains, commitment to our annual growth of 10% to 13% EPS on average, all while we continue to invest back in our Company. And the high levels of ongoing free cash flow generated from our diverse business portfolio, and tremendous capital resources available for deployment, give us a strong degree of flexibility to pursue further value-creation options for our shareholders. With that, I'd like to turn the call over to Tom.
Tom McCarthy - Cigna Corporation - CFO

Thanks, David. Good morning, everyone. In my remarks today, I will briefly review key aspects of Cigna’s third-quarter 2016 results, and discuss our outlook for the full year.

The financial highlights in the quarter are: consolidated revenues of $9.9 billion, consolidated earnings of $503 million, quarterly earnings per share of $1.94, and continued strong free cash flow and financial flexibility. This quarter’s result reflects continued strong revenue and earnings contributions from our commercial healthcare and global supplemental benefits businesses, and improved results in our group disability and life business.

Regarding our business segments, I will first comment on global healthcare. Third-quarter premiums and fees in global healthcare grew to $6.8 billion.

Third-quarter earnings were $416 million, reflecting continued strong performance in our commercial business, driven by customer growth, strong specialty results, and favorable medical cost outcomes. Offsetting these strong commercial results were elevated costs in our government business, related to our CMS audit response, and some loss ratio pressure, primarily in our Medicaid offerings in Texas and Illinois.

Turning to our global supplemental benefits business, premiums and fees grew 9%, and earnings of $81 million represent growth of 31% quarter over quarter, or 25% on a currency-adjusted basis, reflecting business growth and strong operating expense discipline. This business continues to achieve attractive growth and profitability, as we deliver value to our customers, with personalized and affordable offerings in the supplemental benefits space.

For group disability and life, third-quarter results reflect premium and fee growth of 4% over third-quarter 2015. Third-quarter earnings in our group business were $53 million, reflecting stabilized claim experience in our life book of business, and sequential improvement in disability results, as the claim process modifications we made earlier this year continue to mature. Additionally, we completed our annual disability reserve review in the third quarter, and consistent with our commentary last quarter, this review had a de minimus impact on results.

Overall, our third-quarter results reflect strong revenue and earnings contributions from our commercial healthcare and global supplemental benefits businesses, and an improvement in our group disability and life results, with some elevated costs in our government business. We also continue to generate very 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 percentage range over 2015 results. Our outlook for full-year 2016 consolidated adjusted income from operations is now in the range of approximately $2.025 billion to $2.095 billion, or $7.80 to $8.05 per share.

We now expect full-year global healthcare earnings in the range of $1.84 billion to $1.87 billion. This reflects continued strong performance in our commercial healthcare business, offset by a reduction of $60 million from previous expectations in our government business, due to higher-than-previously-anticipated costs associated with our CMS audit response, as well as loss ratio pressure in our Medicaid business. The assumptions reflected in our global healthcare earnings outlook in 2016 include the following: regarding global medical customers, we continue to expect growth in the low-single-digit percentage range in 2016.

Turning to medical costs, for our total US commercial book of business, we now expect full-year medical cost trend to be in the range of 4% to 5%, a 50 basis point improvement over our previous expectations. 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.

Now turning to our medical care ratio outlook. For our total commercial book of business, we continue to expect the 2016 MCR to be in the range of 78.5% to 79.5%, reflecting continued strong performance in our commercial employer business. Consistent with past years, our outlook anticipates a sequentially higher fourth-quarter MCR, due to an increased seasonal impact from the growing share of high-deductible plans in our employer group and individual businesses.
For our total government book of business, we now expect the 2016 MCR to be in the range of 84.5% to 85.5%, reflecting some pressure in our Medicaid offerings in Texas and Illinois. Regarding operating expenses, we continue to expect our 2016 global healthcare operating expense ratio to be in the range of 21% to 22%, which continues to include the impact of spending on our CMS audit response.

For our global supplemental benefits business, we continue to expect strong top-line growth, and now expect earnings in the range of $275 million to $285 million, an increase over our previous outlook. Regarding the group disability and life business, we now expect full-year 2016 earnings in the range of $80 million to $110 million. This also represents an increase in our earnings expectations for group.

Regarding our remaining operations, that is, other operations and corporate, we now expect a loss of $170 million for 2016. So all-in, for full-year 2016, we now expect consolidated adjusted income from operations of $2.025 billion to $2.095 billion or $7.80 to $8.05 per share. 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 $110 million. We ended the quarter with parent-company cash of approximately $2.2 billion. After considering all sources and uses of parent-company funds, 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 remain strong.

