

CIGNA CORP  
Form 10-Q  
November 02, 2005

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

**FORM 10-Q**

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

For the quarterly period ended **September 30, 2005**

OR

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

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

Commission file number 1-8323

**CIGNA Corporation**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction  
of incorporation or  
organization)

**06-1059331**  
(I.R.S. Employer  
Identification No.)

**One Liberty Place, 1650 Market Street**  
**Philadelphia, Pennsylvania 19192**  
(Address of principal executive offices) (Zip Code)

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

Not Applicable

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

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

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

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

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As of September 30, 2005, 125,780,161 shares of the issuer's common stock were outstanding.

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## CIGNA CORPORATION

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As used herein, CIGNA refers to one or more of CIGNA Corporation and its consolidated subsidiaries.

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**Part I. FINANCIAL  
INFORMATION**

Item 1. Financial Statements

**CIGNA CORPORATION  
CONSOLIDATED  
STATEMENTS OF INCOME**

*(In millions, except per share  
amounts)*

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>REVENUES</b>				
Premiums and fees	\$ 3,381	\$ 3,618	\$ 10,151	\$ 10,754
Net investment income	334	340	995	1,298
Other revenues	298	510	1,300	1,335
Realized investment gains	9	11	28	447
Total revenues	4,022	4,479	12,474	13,834
<b>BENEFITS AND EXPENSES</b>				
Health Care medical claims expense	1,579	1,671	4,633	5,044
Other benefit expenses	786	946	2,481	3,022
Other operating expenses	1,274	1,367	3,875	4,202
Total benefits and expenses	3,639	3,984	10,989	12,268
<b>INCOME FROM CONTINUING OPERATIONS</b>				
<b>BEFORE INCOME TAXES</b>				
<b>(BENEFITS)</b>	383	495	1,485	1,566
Income taxes (benefits):				
Current	(58)	58	169	649
Deferred	182	129	250	(102)
Total taxes	124	187	419	547
<b>INCOME FROM CONTINUING OPERATIONS</b>	259	308	1,066	1,019
<b>INCOME FROM DISCONTINUED OPERATIONS</b>	-	-	349	-
<b>INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>	259	308	1,415	1,019
<b>CUMULATIVE EFFECT OF ACCOUNTING CHANGE, NET OF TAXES</b>	-	-	-	(139)

<b>NET INCOME</b>	\$	259	\$	308	\$	1,415	\$	880
<b>EARNINGS PER SHARE - BASIC</b>								
<b>INCOME FROM CONTINUING OPERATIONS</b>	\$	2.04	\$	2.28	\$	8.27	\$	7.39
<b>INCOME FROM DISCONTINUED OPERATIONS</b>		-		-		2.71		-
<b>INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>		2.04		2.28		10.98		7.39
<b>CUMULATIVE EFFECT OF ACCOUNTING CHANGE, NET OF TAXES</b>		-		-		-		(1.01)
<b>NET INCOME</b>	\$	2.04	\$	2.28	\$	10.98	\$	6.38
<b>EARNINGS PER SHARE - DILUTED</b>								
<b>INCOME FROM CONTINUING OPERATIONS</b>	\$	2.00	\$	2.26	\$	8.12	\$	7.32
<b>INCOME FROM DISCONTINUED OPERATIONS</b>		-		-		2.66		-
<b>INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>		2.00		2.26		10.78		7.32
<b>CUMULATIVE EFFECT OF ACCOUNTING CHANGE, NET OF TAXES</b>		-		-		-		(1.00)
<b>NET INCOME</b>	\$	2.00	\$	2.26	\$	10.78	\$	6.32
<b>DIVIDENDS DECLARED PER SHARE</b>	\$	0.025	\$	0.025	\$	0.075	\$	0.380

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



**CIGNA CORPORATION  
CONSOLIDATED BALANCE  
SHEETS**

*(In millions, except per share amounts)*

	<b>As of September 30, 2005</b>	<b>As of December 31, 2004</b>
<b>ASSETS</b>		
Investments:		
Fixed maturities, at fair value (amortized cost, \$14,359; \$14,758)	\$ 15,554	\$ 16,081
Equity securities, at fair value (cost, \$62; \$65)	74	88
Mortgage loans	3,919	3,529
Policy loans	1,341	1,594
Real estate	78	78
Other long-term investments	508	478
Short-term investments	540	71
Total investments	22,014	21,919
Cash and cash equivalents	1,251	2,519
Accrued investment income	285	285
Premiums, accounts and notes receivable	1,667	1,628
Reinsurance recoverables	7,382	14,595
Deferred policy acquisition costs	588	544
Property and equipment	660	777
Deferred income taxes	1,238	1,383
Goodwill	1,620	1,620
Other assets, including other intangibles	330	312
Separate account assets	8,862	35,477
Total assets	\$ 45,897	\$ 81,059
<b>LIABILITIES</b>		
Contractholder deposit funds	\$ 10,359	\$ 17,839
Future policy benefits	8,415	8,428
Unpaid claims and claim expenses	4,365	4,311
Health Care medical claims payable	1,168	1,594
Unearned premiums	357	343
Total insurance and contractholder liabilities	24,664	32,515
Accounts payable, accrued expenses and other liabilities	5,210	6,359
Short-term debt	100	-
Long-term debt	1,338	1,438
Nonrecourse obligations	65	67
Separate account liabilities	8,862	35,477
Total liabilities	40,239	75,856

**CONTINGENCIES - NOTE 13****SHAREHOLDERS' EQUITY**

Common stock (par value per share, \$0.25; shares issued, 160; 160)		40		40
Additional paid-in capital		2,262		2,360
Net unrealized appreciation, fixed maturities	\$	245	\$	392
Net unrealized appreciation, equity securities		10		15
Net unrealized depreciation, derivatives		(14)		(16)
Net translation of foreign currencies		(3)		2
Minimum pension liability adjustment		(759)		(729)
Accumulated other comprehensive loss		(521)		(336)
Retained earnings		5,084		3,679
Less treasury stock, at cost		(1,207)		(540)
Total shareholders' equity		5,658		5,203
Total liabilities and shareholders' equity	\$	45,897	\$	81,059
<b>SHAREHOLDERS' EQUITY PER SHARE</b>	\$	44.98	\$	39.41

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



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

(In millions)

**Three Months Ended September**  
**30,**

	<b>2005</b>		<b>2004</b>	
	<b>Compre- hensive Income</b>		<b>Compre- hensive Income</b>	<b>Share- holders' Equity</b>
		<b>Share- holders' Equity</b>		<b>Share- holders' Equity</b>
<b>Common stock</b>		\$ 40		\$ 69
<b>Additional paid-in capital, July 1</b>		2,285		3,727
Effect of issuance of stock for employee benefits plans		(23)		17
<b>Additional paid-in capital, September 30</b>		2,262		3,744
<b>Accumulated other comprehensive loss, July 1</b>		(390)		(597)
Net unrealized appreciation (depreciation), fixed maturities	\$ (128)	(128)	\$ 197	197
Net unrealized appreciation (depreciation), equity securities	2	2	(6)	(6)
Net unrealized appreciation (depreciation) on securities	(126)		191	
Net unrealized appreciation (depreciation), derivatives	(5)	(5)	3	3
Net translation of foreign currencies	-	-	3	3
Minimum pension liability adjustment	-	-	21	21
Other comprehensive income (loss)	(131)		218	
<b>Accumulated other comprehensive loss, September 30</b>		(521)		(379)
<b>Retained earnings, July 1</b>		4,829		10,024
Net income	259	259	308	308
Common dividends declared		(4)		(4)
<b>Retained earnings, September 30</b>		5,084		10,328
<b>Treasury stock, July 1</b>		(885)		(8,856)
Repurchase of common stock		(466)		(210)
Other, primarily issuance of treasury stock for employee benefit plans		144		8
<b>Treasury stock, September 30</b>		(1,207)		(9,058)

<b>TOTAL COMPREHENSIVE INCOME (LOSS) AND SHAREHOLDERS' EQUITY</b>	\$	128	\$	5,658	\$	526	\$	4,704
<b>Nine Months Ended September 30,</b>								
<b>Common stock</b>			\$	40		\$		69
<b>Additional paid-in capital, January 1</b>				2,360				3,647
Effects of issuance of stock for employee benefits plans				(98)				97
<b>Additional paid-in capital, September 30</b>				2,262				3,744
<b>Accumulated other comprehensive loss, January 1</b>				(336)				(54)
Net unrealized depreciation, fixed maturities	\$	(147)		(147)	\$	(195)		(195)
Net unrealized depreciation, equity securities		(5)		(5)		(9)		(9)
Net unrealized depreciation on securities		(152)				(204)		
Net unrealized appreciation, derivatives		2		2		9		9
Net translation of foreign currencies		(5)		(5)		1		1
Minimum pension liability adjustment		(30)		(30)		(131)		(131)
Other comprehensive loss		(185)				(325)		
<b>Accumulated other comprehensive loss, September 30</b>				(521)				(379)
<b>Retained earnings, January 1</b>				3,679				9,502
Net income		1,415		1,415		880		880
Common dividends declared				(10)				(54)
<b>Retained earnings, September 30</b>				5,084				10,328
<b>Treasury stock, January 1</b>				(540)				(8,557)
Repurchase of common stock				(1,055)				(494)
Other, primarily issuance of treasury stock for employee benefit plans				388				(7)
<b>Treasury stock, September 30</b>				(1,207)				(9,058)
<b>TOTAL COMPREHENSIVE INCOME AND SHAREHOLDERS' EQUITY</b>	\$	1,230	\$	5,658	\$	555	\$	4,704