Now to recap, we continue to invest in capabilities and programs across our businesses, which will deliver significant growth opportunities into the future. Our third-quarter 2016 results reflect strength in our diversified portfolio of global businesses, marked by continued positive momentum in our employer business, commercial employer, and global supplemental benefits businesses, as well as improvement in our group disability and life business. In our government business, the increased investments that we are making with regard to our audit response ensure that we are well-positioned for long-term growth.

Overall, we are confident in our ability to achieve our full-year 2016 earnings outlook, and are well-positioned for attractive earnings growth in 2017. With that, we will turn it over to the operator for the Q&A portion of the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Matt Borsch with Goldman Sachs. You may ask your question.

Matt Borsch - Goldman Sachs - Analyst

Yes, good morning. I was hoping you could give us some more detail on how you’re doing with the group insurance business. Obviously the earnings came in better than we were expecting for this quarter. What should we expect, realizing you've given us a range, but what should we expect directionally for the fourth quarter and going into 2017?

David Cordani - Cigna Corporation - President and CEO

Good morning. It’s David. Just by way of direction, first, we’re pleased with the improvement and performance in the third quarter. As we indicated previously, we expect the improvements to continue to be driven throughout the third, fourth quarter and into 2017.

There’s always some variability in it, hence the range for the business outlook for the full year, but our expectation is throughout 2017, we’d see a continued improvement and stabilization in our disability business, and putting us in the right step-up position as we look to 2018. Adding to that,
as we look to 2017, we would expect stable and consistent life results, and I would note that we saw an appropriate step-up in those results in the third quarter.

Matt Borsch - Goldman Sachs - Analyst
So results so far on the life side would confirm your earlier view that it was a once every decade, or several years fluctuation rather than something systemic?

David Cordani - Cigna Corporation - President and CEO
Matthew, as you recall from the second quarter call, we indicated that the spike, the really significant spike, took place quite early in the second quarter, and we even saw reversion back toward the latter part of the second quarter. That pattern continued through the third quarter. We're pleased with our life results, and expect that to continue as we look forward.

Matt Borsch - Goldman Sachs - Analyst
And would you say at this point, would you think that this in terms of getting back to the -- can you get back to the margin that you were at in the 2013 to 2015 time period for your group insurance business overall, by the time you get to 2018?

David Cordani - Cigna Corporation - President and CEO
Matthew, clearly we're not giving you 2018 guidance, but by way of backdrop, the disability portion of this business is a very strong and well-performing business that focuses on productivity solutions for employers. At this point we fully expect that as we fully mature this model, we will be able to get back to our sustained margin goals.

Matt Borsch - Goldman Sachs - Analyst
Let me just ask one question on a different topic, which is, as you look ahead to next year on Medicare and the star score results, what odds do you think you'll have of either resolving -- sorry. Getting CMS to maybe rethink the approach that they've taken on the star scores for you, for impacting you in 2018, versus what you can do, whether it's cross walking or other activities to offset that?

David Cordani - Cigna Corporation - President and CEO
Matthew, I actually compliment your efficiency getting in so many questions. Relative to the star rating -- by way of backdrop, we're pleased and proud with the position we've developed for ourselves. 2016, 60% of our lives were four-star plus. 2017, 75%.

Per your comment, the current view is that the star rating would step down for 2018, specifically because of the audit process. To be quite clear here, we do not agree with those conclusions, nor do we accept those. In fact, our clinical and service measures reinforce a very positive outcome for the benefit of our seniors and our physician partners, and we're going to use a variety of approaches to resolve that issue, because, again, we don't accept that outcome.

Operator
Thank you, Mr. Borsch. Our next question comes from A.J. Rice with UBS. You may ask your question.
A.J. Rice - UBS - Analyst

First, a detailed question and then a followup. The $60 million of headwind around the government business, I know part of it's audit costs, and part of it sounds like it's this Medicaid issue. I think last quarter, you said the audit costs were about $30 million. Were they similar in this quarter, and can you expand a little bit on the Medicaid issue?

Tom McCarthy - Cigna Corporation - CFO

Sure, AJ. So your recollection from last quarter is right, and I would say the costs in this quarter are a little higher than that. And if we look at the $60 million, which was the change in expectation for the full year, I'd split that about 50-50 between Medicaid and additional remediation costs.

A.J. Rice - UBS - Analyst

Any color on what's happening in Medicaid?

Tom McCarthy - Cigna Corporation - CFO

Oh, sure. Again, let's put it in context. Medicaid is a small business for us, essentially just the dual SNP programs in Texas, and the dual demonstration project in Illinois. And we did report an increased MCR in both Texas and Illinois this quarter.