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



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

	<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Income from continuing operations	\$ 1,066	\$ 1,019
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Insurance liabilities	(447)	(601)
Reinsurance recoverables	1	127
Deferred policy acquisition costs	(45)	(72)
Premiums, accounts and notes receivable	159	309
Accounts payable, accrued expenses and other liabilities	(401)	(180)
Current income taxes	(72)	98
Deferred income taxes	250	(102)
Realized investment (gains)	(28)	(447)
Depreciation and amortization	170	174
Gains on sales of businesses	(374)	(239)
Proceeds from sales and maturities of securities supporting experience-rated pension policyholder contracts, net of purchases	-	1,039
Other, net	(26)	79
Net cash provided by operating activities	253	1,204
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from investments sold:		
Fixed maturities	2,110	2,245
Equity securities	10	62
Mortgage loans	262	64
Other (primarily short-term investments)	5,608	5,803
Investment maturities and repayments:		
Fixed maturities	707	655
Mortgage loans	205	662
Investments purchased:		
Fixed maturities	(2,377)	(3,624)
Equity securities	(9)	(14)
Mortgage loans	(858)	(668)
Other (primarily short-term investments)	(5,885)	(5,575)
Proceeds from sale of businesses	-	2,103
Property and equipment, net	(32)	(32)
Other, net	(18)	(24)
Net cash provided by (used in) investing activities	(277)	1,657
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Deposits and interest credited to contractholder deposit funds	464	2,235
Withdrawals and benefit payments from contractholder deposit funds	(748)	(2,908)
Change in cash overdraft position	(219)	(23)

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Repayment of long-term debt	-	(76)
Repurchase common stock	(1,034)	(526)
Issuance of common stock	301	24
Common dividends paid	(10)	(54)
Net cash used in financing activities	(1,246)	(1,328)
Effect of foreign currency rates on cash	2	-
Net increase (decrease) in cash and cash equivalents	(1,268)	1,533
Cash and cash equivalents, beginning of period	2,519	1,392
Cash and cash equivalents, end of period	\$ 1,251	\$ 2,925
Supplemental Disclosure of Cash Information:		
Income taxes paid, net	\$ 218	\$ 543
Interest paid	\$ 75	\$ 79

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

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CIGNA CORPORATION  
NOTES TO THE FINANCIAL STATEMENTS

**NOTE 1 - BASIS OF PRESENTATION**

The consolidated financial statements include the accounts of CIGNA Corporation, its significant subsidiaries, and variable interest entities of which CIGNA is the primary beneficiary, which are referred to collectively as "CIGNA." Intercompany transactions and accounts have been eliminated in consolidation. These consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States.

The interim financial statements are unaudited but include all adjustments (including normal recurring adjustments) necessary, in the opinion of management, for a fair statement of financial position and results of operations for the periods reported. The interim consolidated financial statements and notes should be read in conjunction with the Consolidated Financial Statements and Notes in CIGNA's 2004 Annual Report to Shareholders and Form 10-K for the year ended 2004.

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

Certain reclassifications have been made to prior period amounts to conform to the 2005 presentation.

**NOTE 2 - RECENT ACCOUNTING PRONOUNCEMENTS**

**Stock compensation.** Effective October 1, 2004, CIGNA elected to early adopt Statement of Financial Accounting Standards (SFAS) No. 123 (as revised in 2004 and referred to as SFAS 123R) "Share-Based Payment." Prior period financial statements have been restated to comply with SFAS 123R. This standard requires companies to recognize in net income an estimate of expense for stock awards and options over their vesting periods typically determined as of the date of grant. Compensation expense for stock options is recorded over their vesting periods based on the estimated fair value of the stock options using an option-pricing model. Compensation expense is recorded for restricted stock grants and deferred stock units over their vesting periods based on fair value, which is equal to the market price of CIGNA common stock on the date of grant. The following information summarizes the effects (reported in Corporate) of implementing this standard on CIGNA's prior year net income and earnings per share for stock option expense:

<i>(In millions, except per share amounts)</i>	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2004
Net income, prior to implementation	\$ 312	\$ 878
Compensation expense for stock options, net of taxes, prior to implementation	8	35
Compensation expense for stock options, net of taxes, under SFAS 123R	(12)	(33)
Net income under SFAS 123R	\$ 308	\$ 880
Net income per share:		
Basic - prior to implementation	\$ 2.31	\$ 6.37
Basic - as restated	\$ 2.28	\$ 6.38
Diluted - prior to implementation	\$ 2.29	\$ 6.30
Diluted - as restated	\$ 2.26	\$ 6.32

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

<i>(In millions)</i>	Three Months Ended September 30,				Nine Months Ended September 30,			
	2005	2004	2005	2004	2005	2004	2005	2004
Compensation expense	\$ 10	\$ 20	\$ 24	\$ 54	\$ 24	\$ 54	\$ 24	\$ 54
Tax benefits	\$ 4	\$ 6	\$ 9	\$ 18	\$ 9	\$ 18	\$ 9	\$ 18

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Compensation expense for stock options was determined using the following data:

<i>(Options in thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Options granted	7	7	825	3,166
Weighted average fair value of options granted	\$ 41.33	\$ 21.85	\$ 34.08	\$ 19.80

The average fair values were determined using the Black-Scholes option-pricing model under the following assumptions:

	As of	
	September 30, 2005	December 31, 2004
Dividend yield	0.1%	0.2%
Expected volatility	35.0%	47.6%
Risk-free interest rate	3.9%	2.2%
Expected option life	5.25 years	3.3 years

The expected volatility of 2005 and 2004 grants reflects CIGNA's past daily stock price volatility. CIGNA does not consider volatility implied in the market prices of traded options to be a good indicator of future volatility because remaining maturities of traded options are less than one year. CIGNA developed the expected option life of 2005 grants by considering certain factors, including assumptions used by other companies with comparable stock option plan features and that CIGNA had cancelled a replacement option feature in June 2004. CIGNA developed the expected option life of 2004 grants considering CIGNA's experience.

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

<i>(Grants in thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Restricted stock granted	19	3	331	421
Weighted average fair value	\$104.90	\$61.64	\$92.45	\$56.98

CIGNA did not award deferred stock units in 2005 or 2004.

In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107, which provided additional guidance to stock option expensing provisions under SFAS 123R. This guidance had no significant impact on CIGNA's early adoption of SFAS 123R; however, CIGNA considered the additional guidance in establishing assumptions to value newly granted stock options under SFAS 123R.

**Long-Duration Contracts.** Effective January 1, 2004, CIGNA implemented SOP 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts."



The SOP addresses accounting for certain contractual features of investment-related and universal life contracts and for separate accounts. The cumulative effect of implementing the SOP in the first quarter of 2004 was a reduction to net income of \$139 million, of which \$136 million resulted from recording liabilities for certain experience-rated pension policyholder contracts based on the appreciated value of associated pools of investments, primarily mortgage loans and real estate. CIGNA recorded additional benefits expense of \$17 million pre-tax (\$11 million after-tax) in the first quarter of 2004 to reflect the post-implementation effect of this accounting requirement. The sale of CIGNA's retirement benefits business generally resulted in the transfer to the buyer of the pool of investments supporting experience-rated pension policyholder contracts. See Note 4 for information about this sale.

The remaining cumulative effect resulted from implementing the SOP's requirements applicable to universal life contracts. CIGNA's accounting for reinsurance of guaranteed minimum death benefit contracts and guaranteed minimum income benefit contracts was not affected by the provisions of the SOP.

### NOTE 3 - INCOME TAXES

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

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

***Distribution from policyholders' surplus account.*** The American Jobs Creation Act of 2004 suspends, for a two-year period commencing January 1, 2005, the tax liability of stock life insurance companies on distributions from the policyholders' surplus account. CIGNA's principal subsidiary distributed, with regulatory approval, the entire account balance of approximately \$450 million to the parent company during the nine months of 2005 without incurring federal income tax.

### NOTE 4 - ACQUISITIONS AND DISPOSITIONS

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

***Sale of Retirement Benefits Business.*** On April 1, 2004, CIGNA sold its retirement benefits business, excluding the corporate life insurance business, for cash proceeds of \$2.1 billion. The sale resulted in an after-tax gain of \$804 million, of which \$267 million after-tax was recognized immediately. The sales agreement provides for post closing adjustments, however, any future adjustments are not expected to be material to CIGNA's consolidated results of operations, liquidity or financial condition.

As this transaction was primarily in the form of a reinsurance arrangement under which CIGNA retains liability, \$537 million of the after-tax gain was deferred. Subsequent to the original reinsurance transaction, the buyer of the retirement benefits business has entered into agreements with some of the insured parties relieving CIGNA of any remaining contractual obligation to those parties (novation). Additional such agreements are expected.