Different dynamics in each market. Texas included pressure from the long-term support service costs. In Illinois we're seeing some rate pressure and more significant mix of higher acuity patients than we'd expected.

A.J. Rice - UBS - Analyst

Okay. And maybe my followup, to stay in the government area. It's been a while since we've had a Company have to go through the open enrollment under sanctions.

Can you just remind us on the ground what can you do to retain your membership and keep others from going after that? And when we get through the end of open enrollment when you're thinking about 2017, is whatever enrollment you end up with, is that where you think you'll be for the year?

I mean, I guess that entails when you think you might get resolution on the sanctions, as well. But any thoughts on that would be helpful.

David Cordani - Cigna Corporation - President and CEO

AJ, good morning. Relative to the framing of your question, first, by way of your backdrop, you're correct, our working assumption is that we will not be participating in the open enrollment period. Specific to the actions, I'm not going to delineate the specific actions you can or cannot take. There's clear rules in terms of what you can do, in terms of the fee marketing versus retention activities.

I think the most important thing to highlight is within our model, you'll recall that our model is largely based where the majority of our lives are, in terms of very mature physician collaborative models, hence those customers or members have very deep relationships with those physician groups. That is a highly retentive tool. Not perfect, but it's a highly retentive tool because there's deep relationships that have been built, there's expanded services, and the like.
So while we expect attrition, and as I noted in my prepared remarks, we're planning for a revenue headwind in 2017, that will be offset by the attrition of the remediation costs. We expect retention to perform better than the historical norms of a sanctioned environment. As it relates to 2017, as soon as we're off sanctions, we'd be back in the monthly enrollment process, and we look forward to that environment.

A.J. Rice - UBS - Analyst
Okay. Thanks a lot.

Operator
Thank you, Mr. Rice. Our next question comes from Joshua Raskin with Barclays. Your line is open. You may ask your question.

Joshua Raskin - Barclays Capital - Analyst
Just want to start on the comments around 2017 being attractive financially, and maybe juxtapose that with the 10% to 13% long-term growth. Does attractive mean you expect to be within that range? And what base should we be using for 2016, maybe if Tom could give us a run rate 2016, once we take out all the remediation costs that are extra and any favorable development, or negative development as well on maybe the life and disability side?

David Cordani - Cigna Corporation - President and CEO
Josh, it's David. Let me give you just a little bit more color in terms of the drivers as we think about moving from 2016 to 2017, and I appreciate your reframing our long-term commitment of the 10% to 13% on average, which we've delivered on average over the last half a dozen years.

Specifically, we see three. We call it the three largest meaningful tailwinds that are specific and compelling. Number one is the continued leverage of our well-performing businesses, specifically our US employer healthcare business, and our global individual business where we expect to continue to deliver attractive both revenue and earnings growth.

Second is a meaningful step-up in the margin performance of the group disability and life business. And third is margin expansion in the government business where the -- largely the attrition of the cost profile that we've incurred this year, which was significant, will more than offset the revenue headwind.

It's important to attach on top of that, that they're going to take place under one of two environments. We'll either be in a so-called Plan A, where we're able to effectuate the combination, when we're stepping into a different environment, or a so-called Plan B, where the government will stop and impede us, in terms of the ability to combine.

In a Plan B scenario, our estimate is towards the latter part of 2017, we'll have between $7 billion and $14 billion of deployable capital, which is made up of about $5 billion of free cash. At the latter part of 2017, leverage that we could step up to one threshold, if we're going to use it solely for internal purposes, dividend, buyback, and the like. And the higher end of the range is if we're going to use leverage, largely to expand ourself through M&A capacity.

So taken as a whole, a significant uptick. I don't think it's constructive, on this call to try to scroll the numbers around the underlying run rate. Suffice it to say, 2016 is a choppy year for us.

2017 will be quite attractive. And if we expect to deliver certain numbers on average, since this year's not an average year from a transition, we'd expect to have a very strong performance for 2017.
I'm sorry, is there a way to parse out, maybe you don't have to give what you think the run rate, but just any extraordinary numbers this year? You talked about the remediation costs. Obviously that's -- I don't know if that's $70 million or so, or any way to just size the one-timers at least?

Let me give you two chunks to try to be helpful here. Chunk one will go to the remediation costs. Our best estimate for the full year is approximately $100 million after tax.

So when we talk significant, it's significant because our objective is to effectively and rapidly, and speed is always in the eyes of the beholder, but effectively and rapidly resolve this, and use whatever resource is necessary to put this behind us. So think about $100 million after tax, which is significant.