The deferred gain is amortized at the rate at which earnings from the sold business would have been expected to emerge (primarily 15 years on a declining basis) until CIGNA is relieved of any remaining contractual obligation. At the time of novation, CIGNA accelerates amortization of a portion of the deferred gain and also reduces the associated contractholder deposit funds, reinsurance recoverables and separate account balances. For the nine months of 2005, liabilities decreased by \$32.9 billion as a result of novation activity attributable to the sold retirement benefits business. This decrease consisted of \$6.9 billion of contractholder deposit funds and \$26.0 billion of separate account liabilities. Corresponding decreases in assets of \$32.9 billion consisted of \$6.9 billion of reinsurance recoverables and \$26.0 billion of separate account assets. See Note 11 for additional information on reinsurance recoverables associated with the sale of the retirement benefits business.

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

<i>(In millions)</i>	Pre-Tax	After-Tax
<b>Three Months Ended September 30, 2005</b>		
Accelerated deferred gain amortization	\$ 10	\$ 2
Normal deferred gain amortization	\$ 3	\$ 2
<b>2004</b>		
Accelerated deferred gain amortization	\$ 122	\$ 79
Normal deferred gain amortization	\$ 28	\$ 18
<b>Nine Months Ended September 30, 2005</b>		
Accelerated deferred gain amortization	\$ 315	\$ 200
Normal deferred gain amortization	\$ 21	\$ 14
<b>2004</b>		
Accelerated deferred gain amortization	\$ 126	\$ 82
Normal deferred gain amortization	\$ 57	\$ 37

The remaining pre-tax deferred gain as of September 30, 2005 was \$76 million.

On January 1, 2005, CIGNA transferred the assets of substantially all of the separate accounts related to the retirement benefits business to the buyer. Since the arrangement is modified coinsurance, CIGNA received units of the buyer's separate accounts and carries those units as separate account assets on its balance sheet for the business not yet directly assumed by the buyer. At September 30, 2005, there were approximately \$5.1 billion of separate account assets and liabilities associated with the business not yet directly assumed by the buyer.

At September 30, 2005, CIGNA had approximately \$2.0 billion of invested assets, primarily fixed maturities and mortgage loans, supporting the modified coinsurance arrangement of the single premium annuity business. These invested assets are held in a business trust established by CIGNA. CIGNA pays or receives cash quarterly to settle the results of the reinsured business, including the investment results of the assets underlying the modified coinsurance arrangement. CIGNA recorded in other operating expenses a pre-tax charge of \$12 million (\$8 million after-tax) for the nine months of 2005 to offset realized investment results. This charge had no effect on CIGNA's net income.

As a result of this modified coinsurance arrangement, CIGNA has an embedded derivative that transfers to the buyer certain unrealized changes in fair value due to interest rate and credit risks of these assets. CIGNA records these effects in other liabilities and other revenues. A decrease in interest rates could result in a charge to CIGNA's consolidated net income until the modified coinsurance arrangement ends in 2006 when the impact of accounting for this embedded derivative will unwind.

The modified coinsurance arrangement provides for conversion to an indemnity reinsurance structure. The buyer will assume ownership of the trust assets in 2006 unless the buyer elects termination, in which case CIGNA would retain the single premium annuity business, including the trust assets and the insurance liabilities. If the buyer elects termination, CIGNA does not expect a material adverse effect to its consolidated results of operations, liquidity or financial condition.

CIGNA had another modified coinsurance arrangement (terminated on December 1, 2004), which created an embedded derivative that transferred to the buyer certain unrealized changes in fair value due to interest rates and credit risk of assets supporting certain separate accounts. In the third quarter of 2004, CIGNA recorded a pre-tax charge in other revenues of \$14 million for these effects. For the nine months of 2004, other revenues included a

pre-tax benefit of \$27 million for these effects and a related pre-tax charge of \$41 million reflecting the amortization for the period of the excess of the fair value of related assets over the liabilities under this arrangement.

**Discontinued Operations.** The table below represents tax benefits recognized in the second quarter of 2005 from past divestitures. See Note 3 for additional information.

**FINANCIAL SUMMARY**

<i>(In millions)</i>	Nine Months Ended September 30, 2005	
Income tax benefits:		
Property and Casualty insurance business	\$	287
Brazilian Health Care operations		62
Income from discontinued operations	\$	349

**NOTE 5 - COST REDUCTION PROGRAMS**

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

<i>(In millions)</i>	Health Care		Corporate		Total
First quarter 2005 charge	\$	22	\$	29	\$ 51
First quarter 2005 payments		(1)		(2)	(3)
Balance as of March 31, 2005		21		27	48
Second quarter 2005 payments		(5)		(6)	(11)
Balance as of June 30, 2005		16		21	37
Third quarter 2005 payments		(4)		(5)	(9)
Balance as of September 30, 2005	\$	12	\$	16	\$ 28

**Operational effectiveness review.** In the first quarter of 2004, CIGNA adopted a restructuring program associated with planned organizational changes to streamline functional support resources and to adjust its operations to current business volumes. As a result, CIGNA recognized in other operating expenses total pre-tax charges of \$86 million (\$56 million after-tax) of which \$75 million pre-tax (\$49 million after-tax) was recorded in the first quarter of 2004.

The table below shows CIGNA's restructuring activity (pre-tax) related to severance and real estate for this program:

<i>(In millions)</i>	Health Care/ Disability and Life*		Corporate		Total
Balance as of December 31, 2004:					
Severance	\$	11	\$	9	\$ 20
Real estate		8		1	9
		19		10	29
First quarter 2005 payments:					
Severance		(6)		(6)	(12)
Real estate		(1)		-	(1)
Balance as of March 31, 2005		12		4	16
Second quarter 2005 payments:					
Severance		(4)		(2)	(6)

Real estate		(1)		(1)	(2)
Balance as of June 30, 2005		7		1	8
Third quarter 2005 payments:					
Severance		(1)		-	(1)
Real estate		(1)		-	(1)
Balance as of September 30, 2005	\$	5	\$	1	\$ 6

#### **NOTE 6 - GUARANTEED MINIMUM DEATH BENEFIT AND INCOME BENEFIT CONTRACTS**

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

The determination of reserves for guaranteed minimum death benefits requires CIGNA to make critical accounting estimates. CIGNA describes the assumptions used to develop the reserves for these death benefits, and provides the effects of hypothetical changes in those assumptions on page 22 of CIGNA's 2004 Annual Report to Shareholders. CIGNA regularly evaluates the assumptions used in establishing reserves and changes its estimates if actual experience or other evidence suggests that earlier assumptions should be revised. If actual experience differs from the assumptions and other considerations (including lapse, partial surrender, mortality, interest rates and volatility) used in

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\* Initial charge in the first quarter of 2004 included \$2 million pre-tax in the Disability and Life segment.

estimating these reserves, the resulting change could have a material adverse effect on CIGNA's consolidated results of operations, and in certain situations, could have a material adverse effect on CIGNA's financial condition. During the first quarter of 2005, CIGNA completed its normal quarterly review of assumptions and recorded an after-tax charge of \$11 million (\$17 million pre-tax). This charge primarily resulted from an update to lapse assumptions based on emerging experience. The charge also reflects updates to partial surrender assumptions, reflecting the impact of stock market declines, as well as other assumptions. CIGNA had future policy benefit reserves for guaranteed minimum death benefit contracts of approximately \$1.0 billion as of September 30, 2005 and December 31, 2004.

The following provides information about CIGNA's reserving methodology and assumptions for guaranteed minimum death benefits as of September 30, 2005:

- The reserves represent estimates of the present value of net amounts expected to be paid, less the present value of net future premiums. Included in net amounts expected to be paid is the excess of the guaranteed death benefits over the values of the contractholders' accounts (based on underlying equity and bond mutual fund investments).
- The reserves include an estimate for partial surrenders that essentially lock in the death benefit for a particular policy based on annual election rates that vary from 0-20% depending on the net amount at risk for each policy and whether surrender charges apply.
- The mean investment performance assumption is 5% considering CIGNA's program to reduce equity market exposures using futures and forward contracts.
- The volatility assumption is 15-30%, varying by equity fund type; 3-8%, varying by bond fund type; and 1% for money market funds.

· The discount rate is 5.75%.

- The mortality assumption is 70-75% of the 1994 Group Annuity Mortality table, with 1% annual improvement beginning January 1, 2000.
- The lapse rate assumption is 0-15%, depending on contract type, policy duration and the ratio of the net amount at risk to account value.

As of September 30, 2005, the aggregate fair value of the underlying mutual fund investments was approximately \$41.5 billion. The death benefit coverage in force as of that date (representing the amount that CIGNA would have to pay if all 1.1 million contractholders had died on that date) was approximately \$7.5 billion. The death benefit coverage in force represents the excess of the guaranteed benefit amount over the fair value of the underlying mutual fund investments.