Secondly you know us quite well, and you know even with the revised outlook for our group disability and life business, the earnings dislocation there is significant, and if you will just project forward a mindset that our view is a stable and consistent performance of the life business, that's a meaningful step-up, and then continued improvement in the disability business, there's a significant step-up, or in example to your point of a one-time dislocation when you would compare 2016 to 2017.

Albeit, we don't expect to be at full earnings potential in 2017, because disability will ramp throughout the course of the year. Those are two items I'd ask you to focus on.

Okay, perfect.

Thank you. Our next question comes from Justin Lake with Wolfe Research. You may ask your question.

Thanks, good morning. First question, just to tie out this whole CMS audit stuff, I wanted to ask, at what point, do you think the work is going to be complete here, David? And then you put that $100 million number out there for the year, is there anything of it that you think remains in 2017, or does it all go away? You talked about being better than average, and I went back to Aetna and HealthNet when they were out of the market, and I think they lost about 20% of their membership during open enrollment while they were on sanctions. Is that -- is that the bogey you're comparing yourself to, when you're saying you're going to be better than average? Any way to give us directionality on that would be great.

Justin, a few different comments there. First, by way of context, so this is obviously a complex undertaking, and as I noted, the $100 million reinforces it's complex in terms of what we're confronting here. We confronted an audit process that was changed and modernized for CMS, so a new audit methodology.

We operate a business model that functions off the more modern collaborative or value-based environment, and what that means is, we have a lot of partners. Think about entities that we work with in partnership to get that value-based environment, and think about the better part of a
couple hundred. So the ability to operate in this more modernized audit environment, relative to that, which we believe is a big part of what the future of healthcare looks like required us to drive some changes. We're driving those changes and we'll seek to get those resolved in short order.

So we think we're in the latter phases, point one. Two, we believe the large majority of those costs will not be recurring, that otherwise will be contributors to 2017's earnings, or the margin inflection. And third, we fully expect our retention levels to outperform the numbers that you referenced, largely based on the different orientation we have in our model, and we can look back and look at the retentive nature of our business over a long period of time and those relationships.

So while we expect a revenue headwind that will be meaningful, our revenue headwind projection is not in line with the numbers you made reference to. And we think it's largely driven by the different model we have, whereby once our customers are with us a year or more, they tend to be with us for a long, long time, largely because of those collaborative relationships.

Justin Lake - Wolfe Research - Analyst
Great. And then just a quick followup on the healthcare earnings. I understand, obviously there's some headwinds and tailwinds going next year on the Medicare side, but the increase in the remediation costs, basically you took down healthcare by $60 million.

I'm curious, when -- we normally think about your healthcare business as a mid to high single-digit grower. Would it be reasonable to think that you grow in that capacity off of the original guidance, given that Medicaid and the CMS audit increases would seem to be transitory? Or should we think about that growth coming off the new 1840 to 1870 guidance? Thanks.

David Cordani - Cigna Corporation - President and CEO
Justin, we're not providing the detailed guidance for 2017. We look forward to doing that on our year-end call. But I think there's two important points you tease out.

One, noted in my prepared comments, we continue to feel quite good about our employer healthcare business, and that employer healthcare business has continued to perform well, as the marketplace looks for more engagement, more affordability solutions, more partnership solutions. And we would expect to see continued strong performance relative to our top line as well as our bottom line, and I'd ask you to think about our historical performance there, and I think you made reference to that.

If you extract out the government portion of the business, that's been lumpy, beyond the shadow of a doubt, and we expect to see a step up in earnings next year. So I ask you to pull those two pieces apart as you think about your 2017. Clearly, we'll provide guidance at the end of the year as we go into our fourth-quarter call.

Justin Lake - Wolfe Research - Analyst
Thanks.

Gary Taylor - JPMorgan - Analyst
Just a couple questions. One, just to -- on the same topic, just the progression of the global healthcare earnings through the year, I just want to make sure I understand. So if we look at the first quarter, net income in this segment up about $100 million, 2Q was down $42 million, third quarter
David Cordani - Cigna Corporation - President and CEO

Gary, a couple things. First, you've cited the quarter-over-quarter earnings in the third quarter, and you got that right, and that's largely driven by the Medicaid and remediation costs. As we look to the fourth quarter, again, the remediation costs we expect to moderate. Fundamentals in the fourth quarter continue to be the same, very strong underlying employer business, really not much news on the individual side. A little bit of timing difference in the group disability and life and global supp business, but that's generally the picture for the balance of the year.

Gary Taylor - JPMorgan - Analyst

Okay. Second question, just going back to disability for a moment, David, I think when you had the issue in the 2Q, you were very clear that in the disability claims, you're not having a frequency issue, it was primarily a duration of claims issue, caused by the disruption. So as we look at this nice sequential improvement, is that where we'd be looking to, that claims duration has improved sequentially?

David Cordani - Cigna Corporation - President and CEO

Gary, I appreciate the framing. Two dimensions here. So we have the same convention. There's claims that are presented, there's validated claims, we call those occurrences or open claims, and then there's closed claims.

So point one is, throughout the course of the year, we have not seen a different pattern. Again, we have not seen a different pattern of the volume of claims that present themselves for consideration. So that's your first point.

As we changed our model, we saw more claims go from that first bucket of potential claims to activated claims, open claims, because of the disruption of our process. So that is disruption point number one, disruption point number two is, more claims stayed open or active for an elongated period of time, because of the disruption.

If I understand your question, if you think about the third quarter, we're seeing, again, no change in the number that are presenting themselves for consideration, but improvement in that bucket two and bucket three, which are validated claims that are opened, and the rate and pace in which claims are closed. And we expect over time that pattern to continue.

Gary Taylor - JPMorgan - Analyst

Okay. Perfect. Thank you.

Operator

Thank you, Mr. Taylor. Our next question comes from Christine Arnold with Cowen. You may ask your question.

Christine Arnold - Cowen and Company - Analyst

With respect to the Medicare Advantage book, was the MLR elevated there at all? And as we go through open enrollment and experience some attrition, should we expect any impact on the MLR, owing to the sanctions, or is it just a revenue issue?
Tom McCarthy - Cigna Corporation - CFO
Christine, it’s Tom. So to answer your last question first, I would expect the impact from sanctions will largely be in revenue. The physician engagement model in HealthSpring continues to deliver strong medical costs consistently throughout the year. On a year-to-date basis, the Medicare results are about flat MCR wise, which, again, reflects that consistent strong performance. As we commented on last time, it is a little bit of a higher MCR in some of the expansion markets, some of the less engaged markets, but generally consistent with our expectations for the year.

Christine Arnold - Cowen and Company - Analyst
And it sounds like the improvement from second to third quarter in D&L was both life and disability. Is there any way to parse out how much we saw in improvement in life versus disability, so we can get a sense for how much more disability is going to drive improvement? And have we maximized our life experience, are we back to normal there?

Tom McCarthy - Cigna Corporation - CFO
Well, again, last quarter, we highlighted we had significant variability in life, so obviously more of the improvement sequentially has come from life, just getting back to normal. And, in fact, that is the headline. Life business back to normal expectations, disability improving.

Christine Arnold - Cowen and Company - Analyst
Great. Thank you.

Operator
Thank you, Ms. Arnold. The next question comes from Kevin Fischbeck with Bank of America Merrill Lynch. You may ask your question.

Kevin Fischbeck - BofA Merrill Lynch - Analyst
I want to go back to the headwinds and tailwinds for 2017. You didn't mention Medicaid improvement as a tailwind of 2017, so does that mean that you're not expecting improvement there? And then as far as headwinds, I think the only headwind I heard you mention was MA membership attrition. Is that the only meaningful headwind that you expect for 2017?

David Cordani - Cigna Corporation - President and CEO
Kevin, good morning, it's David. You're correct. There's a variety of items we didn't mention. So there's always some smaller puts and takes, what we tried to call out were the three compelling major drivers. So there's going to be other small puts and takes, and you should expect that if we're underperforming in Medicaid, we'd expect to take actions to slightly improve that, as we move forward, but it's a small portion of our business, and in the scope of the moving parts that we talked about, those are the three items I'd ask you to consider, relative to the fundamentals, with the fourth being just tremendous capital deployment opportunity that sits in front of us.

Kevin Fischbeck - BofA Merrill Lynch - Analyst
Okay. But it sounded like you said that the Medicaid was half of the government issue in the quarter, and you took down healthcare by $60 million, so it's not right to think that Medicaid was a $30 million drag?
Relative to the current year, we’re feeling the pressure relative to the Medicaid number. All the other fundamentals are holding. If you look at the year to date, our Medicare number, as Tom noted, is performing cleanly year over year in totality with some puts and takes. Our PDP results improved somewhat, our Medicaid results eroded somewhat.

As we project forward to next year, again, we would expect to take actions to improve the Medicaid numbers, but the size of that delta in a well over $2 billion after-tax earnings franchise, what we’re trying to call out here, these are the three discrete drivers that are most significant. There’ll be some other puts and takes, absolutely, and you’re correct, we would expect to improve that result, as well.