CIGNA recorded in other revenues pre-tax losses of \$45 million for the third quarter and \$28 million for the nine months of 2005, compared with pre-tax gains of \$33 million for the third quarter and pre-tax losses of \$27 million for the nine months of 2004 from futures and forward contracts. Expense offsets reflecting corresponding changes in liabilities for these guaranteed minimum death benefit contracts were included in benefits and expenses. During the first quarter of 2005, CIGNA began using foreign currency futures contracts in place of foreign currency forward contracts as part of its program to reduce international equity market risks associated with this business. The notional amount of the futures contract positions held by CIGNA at September 30, 2005, was \$1.2 billion.

For further information and details on these contracts and the program adopted to reduce related equity market risk, refer to Note 6 of CIGNA's 2004 Annual Report to Shareholders.

CIGNA has also written reinsurance contracts with issuers of variable annuity contracts that provide annuitants with certain guarantees related to minimum income benefits. See [Note 13](#) for further information.

**NOTE 7 - PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS**

**Pension benefits.** CIGNA funds its qualified pension plans by at least the minimum amount required by the Employee Retirement Income Security Act of 1974 (ERISA). CIGNA contributed approximately \$545 million in 2005 as follows:

- \$105 million for minimum funding requirements for the domestic pension plan and for voluntary contributions to the international pension plans; and
- \$440 million for voluntary contributions to the domestic pension plan, which represent an acceleration of expected payments for minimum funding requirements in 2006 and 2007.

The decision to make voluntary contributions to the domestic pension plan was based upon the favorable economic impact the contributions will have on the funding status of CIGNA's pension plan, including the potential for reducing future additional funding requirements as well as reducing premiums to the Pension Benefit Guaranty Corporation.

Components of net pension cost were as follows:

<i>(In millions)</i>	Three Months Ended September 30,				Nine Months Ended September 30,			
	2005		2004		2005		2004	
Service cost	\$	18	\$	18	\$	54	\$	56
Interest cost		56		55		166		165
Expected return on plan assets		(46)		(47)		(136)		(143)
Amortization of:								
Net loss from past experience		35		28		105		76
Prior service cost		—		(1)		(1)		(1)
Net pension cost	\$	63	\$	53	\$	188	\$	153

**Pension Liability**

2005

Through the nine months of 2005, CIGNA recorded an after-tax charge of \$30 million to increase plan obligations, which resulted in a decrease to shareholders' equity. This charge was primarily due to the annual update of plan census data.

2004

During the third quarter of 2004, CIGNA amended its qualified domestic pension plan and remeasured plan assets and obligations. As a result, CIGNA increased equity by \$21 million after-tax due to an increase in long-term interest rates (5.75% to 6.00%) used to determine the accumulated benefit obligation, partially offset by the effect of stock market depreciation on plan assets.

For the nine months of 2004 as a result of the sale of the retirement benefits business, the operational effectiveness review, the annual update of plan census data and the plan amendment, CIGNA remeasured plan assets and obligations and recorded an after-tax charge, which decreased equity by \$131 million. This charge was primarily due to a reduction in long-term interest rates (from 6.25% to 6.00%) used to determine the accumulated benefit obligation, as well as the update of plan census data, partially offset by the effect of stock market appreciation on plan assets.



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

<i>(In millions)</i>	Three Months Ended September 30,				Nine Months Ended September 30,			
	2005		2004		2005		2004	
Service cost	\$	1	\$	1	\$	2	\$	2
Interest cost		7		7		20		24
Expected return on plan assets		(1)		(1)		(2)		(2)
Amortization of:								
Net gain from past experience		—		—		(1)		—
Prior service cost		(4)		(4)		(12)		(12)
Net other postretirement benefit cost	\$	3	\$	3	\$	7	\$	12

CIGNA also recognized gains of \$5 million pre-tax (\$3 million after-tax) for the third quarter of 2004 and \$19 million pre-tax (\$12 million after-tax) for the nine months of 2004 for other postretirement benefits in connection with the 2004 operational effectiveness review and the sale of the retirement benefits business.

**NOTE 8 - INVESTMENTS****Realized Investment Gains and Losses**

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

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Fixed maturities	\$ 10	\$ 3	\$ 25	\$ 119
Equity securities	2	7	2	19
Mortgage loans	-	(4)	(2)	215
Real estate	1	(1)	-	51
Derivatives and other	(4)	6	3	43
Realized investment gains, before income taxes	9	11	28	447
Less income taxes	3	3	10	156
Net realized investment gains	\$ 6	\$ 8	\$ 18	\$ 291

**Fixed Maturities and Equity Securities**

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

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Proceeds from sales	\$635	\$1,164	\$2,120	\$2,307
Gross gains on sales	\$11	\$26	\$33	\$236
Gross losses on sales	\$(4)	\$(7)	\$(18)	\$(41)

Fixed maturities included securities of \$45 million at September 30, 2005 and \$56 million at December 31, 2004 classified as trading. These securities are carried at fair value with changes in fair value reported in other revenues.

**Review of Declines in Fair Value.** Management reviews fixed maturities and equity securities for impairment based on criteria that include:

- length of time and severity of decline;
- financial health and specific near term prospects of the issuer; and
- changes in the regulatory, economic or general market environment of the issuer's industry or geographic region.

As of September 30, 2005, fixed maturities (primarily investment grade corporate bonds) and equity securities with a decline in fair value from cost were as follows, including the length of time of such decline:

<i>(In millions)</i>	Fair Value	Amortized Cost	Unrealized Depreciation
Fixed maturities:			
One year or less:			
Investment grade	\$ 3,197	\$ 3,250	\$ (53)

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Below investment grade	\$	180	\$	185	\$	(5)
More than one year:						
Investment grade	\$	615	\$	638	\$	(23)
Below investment grade	\$	28	\$	29	\$	(1)
Equity securities:						
Greater than one year	\$	9	\$	10	\$	(1)

As of September 30, 2005, CIGNA had commitments to purchase the following investments:

<i>(In millions)</i>		As of September 30, 2005
Fixed maturities	\$	91
Mortgage loans		360
Real estate joint ventures		45
Investments in partnerships secured by real estate		109
Investments in partnerships secured by securities		196
Total	\$	801

CIGNA expects to disburse approximately \$475 million of these committed amounts in the fourth quarter of 2005.

**NOTE 9 - ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

Accumulated other comprehensive income (loss) excludes:

- amounts required to adjust future policy benefits for certain annuities; and
- amounts required to adjust other liabilities after the initial reclassification of unrealized appreciation under a modified coinsurance arrangement.

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

<i>(In millions)</i>	Pre-Tax	Tax (Expense) Benefit	After-Tax
<b>Three Months Ended September 30, 2005</b>			
<b>Net unrealized depreciation, securities:</b>			
Unrealized depreciation on securities held	\$ (183)	\$ 64	\$ (119)
Gains realized on securities	(12)	5	(7)
Net unrealized depreciation, securities	\$ (195)	\$ 69	\$ (126)
<b>Net unrealized depreciation, derivatives</b>	\$ (9)	\$ 4	\$ (5)
<b>Minimum pension liability adjustment</b>	\$ 1	\$ (1)	\$ -
<b>2004</b>			
<b>Net unrealized appreciation, securities:</b>			
Unrealized appreciation on securities held	\$ 303	\$ (106)	\$ 197
Gains realized on securities	(10)	4	(6)
Net unrealized appreciation, securities	\$ 293	\$ (102)	\$ 191
<b>Net unrealized appreciation, derivatives</b>	\$ 6	\$ (3)	\$ 3
<b>Net translation of foreign currencies</b>	\$ 5	\$ (2)	\$ 3
<b>Minimum pension liability adjustment</b>	\$ 32	\$ (11)	\$ 21
<b>Nine months ended September 30, 2005</b>			
<b>Net unrealized depreciation, securities:</b>			
Unrealized depreciation on securities held	\$ (208)	\$ 73	\$ (135)
Gains realized on securities	(27)	10	(17)
Net unrealized depreciation, securities	\$ (235)	\$ 83	\$ (152)
<b>Net unrealized appreciation, derivatives</b>	\$ 3	\$ (1)	\$ 2
<b>Net translation of foreign currencies</b>	\$ (6)	\$ 1	\$ (5)
<b>Minimum pension liability adjustment</b>	\$ (45)	\$ 15	\$ (30)
<b>2004</b>			
<b>Net unrealized depreciation, securities:</b>			
Unrealized appreciation on securities held	\$ 85	\$ (34)	\$ 51
Gains realized on securities	(138)	49	(89)
Reclassification to other liabilities for modified coinsurance	(256)	90	(166)
Net unrealized depreciation, securities	\$ (309)	\$ 105	\$ (204)
<b>Net unrealized appreciation, derivatives</b>	\$ 14	\$ (5)	\$ 9
<b>Net translation of foreign currencies</b>	\$ 1	\$ —	\$ 1
<b>Minimum pension liability adjustment</b>	\$ (202)	\$ 71	\$ (131)

#### NOTE 10 - EARNINGS PER SHARE

Basic and diluted earnings per share were computed as follows:

<i>(Dollars in millions, except per share amounts)</i>	Basic	Effect of Dilution	Diluted
<b>Three Months Ended September 30, 2005</b>	\$ 259	—	\$ 259

**Income from continuing operations**Shares (*in thousands*):

Weighted average	126,888	—	126,888
Options and restricted stock grants		2,795	2,795
<b>Total shares</b>	<b>126,888</b>	<b>2,795</b>	<b>129,683</b>
<b>EPS</b>	<b>\$ 2.04</b>	<b>\$ (0.04)</b>	<b>\$ 2.00</b>