Kevin Fischbeck - BofA Merrill Lynch - Analyst

Okay. And I guess my last question on your bids for next year, for MA, with the HIF expiring and also with the sanction, a lot of moving parts as to how you’d want to do this. It sounds like you’re saying margin improvement in MA is driven more by the CMS sanction costs winding down, rather than material MLR improvement. Wasn’t sure how you -- did you bid for margin, did you bid, assuming a stable margin for next year? What were your thoughts there going into next year?

David Cordani - Cigna Corporation - President and CEO

with an eye towards 2017, obviously when we have to put the bids in, we understood the environment we’re in, we’re already through the audit process, so we knew the sanctions, et cetera. If you look back historically, we typically position ourselves for more stable offerings, consistent benefits. As I referenced before, long-term customer relationships are an important part of our model, because it facilitates the interaction back and forth through the value-based offerings.

Clearly, we sought to improve margins in some of the markets that were underperforming. With a portfolio our size, there’s always opportunities in some select markets to improve margins, but that’s a market-by-market approach. So think guiding force, stable benefits, stable offerings, the customer-first orientation, working with our physician collaboratives.

Looking at all the tools that are available to us, especially in the markets that may be underperforming. Some of those are the less mature markets, so we took some actions in some of the less mature markets, and we expect to see a little bit more disruption there, but margin improvement that would take place, but by and large, stable offerings.

Kevin Fischbeck - BofA Merrill Lynch - Analyst

Okay. Thanks.

Ralph Giacobbe - Citigroup - Analyst

Just wanted to give it back to the MA side. You talked about $100 million in costs coming back to you after sanctions are lifted, and you said that, that’s going to be more than offset, or more than offset any losses in enrollment. Back of the envelope, we’re estimating that’s about 15,000 lives, off of your base, which suggests about a 3% drop in enrollment. When I look at the last couple of quarters, you’ve had a 2% to 3% drop sequentially, outside of open enrollment. So just want to see if I’m missing anything and just your comfort around those expectations.
David Cordani - Cigna Corporation - President and CEO

Ralph, good morning, it's David. I'm not going to go through the moving parts at this point. We'll provide full 2017 guidance at the end of the year, as we go through our fourth-quarter call.

The three headlines here are as follows: one, we expect better than market retention because we've typically delivered better than market retention levels from our customers, specifically tied to the collaborative model. You could actually look at -- to your point, you can look at our attrition rates throughout the course of the year, as we've been able to manage the business.

Point two is the remediation costs will essentially -- the large majority of those costs will attrit next year which will offset the earnings implication. Broad sweeping numbers, we expect to grow the franchise in aggregate revenue numbers, because of the strength of the business, as I referenced before. The US commercial employer business, the global supplemental benefits business, our specialty portfolio, et cetera. And that will more than offset the revenue implications here as well.

Lastly, order of magnitude, you could think about $1 billion of revenue, that unfortunately currently is low margin. We'll step the margin up, and that will more than offset the earnings implication from that, as we look through the attrition, both the member attrition for this year as well as the open enrollment attrition from next year.

Ralph Giacobbe - Citigroup - Analyst

Okay. And then just my follow-up. Just wanted to go into the commercial MLR a little bit more. You mentioned taking down cost trend. Maybe go through some of the components of what you're seeing as the drivers there, and how that's impacting or maybe how that impacted how you priced and thought about 2017? Thanks.

Tom McCarthy - Cigna Corporation - CFO

Ralph, it's Tom. So obviously we're very pleased with the medical trend results. We are continuing to build on a competitively attractive record here, and since most of our commercial customers are in self-funded arrangements, they directly benefit from this well-managed trend.

So the components, the experience to date generally says all of our trend components are in the low- to mid-single digits, so we're pretty happy with that result. As far as impact on pricing, our philosophy has typically, and remains consistent to anticipate medical cost trend in our pricing, and effectively, we're seeing great results in delivering medical cost trend, and good trajectory for this business going forward.

Ralph Giacobbe - Citigroup - Analyst

Okay. Thank you.

Operator

Thank you, Mr. Giacobbe. Our next question comes from Ana Gupte with Leerink Partners.

Ana Gupte - Leerink Partners - Analyst

Following up on the government loss ratio, this year, you had year-over-year compared to last year, give or take maybe 150 basis points or so of deterioration. Can you parse out how much of that came from this Texas, Illinois duals issue versus the Medicare Advantage deterioration, Part D deterioration? And then given that you've been under CMS now apparently has a new claims audit process, for next year, as you look at recovery
in the MA and the Part D piece on loss ratio, how much of that is recoverable or, is this the new normal because of the more stringent claims audit process?