**2004****Income from continuing operations**Shares (*in thousands*):

Weighted average	134,910	—	134,910
Options and restricted stock grants		1,365	1,365
<b>Total shares</b>	<b>134,910</b>	<b>1,365</b>	<b>136,275</b>
<b>EPS</b>	<b>\$ 2.28</b>	<b>\$ (0.02)</b>	<b>\$ 2.26</b>

**Nine Months Ended September 30, 2005****Income from continuing operations**Shares (*in thousands*):

Weighted average	128,852	—	128,852
Options and restricted stock grants		2,386	2,386
<b>Total shares</b>	<b>128,852</b>	<b>2,386</b>	<b>131,238</b>
<b>EPS</b>	<b>\$ 8.27</b>	<b>\$ (0.15)</b>	<b>\$ 8.12</b>

**2004****Income from continuing operations**Shares (*in thousands*):

Weighted average	137,893	—	137,893
Options and restricted stock grants		1,303	1,303
<b>Total shares</b>	<b>137,893</b>	<b>1,303</b>	<b>139,196</b>
<b>EPS</b>	<b>\$ 7.39</b>	<b>\$ (0.07)</b>	<b>\$ 7.32</b>

The following outstanding employee stock options were not included in the computation of diluted earnings per share because their effect would have increased diluted earnings per share (antidilutive) as the estimated proceeds from their exercise was greater than the average share price of CIGNA's common shares for the period.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
(In millions)	2005	2004	2005	2004
<b>Antidilutive options</b>	0.3	11.6	3.3	12.9

CIGNA held 34,248,300 common shares as Treasury shares as of September 30, 2005, and 141,718,172 as of September 30, 2004.

#### NOTE 11 - REINSURANCE

In the normal course of business, CIGNA's insurance subsidiaries enter into agreements with other insurance companies to assume and cede reinsurance. Reinsurance is ceded primarily to limit losses from large exposures and to permit recovery of a portion of direct losses. Reinsurance does not relieve the originating insurer of liability. CIGNA evaluates the financial condition of its reinsurers and monitors their concentrations of credit risk.

**Retirement benefits business.** CIGNA had a reinsurance recoverable of \$1.5 billion as of September 30, 2005, and \$8.6 billion as of December 31, 2004, from Prudential Retirement Insurance and Annuity Company resulting from the sale of the retirement benefits business, which was primarily in the form of reinsurance arrangements. The reinsurance recoverable is secured primarily by fixed maturities and mortgage loans held in a business trust established by the reinsurer. This recoverable is reduced as CIGNA's reinsured liabilities are paid or directly assumed by the reinsurer.

**Individual life and annuity reinsurance.** CIGNA had a reinsurance recoverable of \$5.0 billion at September 30, 2005, and \$5.2 billion at December 31, 2004, from Lincoln National Corporation that arose from the 1998 sale of CIGNA's individual life insurance and annuity business through an indemnity reinsurance arrangement.

**Unicover and other run-off reinsurance.** The Run-off Reinsurance operations participate in a workers' compensation reinsurance pool, which ceased accepting new risks in early 1999. This pool was formerly managed by Unicover Managers, Inc. Although an arbitration over the most significant reinsurance (retrocessional) contracts for the pool was completed in 2002, some disputes over collection of amounts due CIGNA from those retrocessionaires continue and may require further arbitration actions to resolve. Disputes and arbitrations regarding other reinsurance (retrocessional) contracts for the pool are likely to be substantially resolved by the end of 2006.

Run-off Reinsurance also includes other (non-Unicover) workers' compensation reinsurance contracts, as well as personal accident reinsurance contracts, including contracts assumed in the London market. CIGNA is in dispute and arbitration with some ceding companies over the amount of liabilities assumed under their contracts, and expects that these disputes and arbitrations will be substantially resolved by the end of 2007. CIGNA obtained retrocessional reinsurance coverage for a significant portion of its liabilities under these contracts, and some of these retrocessionaires have disputed the validity of their contracts with CIGNA. Several of these disputes with retrocessionaires were settled in 2004 and 2005 and several remain in arbitration. These arbitrations are expected to be substantially resolved by the end of 2006.

Unfavorable claims experience related to workers' compensation and personal accident exposures is possible and could result in future losses, including losses attributable to the inability to recover amounts from retrocessionaires (either due to disputes with the retrocessionaires or their financial condition).

CIGNA's reserves for amounts recoverable from retrocessionaires, as well as reserves associated with underlying reinsurance exposures assumed by CIGNA, are considered appropriate as of September 30, 2005, based on current information. However, it is possible that future developments could have a material adverse effect on CIGNA's consolidated results of operations and, in certain situations, could have a material adverse effect on CIGNA's financial condition.

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

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

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<b>Premiums and fees</b>				
Individual life insurance and annuity business sold	\$ 66	\$ 72	\$ 202	\$ 219
Other	51	34	147	111
Total	\$ 117	\$ 106	\$ 349	\$ 330
<b>Reinsurance recoveries</b>				
Individual life insurance and annuity business sold	\$ 93	\$ 75	\$ 233	\$ 224
Other	41	56	136	108
Total	\$ 134	\$ 131	\$ 369	\$ 332

#### NOTE 12 - SEGMENT INFORMATION

Operating segments generally reflect groups of related products, but the International segment is based on geography. CIGNA measures the financial results of its segments using "segment earnings (loss)" which is defined as income (loss) from continuing operations before realized investment gains (losses).

Summarized segment financial information was as follows:

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<b>Premiums and fees and other revenues</b>				
Health Care	\$ 2,783	\$ 3,038	\$ 8,352	\$ 9,025
Disability and Life	557	532	1,667	1,578
International	316	252	920	748
Run-off Retirement	13	194	338	522
Run-off Reinsurance	(25)	50	37	32
Other Operations	47	66	165	218
Corporate	(12)	(4)	(28)	(34)
Total	\$ 3,679	\$ 4,128	\$ 11,451	\$ 12,089
<b>Income (loss) from continuing operations</b>				
Health Care	\$ 164	\$ 206	\$ 528	\$ 533
Disability and Life	57	41	175	128
International	24	23	86	58
Run-off Retirement	2	90	200	146
Run-off Reinsurance	(3)	(54)	(29)	(77)
Other Operations	25	23	95	59



Corporate	(16)	(29)	(7)	(119)
Segment earnings	253	300	1,048	728
Realized investment gains, net of taxes	6	8	18	291
Income from continuing operations	\$ 259	\$ 308	\$ 1,066	\$ 1,019

**NOTE 13 - CONTINGENCIES AND OTHER MATTERS**

CIGNA, through its subsidiaries, is contingently liable for various financial guarantees provided in the ordinary course of business.

**Separate Account Guarantees**

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

CIGNA guarantees that separate account assets will be sufficient to pay certain retiree and life benefits. The sponsoring employers are primarily responsible for ensuring that assets are sufficient to pay these

benefits and are required to maintain assets that exceed a certain percentage of benefit obligations. This percentage varies depending on the asset class within a sponsoring employer's portfolio (for example, a bond fund would require a lower percentage than a riskier equity fund) and thus will vary as the composition of the portfolio changes. If employers do not maintain the required levels of separate account assets, CIGNA or the affiliate of the buyer has the right to redirect the management of the related assets to provide for benefit payments. As of September 30, 2005, employers maintained assets that exceeded the benefit obligations. Benefit obligations under these arrangements were \$2.1 billion as of September 30, 2005. As of September 30, 2005, approximately 80% of these guarantees were associated with the sold retirement benefits business and reinsured by the affiliate of the buyer of the retirement benefits business. There were no additional liabilities required for these guarantees as of September 30, 2005.

CIGNA guarantees that separate account assets, primarily fixed income investments, will be sufficient to pay retiree benefits for participants under a certain group annuity contract. These guarantees are fully reinsured by an affiliate of the buyer of the retirement benefits business. These guaranteed benefit obligations were \$36 million as of September 30, 2005. CIGNA had no additional liabilities for these guarantees as of September 30, 2005.

### **Other Financial Guarantees**

CIGNA had indemnification obligations to lenders up to \$331 million as of September 30, 2005 related to borrowings by certain real estate joint ventures, which CIGNA either records as an investment or consolidates. These borrowings, which are nonrecourse to CIGNA, are secured by the joint ventures' real estate properties with fair values in excess of the loan amounts and mature at various dates beginning in 2006 through 2017. CIGNA's indemnification obligations would require payment to lenders for any actual damages resulting from certain acts such as unauthorized ownership transfers, misappropriation of rental payments by others or environmental damages. Based on initial and ongoing reviews of property management and operations, CIGNA does not expect that payments will be required under these indemnification obligations. Any payments that might be required could be recovered through a refinancing or sale of the assets. In some cases, CIGNA also has recourse to partners for their proportionate share of amounts paid. There were no liabilities required for these indemnification obligations as of September 30, 2005.

To increase investment returns through credit exposure, CIGNA guaranteed principal payments for groups of investment grade corporate debt issuers by entering Dow Jones indexed credit default swaps with notional amounts of \$290 million as of September 30, 2005. Under these contracts, CIGNA receives periodic fees to provide future payment if an issuer of an underlying corporate bond defaults on scheduled payments or files for bankruptcy through 2010. If a default or bankruptcy occurs, CIGNA will make payment for par value of the underlying corporate bond and may subsequently sell or hold that bond as an invested asset. CIGNA has recorded liabilities of less than \$1 million for the fair value of these indexed credit default swaps as of September 30, 2005.

As of September 30, 2005, CIGNA guaranteed that it would compensate the lessor for a shortfall of up to \$49 million in the market value of leased equipment at the end of the lease. Guarantees of \$21 million expire in 2006 and \$28 million expire in 2012. CIGNA had additional liabilities for these guarantees of \$3 million as of September 30, 2005.

CIGNA guaranteed construction loans of \$24 million as of September 30, 2005 related to real estate joint venture investments. The loans are secured by joint venture real estate property with fair values in excess of the loan amounts and mature by 2008, including extension options. CIGNA would be required to repay the construction loans if permanent financing could not be obtained. There were no liabilities required for these guarantees as of September 30, 2005.

CIGNA had indemnification obligations as of September 30, 2005 in connection with acquisition and disposition transactions. These indemnification obligations are triggered by the breach of representations or covenants provided by CIGNA, such as representations for the presentation of financial statements, the filing of tax returns, compliance with law or the identification of outstanding litigation. These obligations are typically subject to various time limitations, defined



by the contract or by operation of law, such as statutes of limitation. In some cases, the maximum potential amount due is subject to contractual limitations based on a percentage of the transaction purchase price, while in other cases limitations are not specified or applicable. CIGNA does not believe that it is possible to determine the maximum potential amount due under these guarantees, since not all amounts due under these indemnification obligations are subject to limitation. There were no liabilities required for these indemnification obligations as of September 30, 2005.

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

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

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

CIGNA regularly evaluates the assumptions used in establishing these assets and liabilities and changes its estimates if actual experience or other evidence suggests that earlier assumptions should be revised. CIGNA describes these assumptions and provides an estimate of the effects of the hypothetical changes in those assumptions on page 23 of CIGNA's 2004 Annual Report to Shareholders. If actual experience differs from the assumptions and other considerations used in estimating these assets and liabilities, the resulting change could have a material adverse effect on CIGNA's consolidated results of operations, and in certain situations, could have a material adverse effect on CIGNA's financial condition.

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

- These liabilities represent estimates of the present value of net amounts expected to be paid, less the present value of net future premiums expected to be received. Included in net amounts expected to be paid is the excess of the expected value of the income benefits over the values of the annuitant's accounts at the time of annuitization. The assets associated with these contracts represent receivables in connection with reinsurance that CIGNA has purchased from third parties.
- The market return assumption is 8-12% varying by equity fund type; 6-9% varying by bond fund type; and 5-6% for money market funds.
- The volatility assumption is 14-24%, varying by equity fund type; 6-7%, varying by bond fund type; and 2-3% for money market funds.
- The discount rate is 5.75%.
- The projected interest rate used to calculate the reinsured income benefits at the time of annuitization varies by economic scenario, reflects interest rates as of the valuation date, and has a long-term mean rate of 5-6% and a standard deviation of 12-13%.
- The mortality assumption is 75% of the 1994 Group Annuity Mortality table, with 1% annual improvement beginning January 1, 2000.
- The lapse rate assumption is 2-15%, depending on policy duration.
- The annuity election rate assumption is that no more than 5% of the policies eligible to annuitize their variable annuity contracts will do so each year.

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

- No annuitants surrendered their accounts, and
- All annuitants lived to elect their benefits; and
- All annuitants elected to receive their benefit on the first available date (2005 through 2014); and
- All underlying mutual fund investment values remained at the September 30, 2005 value of \$3.3 billion, with no future returns.

The maximum potential undiscounted payments that CIGNA would make under those assumptions

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would aggregate \$1.4 billion before reinsurance recoveries. CIGNA believes the likelihood of such payment is remote and expects the amount of actual payments to be significantly less than this hypothetical undiscounted aggregate amount. CIGNA has purchased reinsurance from third parties which cover 55% of the exposures on these contracts.

As of September 30, 2005, CIGNA had liabilities of \$78 million related to these contracts and amounts recoverable from reinsurers of \$43 million. CIGNA had an additional liability of \$39 million associated with the cost of reinsurance as of September 30, 2005. As of December 31, 2004, CIGNA had liabilities of \$71 million related to these contracts and amounts recoverable from reinsurers of \$39 million. CIGNA had an additional liability of \$41 million associated with the cost of reinsurance as of December 31, 2004. Management believes the current assumptions used to estimate reserves for these liabilities are appropriate.

## **Regulatory and Industry Developments**

***Employee benefits regulation.*** The business of administering and insuring employee benefit programs, particularly health care programs, is heavily regulated by federal and state laws and administrative agencies, such as state departments of insurance and the federal Departments of Labor and Justice, as well as the courts. Regulation and judicial decisions have resulted in changes to industry and CIGNA's business practices and will continue to do so in the future. In addition, CIGNA's subsidiaries are routinely involved with various claims, lawsuits and regulatory audits and investigations that could result in financial liability, changes in business practices, or both. Health care regulation in its various forms could have an adverse effect on CIGNA's health care operations if it inhibits CIGNA's ability to respond to market demands or results in increased medical or administrative costs without improving the quality of care or services.

Other possible regulatory changes that could have an adverse effect on CIGNA's businesses include:

- additional mandated benefits or services that increase costs without improving the quality of care;
- legislation that would grant plan participants broader rights to sue their health plans;
- changes in ERISA regulations resulting in increased administrative burdens and costs;
- additional restrictions on the use of prescription drug formularies;
- additional privacy legislation and regulations that interfere with the proper use of medical information for research, coordination of medical care and disease and disability management;
- additional rules establishing the time periods for payment of health care provider claims that vary from state to state;
- legislation that would exempt independent physicians from antitrust laws; and
- changes in federal laws, such as amendments to income tax laws, which could affect the taxation of employer provided benefits, and pension legislation, which could increase pension cost.

The employee benefits industry remains under scrutiny by various state and federal government agencies and could be subject to government efforts to bring criminal actions in circumstances that could previously have given rise only to civil or administrative proceedings.

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

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



## Litigation and Other Legal Matters

In 2004, a Florida federal court handling multi-district health care litigation against CIGNA and several health care industry competitors approved a settlement agreement between the physician class and CIGNA. In April 2005, the court approved a settlement between CIGNA and the remaining plaintiffs, a class of non-physician health care professionals. A dispute with a representative of certain physicians over administration of the settlement with the physician class is likely to be resolved in early 2006.

Beginning in 2004, various regulators, including the New York and Connecticut Attorneys General, began investigating insurance broker compensation. Some regulators have brought suit against certain insurance brokers, including Universal Life Resources (ULR), alleging, among other things, that these brokers sought rigged bids from, and steered business to, insurers with whom they had contingent compensation arrangements. CIGNA and some of its subsidiaries are included in one such lawsuit seeking injunctive relief against these types of contingent compensation arrangements. In addition, CIGNA is providing information about ULR in connection with an investigation by the U.S. Attorney's Office for the Southern District of California. CIGNA is cooperating with the inquiries and investigations by regulators and the U.S. Attorney's Office. Separately, several purported class action lawsuits have been filed against brokers and insurance companies, including CIGNA and certain of its subsidiaries, asserting that contingent commissions are unlawful. CIGNA disagrees with the assertions against it in the lawsuits. In addition, in early 2005, a shareholder filed a derivative lawsuit against certain CIGNA directors and officers alleging breach of fiduciary duty based upon allegations similar to those contained in the ULR cases.

In 2004, the New York Attorney General commenced a lawsuit against Express Scripts, Inc. and two CIGNA insurance companies. Under an agreement with the CIGNA companies, Express Scripts is responsible for administering the prescription drug benefit program under New York State's principal employee health plan, the Empire Plan. The CIGNA companies insure the prescription drug benefit program and hold the contract with the New York State Department of Civil Service. The complaint primarily focuses on administration of the prescription drug benefit program.

A purported class action lawsuit and a shareholder derivative lawsuit against CIGNA and certain of its senior officers and directors allege securities law violations and breach of fiduciary duty. These suits originated in 2002. Separately, a court has granted final approval of a settlement agreement in a purported class action lawsuit against CIGNA and certain of its officers asserting violations of ERISA based on losses in investments in CIGNA stock by CIGNA 401(k) Plan participants.

Plaintiffs representing CIGNA Pension Plan participants who earned certain Plan benefits prior to 1998 filed a class action lawsuit against CIGNA and the CIGNA Pension Plan. The plaintiffs allege, among other things, that the Plan violated ERISA by impermissibly conditioning certain post-1997 benefit accruals on the amount of pre-1998 benefit accruals, that these conditions are not adequately disclosed to Plan participants, and that the Plan's cash balance formula discriminates against older employees.

See "Unicover and other run-off reinsurance" in Note 11 for a description of legal matters arising out of the run-off reinsurance operations.