Tom McCarthy - Cigna Corporation - CFO

It’s Tom. Rather than getting into all the pieces here, let me give you the high-level message. The quarter-over-quarter deterioration, you mentioned that 160, 170 basis points, that’s all attributable to Medicaid, and the difference in prior-year development, less favorable prior-year development this year compared to last year.

So I wouldn’t be anticipating that we’d be seeking significant improvements in the Medicare Advantage loss ratio going into 2017, we’d expect to have significant continued ongoing strong performance there. And as far as splitting the difference in the variance in the quarter, it’s splits about 60-40, Medicaid the more significant variance, about 40%. A little bit minor puts and takes other than that, but about 40% related to the difference in prior year.

David Cordani - Cigna Corporation - President and CEO

Ana, on the latter part of your question, I’d ask you not to think about an impact of the audit on the sustainable loss ratio. I think I heard you say the claim audit process having an impact on the loss ratio going forward. We do not expect any implication on the sustainability of the loss ratio there. We have operating expenses which we referenced, that we had to incur to make process changes, but there are not fundamental differences of our cost or quality or clinical performance measures in any way, shape or form, that you need to worry about there.

Ana Gupte - Leerink Partners - Analyst

That’s helpful. Just going through the individual side, you don’t say much here, the commercial book is performing very well. I’m estimating you have maybe $800 million to $1 billion or so in premiums. You look at how sequentially your experience from 2Q to 3Q, what is that telling you about that book, even though it’s small compared to your peers? And what does that mean for next year in relation to your bids? And I believe you have entered one more state, at least?

David Cordani - Cigna Corporation - President and CEO

Ana, two headlines there. Relative from 2Q to 3Q, essentially consistent, I think, is the big picture headline, relative to the individual book of business. Relative to next year, important to put a backdrop on it.

As you recall, we have been cautious and slow in this space is the headline, as we viewed the opening of this marketplace in 2014, is probably being much smaller than projections, not profitable for the industry and choppy or less than stable operationally. And then fortunately it’s proven to be more right than wrong, we entered five markets, and we deliberately and slowly grew to seven markets.

As we look to 2017, our initial plan had us growing into 10 markets. After assessing all the market dynamics, we’re going to end up in seven markets in 2017, but a different mix, where we will shrink our footprint in three markets, by leaving three markets on the exchange. And then we’ll have a new offering in three different markets specifically built on our collaborative model. So some change in the overall profile of our marketplace, but a smaller geographic footprint than we were anticipating.

We anticipated going from 7 to 10, we’re actually going to be in 7, with a different mix. Net-net, taking it all as a whole for next year, we’re going to expect to see some revenue growth there. We’re continuing to plan for a loss in the business, which is what we think is appropriate, as we continue to refine our learnings and look to determine whether there’s a sustainable future here.
Ana Gupte - Leerink Partners - Analyst
Great. Thanks so much.

Operator
Thank you Ms. Gupte. Our next question comes from David Windley of Jefferies. You may ask your question.

David Windley - Jefferies LLC - Analyst
I wanted to pivot to a couple of questions on international. David, your international risk business growth -- membership growth ticked up pretty nicely in the third quarter. Wondering if that’s another bright spot in global healthcare, and if there’s anything in particular to call out there in the growth path of that business? And then over on global supp, I’m just interested in an update on the overall strategy and model. Is it basically unchanged, and continuing to roll out in additional markets or countries, noting that Korea had an 18% growth in the quarter?

David Cordani - Cigna Corporation - President and CEO
Dave, good morning. So two headlines here. First, as we noted, both through Tom’s comments and my comments, continued strong performance of our global business, that’s headline number one.

Two different businesses, big picture to think about, one is largely an employer globally mobile business, where we take care of corporate expats, IGOs, NGOs, et cetera, and we’ve seen a bit of growth in there, that we’re pleased with and a bit of continuation of growth there that we’re pleased with. That’s part of our global employer business. And then the global supplemental or global individual business, where we continue to see strong growth anchored in our strongest market, which is Korea.

You referenced a phraseology in terms of, is there nothing changed. I’ll pause on that one because in a dynamic global market, everything is changing all the time, but the core of our business model remains. Which is a focus for that business, the supplemental business, a focus on the individual, understanding their needs, innovating derivative products, and having distribution capabilities and unique ways to meet them in a direct fashion, be it telemarketing, be it direct-through pull internet, be it TV, be it retail based, et cetera.

That iterative evolution is what's driving our business growth as the global markets continue to evolve, and the global middle class continues to grow. So looking forward, as we noted, we expect this to continue to be a positive driver for us in 2017, and look into the future.

David Windley - Jefferies LLC - Analyst
Okay. Thank you.

Operator
Thank you, Mr. Windley. Our next question comes from Chris Rigg, Susquehanna Financial Group. You may ask your question.