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





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

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**INTRODUCTION**

In this filing and in other marketplace communications, CIGNA makes certain forward-looking statements relating to its financial condition and results of operations, as well as to trends and assumptions that may affect CIGNA. Generally, forward-looking statements can be identified through the use of predictive words (e.g., “Outlook for 2005”). Actual results may differ from CIGNA’s predictions. Some factors that could cause results to differ are discussed throughout Management’s Discussion and Analysis, including in the Cautionary Statement on page 43.

The following discussion addresses the financial condition of CIGNA as of September 30, 2005, compared with December 31, 2004, and its results of operations for the third quarter and nine months ended September 30, 2005,

compared with the same periods last year. This discussion should be read in conjunction with Management's Discussion and Analysis included in CIGNA's 2004 Annual Report to Shareholders, to which the reader is directed for additional information.

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

## OVERVIEW

CIGNA Corporation's subsidiaries provide health care and related benefits offered through the workplace. Key product lines include health care products and services (medical, pharmacy, behavioral health, dental benefits, and disease management) as well as group disability, life and accident insurance, and disability and workers' compensation case management and related services. In addition, CIGNA has an international operation that offers similar products to businesses and individuals in selected markets, and has certain inactive businesses including a run-off retirement operation (see page 32 for further discussion) and a run-off reinsurance operation.

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

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

CIGNA generates revenues, income and cash flows by maintaining and growing its relationships with employers and consumers, charging prices that reflect emerging experience and investing available

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

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

- competitiveness of CIGNA's product design and service quality;
- the absolute level of and trends in benefit costs;
- the volume of customers served and the mix of products and services purchased by those customers;
- the ability to price products and services competitively at levels that appropriately account for underlying cost inflation and utilization patterns; and
- the relationship between administrative costs and revenues.

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

CIGNA is focused, in particular, on continuing to improve the performance of the health care operations, on profitably growing the disability and life and international businesses and on managing the risks associated with the run-off reinsurance operations. In the health care operations, CIGNA has initiatives in place to (1) offer products that meet emerging consumer and market trends; (2) improve medical membership results; (3) lower medical cost trends; (4) deliver quality member service; and (5) lower administrative expenses (see pages [30](#) and [31](#) for further discussion of these initiatives).

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

CIGNA's disability and life operations continue to focus on profitable growth with a particular emphasis on middle market disability business. The international business is focused on profitable growth particularly in the life accident and health and expatriate benefits businesses. In the run-off reinsurance operations, CIGNA maintains a program to reduce the equity market risk associated with its guaranteed minimum death benefit reinsurance exposures. CIGNA is also pursuing the resolution of disputes associated with workers' compensation and other reinsurance contracts through audits of claims from assumed business and managing collections from retrocessionaires (see page [34](#) for further discussion).

## CONSOLIDATED RESULTS OF OPERATIONS

### FINANCIAL SUMMARY

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<i>(In millions)</i>				
Premiums and fees	\$ 3,381	\$ 3,618	\$ 10,151	\$ 10,754
Net investment income	334	340	995	1,298
Other revenues	298	510	1,300	1,335
Realized investment gains	9	11	28	447

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Total revenues	4,022		4,479		12,474		13,834
Benefits and expenses	3,639		3,984		10,989		12,268
Income from continuing operations before taxes	383		495		1,485		1,566
Income taxes	124		187		419		547
Income from continuing operations	259		308		1,066		1,019
Income from discontinued operations	—		—		349		—
Income before cumulative effect of accounting change	259		308		1,415		1,019
Cumulative effect of accounting change, net of taxes (See <u>Note 2</u> to the Financial Statements)	—		—		—		(139)
Net income	\$ 259	\$	308	\$	1,415	\$	880
Realized investment gains, net of taxes	\$ 6	\$	8	\$	18	\$	291

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Income from continuing operations includes special items, which are discussed below. Excluding these special items and realized investment gains, CIGNA's results for the nine months of 2005, compared with the same period last year reflect;

- lower losses in the Run-off Reinsurance segment and Corporate;
- higher earnings in ongoing operating businesses; and
- lower results in the Run-off Retirement segment.

## Income Taxes

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

- \$287 million resulting from capital losses realized in connection with the divestiture of the property and casualty insurance operations in 1999, which is included in income from discontinued operations; and
  - \$150 million resulting primarily from the release of tax reserves and valuation allowances of which:
    - \$88 million (of which \$81 million is reported as a special item) is reported in the International segment, Other Operations and Corporate as income from continuing operations; and
    - \$62 million relates to the divestiture of CIGNA's Brazilian health care business, which is included in income from discontinued operations.

In October 2005, CIGNA recovered approximately \$220 million in net cash relating to its refund claim and the settlement of audit issues.

In order to facilitate an understanding and comparison of results of operations and permit analysis of trends in underlying revenues, expenses and income from continuing operations, the following table presents special items, which management believes are not representative of the underlying results of operations.

<b>SPECIAL ITEMS</b> (In millions)	Pre-Tax Benefit (Charge)	After-Tax Benefit (Charge)
<b>Three Months Ended September 30, 2005</b>		
Accelerated amortization of deferred gain on sale of retirement benefits business (see page 25)	\$ 10	\$ 2
<b>2004</b>		
Accelerated amortization of deferred gain on sale of retirement benefits business	\$ 122	\$ 79
Net charge associated with a modified coinsurance arrangement	(14)	(9)
Total	\$ 108	\$ 70
<b>Nine Months Ended September 30, 2005</b>		
Accelerated amortization of deferred gain on sale of retirement benefits business (see page 25)	\$ 315	\$ 200
IRS tax settlement (see page 22)	83	81
Cost reduction charge (see page 26)	(51)	(33)
Charge associated with a modified coinsurance arrangement (see page 25)	(12)	(8)
Total	\$ 335	\$ 240

**2004**

Accelerated amortization of deferred gain on sale of retirement benefits business	\$	122	\$	79
Cost reduction charge		(75)		(49)
Net charge associated with a modified coinsurance arrangement		(14)		(9)
Effect of new accounting pronouncement		(17)		(11)
Total	\$	16	\$	10

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## Revenues

Revenues decreased for the third quarter of 2005, compared with the same period last year, primarily because of:

- lower premiums and fees in the Health Care segment primarily due to lower membership;
- lower gain amortization associated with the sale of the retirement benefits business; and
- losses from futures contracts, compared to gains in the prior year, in connection with the program to reduce equity market risks (see guaranteed minimum death benefit contracts on page 34).

Revenues decreased for the nine months of 2005 primarily due to:

- lower realized gains and reduced net investment income associated with the sale of the retirement benefits business; and
- lower premiums and fees in the Health Care segment primarily due to lower membership.

For the nine months of 2005, these declines were partially offset by increased recognition of deferred gain amortization associated with the sale of the retirement benefits business.

## Outlook for 2005 and 2006

Management expects full year 2005 income from continuing operations excluding realized investment results and special items to be lower than the nine months of 2005 on an annualized basis. The full year outlook assumes that certain favorable items noted in the first nine months of 2005 will not recur, including prior year claim development and the level of favorable mortality experience in the life insurance business.

Information is not available for management to reasonably estimate future income from continuing operations at this time. Full year 2005 income from continuing operations will include realized investment results, which are not predictable, and special items. In addition to amounts reported as special items through the nine months of 2005, special items for the fourth quarter of 2005 may include:

- additional accelerated recognition of the deferred gain on the sale of the retirement benefits business; and
- additional amounts associated with a modified coinsurance arrangement (see page 25).

CIGNA expects full year 2006 income from continuing operations excluding realized investment results, and special items to be lower than the comparable 2005 amount primarily reflecting the absence of favorable prior year claim development recognized in 2005. Excluding this factor, CIGNA expects 2006 to be higher than 2005 due to fundamental improvement in the health care operations.

## Critical Accounting Estimates

The preparation of financial statements in accordance with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect reported amounts and related disclosures in the financial statements. Management considers an accounting estimate to be critical if:

- it requires assumptions to be made that were uncertain at the time the estimate was made; and
- changes in the estimate or different estimates that could have been selected could have a material impact on CIGNA's consolidated results of operations or financial condition.



CIGNA's most critical accounting estimates, as well as the effects of hypothetical changes in material assumptions used to develop each estimate, are described in CIGNA's 2004 Annual Report to Shareholders beginning on page 22 and are as follows:

- future policy benefits - guaranteed minimum death benefits;
- Health Care medical claims payable;
- other liabilities and other assets - guaranteed minimum income benefits;
- reinsurance recoverables for Run-off Reinsurance; and
- investments - recognition of losses from other-than-temporary impairments of public and private placement fixed maturities.

In addition, there are other accounting estimates used in the preparation of CIGNA's consolidated financial statements, including estimates of liabilities for future policy benefits other than those identified above, as well as estimates with respect to unpaid claims and claim expenses, post-employment and postretirement benefits, certain compensation accruals and income taxes.

Management believes the current assumptions and other considerations used to estimate amounts reflected in CIGNA's consolidated financial statements are appropriate. However, if actual experience differs from the assumptions and other considerations used in estimating amounts reflected in CIGNA's consolidated financial statements, the resulting changes could have a material adverse effect on CIGNA's consolidated results of operations, and in certain situations, could have a material adverse effect on liquidity and CIGNA's financial condition.