Chris Rigg - Susquehanna Financial Group - Analyst
Just want to come back to global healthcare income quickly here. Sorry to keep coming back to this. But I guess, when we think about where you were when you reported second-quarter results at the end of July, relative to what you’re looking for now in terms of the remediation costs, it’s a $30 million step-up in a pretty short window of time. I guess I’m just not fully understanding why it increased so rapidly, relative to what you were looking for at mid year.
Tom McCarthy - Cigna Corporation - CFO

Chris, it's Tom. We've invested a lot in technology, augmenting staff, and engaging consultants to get this done as quickly as possible, and the costs have been substantial. Total costs to date are in the about $80 million range after taxes.

David indicated we're expecting about $100 million for the full year. We see the costs have peaked in the third quarter. They have significantly ramped down in the fourth quarter, and that ramp down reflects a more narrowly focused work effort, as we just address the remaining issues, so that's the general pattern of what's going on here.

Chris Rigg - Susquehanna Financial Group - Analyst

Okay, and then just on the two Medicaid issues, Texas normally has a rate increase on September 1, and I can't remember where Illinois stands. But nevertheless, do you think at least in Texas, the rate increase there gets you back to break-even pretty quickly? And likewise, can you give us a sense for where things stand in Illinois? Thank you.

Tom McCarthy - Cigna Corporation - CFO

Yes. I'd say in Texas -- well, perhaps there'll be a rate increase that will help us. That's more impacting costs. In Illinois, we'd expect it to be more through a rate increase, and we'd expect that to be closer to the beginning of the year. So, all-in, again, this is a small business for us, so I think on the margin, the impact is marginal, but all-in we'd expect to get some improvement in results here.

Chris Rigg - Susquehanna Financial Group - Analyst

Thank you.

Operator

Thank you, Mr. Rigg. Our last question comes from Michael Newshel with Evercore ISI. You may ask your question.

Michael Newshel - Evercore ISI - Analyst

On your decrease to cost trend guidance for the commercial business, is there any particular utilization categories to call out that drove the decline there, in terms of inpatient versus outpatient, versus prescription?

Tom McCarthy - Cigna Corporation - CFO

Yes, again. We're pretty happy with the overall results here. I would call out the driver of the change is largely pharmacy, the pharmacy trend we're seeing benefit both from the moderation in specialty drug costs and the continued strong performance of our integrated model.

Michael Newshel - Evercore ISI - Analyst

Maybe just one more on star ratings, and Medicare Advantage. Given the decline there for the 2018 payment year, what do you think your prospects are for improving those ratings for 2019?
David Cordani - Cigna Corporation - President and CEO

Yes, Michael, it’s David. First, as I indicated previously on the call, we’re pleased with the quality indicators we’re able to deliver, so off a base of 60% four star plus in 2016, 75% four star plus in 2017. Absolutely not lost on us that the current view is to meaningfully down draft us for 2018. We do not agree, and therefore do not accept that.

Our outcome measures - both satisfaction, service satisfaction, and retention, clinical outcomes, physician partnership members do not reinforce that, so we have a variety of paths in front of us to seek to address that for 2018, long before we look at 2019. Fundamentally, we would expect to be rewarded for and recognized for the strong performance we’re able to deliver as we look to 2018 and 2019.

Michael Newshel - Evercore ISI - Analyst

Great. Thanks, guys.

Operator

Thank you Mr. Newshel. I will now turn the call back over to David Cordani for closing remarks.

David Cordani - Cigna Corporation - President and CEO

Thanks, everyone. So to conclude our call this morning, I’d like to underscore just a few key points from our discussion. Cigna’s third-quarter results include meaningful revenue and earnings contributions from our global healthcare and global supplemental benefits business, and improving financial performance in our group disability and life segment.

This gives us confidence that we’ll achieve our full-year 2016 outlook, and deliver attractive earnings and revenue growth in 2017. We’re anticipating and meeting customer and client needs through innovation, engagement, and value-based programs, which continue to drive our business performance. We have significant capital resources available for deployment, and our business remains well-positioned to deliver strong results for the benefit of shareholders over the long term.

And finally, we’re fortunate to have a passionate and engaged work force of over 40,000 colleagues around the globe, who are guided by our strategy to drive value for our customers, clients and shareholders each and every day. Again, thank you for joining our call and for your investment in Cigna.

Operator

Ladies and gentlemen, this concludes Cigna’s third-quarter 2016 results review. Cigna Investor Relations will be able 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 1-866-463-4972 or 1-203-369-1407. No pass code is required. Thank you for participating. We will now disconnect.