## ACQUISITIONS AND DISPOSITIONS

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

***Sale of Retirement Benefits Business.*** On April 1, 2004, CIGNA sold its retirement benefits business, excluding the corporate life insurance business, for cash proceeds of \$2.1 billion. The sale resulted in an after-tax gain of \$804 million, of which \$267 million after-tax was recognized immediately. The sales agreement provides for post closing adjustments; however, any future adjustments are not expected to be material to CIGNA's consolidated results of operations, liquidity or financial condition.

As this transaction was primarily in the form of a reinsurance arrangement under which CIGNA retains liability, \$537 million of the after-tax gain was deferred. Subsequent to the original reinsurance transaction, the buyer of the retirement benefits business has entered into agreements with some of the insured parties relieving CIGNA of any remaining contractual obligation to those parties (novation). Additional such agreements are expected.

The deferred gain is amortized at the rate at which earnings from the sold business would have been expected to emerge (primarily 15 years on a declining basis) until CIGNA is relieved of any remaining contractual obligation. At the time of novation, CIGNA accelerates amortization of a portion of the deferred gain and also reduces the associated contractholder deposit funds, reinsurance recoverables and separate account balances. For the nine months of 2005, liabilities decreased by \$32.9 billion as a result of novation activity attributable to the sold retirement benefits business. This decrease consisted of \$6.9 billion of contractholder deposit funds and \$26.0 billion of separate account liabilities. Corresponding decreases in assets of \$32.9 billion consisted of \$6.9 billion of reinsurance recoverables and \$26.0 billion of separate account assets. See Note 11 to the Financial Statements for additional information on reinsurance recoverables associated with the sale of the retirement benefits business.



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

<i>(In millions)</i>	Pre-Tax	After-Tax
<b>Three Months Ended September 30, 2005</b>		
Accelerated deferred gain amortization	\$ 10	\$ 2
Normal deferred gain amortization	\$ 3	\$ 2
<b>2004</b>		
Accelerated deferred gain amortization	\$ 122	\$ 79
Normal deferred gain amortization	\$ 28	\$ 18
<b>Nine Months Ended September 30, 2005</b>		
Accelerated deferred gain amortization	\$ 315	\$ 200
Normal deferred gain amortization	\$ 21	\$ 14
<b>2004</b>		
Accelerated deferred gain amortization	\$ 126	\$ 82
Normal deferred gain amortization	\$ 57	\$ 37

The remaining pre-tax deferred gain as of September 30, 2005 was \$76 million.

On January 1, 2005, CIGNA transferred the assets of substantially all of the separate accounts related to the retirement benefits business to the buyer. Since the arrangement is modified coinsurance, CIGNA received units of the buyer's separate accounts and carries those units as separate account assets on its balance sheet for the business not yet directly assumed by the buyer. At September 30, 2005, there were approximately \$5.1 billion of separate account assets and liabilities associated with the business not yet directly assumed by the buyer.

At September 30, 2005, CIGNA had approximately \$2.0 billion of invested assets, primarily fixed maturities and mortgage loans, supporting the modified coinsurance arrangement of the single premium annuity business. These invested assets are held in a business trust established by CIGNA. CIGNA pays or receives cash quarterly to settle the results of the reinsured business, including the investment results of the assets underlying the modified coinsurance arrangement. CIGNA recorded in other operating expenses a pre-tax charge of \$12 million (\$8 million after-tax) for the nine months of 2005 to offset realized investment results. This charge had no effect on CIGNA's net income.

As a result of this modified coinsurance arrangement, CIGNA has an embedded derivative that transfers to the buyer certain unrealized changes in fair value due to interest rate and credit risks of these assets. CIGNA records these effects in other liabilities and other revenues. A decrease in interest rates could result in a charge to CIGNA's consolidated net income until the modified coinsurance arrangement ends in 2006 when the impact of accounting for this embedded derivative will unwind.

The modified coinsurance arrangement provides for conversion to an indemnity reinsurance structure. The buyer will assume ownership of the trust assets in 2006 unless the buyer elects termination, in which case CIGNA would retain the single premium annuity business, including the trust assets and the insurance liabilities. If the buyer elects termination, CIGNA does not expect a material adverse effect to its consolidated results of operations, liquidity or financial condition.

CIGNA had another modified coinsurance arrangement (terminated on December 1, 2004), which created an embedded derivative that transferred to the buyer certain unrealized changes in fair value due to interest rates and credit risk of assets supporting certain separate accounts. In the third quarter of 2004, CIGNA recorded a pre-tax charge in other revenues of \$14 million for these effects. For the nine months of 2004, other revenues included a

pre-tax benefit of \$27 million for these effects and a related pre-tax charge of \$41 million reflecting the amortization for the period of the excess of the fair value of related assets over the liabilities under this arrangement.

**OTHER MATTERS****Cost Reduction Programs**

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

<i>(In millions)</i>	Health Care	Corporate	Total
First quarter 2005 charge	\$ 22	\$ 29	\$ 51
First quarter 2005 payments	(1)	(2)	(3)
Balance as of March 31, 2005	21	27	48
Second quarter 2005 payments	(5)	(6)	(11)
Balance as of June 30, 2005	16	21	37
Third quarter 2005 payments	(4)	(5)	(9)
Balance as of September 30, 2005	\$ 12	\$ 16	\$ 28

CIGNA expects to complete this program by mid-2006 and estimates annualized after-tax savings to be approximately \$65 million.

**Operational effectiveness review.** In the first quarter of 2004, CIGNA adopted a restructuring program associated with planned organizational changes to streamline functional support resources and to adjust its operations to current business volumes. As a result, CIGNA recognized in other operating expenses total pre-tax charges of \$86 million (\$56 million after-tax) of which \$75 million pre-tax (\$49 million after-tax) was recorded in the first quarter of 2004. CIGNA substantially completed this program in the second quarter of 2005 and estimates after-tax savings to be approximately \$80 million annually.

The table below shows CIGNA's restructuring activity (pre-tax) related to severance and real estate for this program:

<i>(In millions)</i>	Health Care/ Disability and Life*	Corporate	Total
Balance as of December 31, 2004:			
Severance	\$ 11	\$ 9	\$ 20
Real estate	8	1	9
	19	10	29
First quarter 2005 payments:			
Severance	(6)	(6)	(12)
Real estate	(1)	—	(1)
Balance as of March 31, 2005	12	4	16
Second quarter 2005 payments:			
Severance	(4)	(2)	(6)
Real estate	(1)	(1)	(2)
Balance as of June 30, 2005	7	1	8
Third quarter 2005 payments:			
Severance	(1)	—	(1)
Real estate	(1)	—	(1)
Balance as of September 30, 2005	\$ 5	\$ 1	\$ 6

### **Pension Liability**

Through the nine months of 2005, CIGNA recorded an after-tax charge of \$30 million to increase plan obligations, which resulted in a decrease to shareholders' equity. This charge was primarily due to the annual update of plan census data.

During the third quarter of 2004, CIGNA amended its qualified domestic pension plan and remeasured plan assets and obligations. As a result, CIGNA increased equity by \$21 million after-tax due to an increase in long-term interest rates (5.75% to 6.00%) used to determine the accumulated benefit obligation, partially offset by the effect of stock market depreciation on plan assets.

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\* Initial charge in the first quarter of 2004 included \$2 million pre-tax in the Disability and Life segment.

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For the nine months of 2004, as a result of the sale of the retirement benefits business, the operational effectiveness review, the annual update of plan census data and the plan amendment, CIGNA remeasured plan assets and obligations and recorded an after-tax charge, which decreased equity by \$131 million. This charge was primarily due to a reduction in long-term interest rates (from 6.25% to 6.00%) used to determine the accumulated benefit obligation, as well as the update of plan census data, partially offset by the effect of stock market appreciation on plan assets.

CIGNA contributed approximately \$545 million in 2005 as follows:

- \$105 million for minimum funding requirements for the domestic pension plan and for voluntary contributions to the international pension plans; and
- \$440 million for voluntary contributions to the domestic pension plan, which represent an acceleration of expected payments for minimum funding requirements in 2006 and 2007.

The decision to make voluntary contributions to the domestic pension plan was based upon the favorable economic impact the contributions will have on the funding status of CIGNA's pension plan, including the potential for reducing future additional funding requirements as well as reducing premiums to the Pension Benefit Guaranty Corporation.

Actual cash contributions made to the pension plans could vary significantly from the estimates of plan obligations based on actual future returns on pension assets and future interest rates, both of which are highly unpredictable, and any regulatory changes to funding requirements.

For additional information, see [Note 7](#) to the Financial Statements.

## Regulatory and Industry Developments

**Employee benefits regulation.** The business of administering and insuring employee benefit programs, particularly health care programs, is heavily regulated by federal and state laws and administrative agencies, such as state departments of insurance and the federal Departments of Labor and Justice, as well as the courts. Regulation and judicial decisions have resulted in changes to industry and CIGNA's business practices and will continue to do so in the future. In addition, CIGNA's subsidiaries are routinely involved with various claims, lawsuits and regulatory audits and investigations that could result in financial liability, changes in business practices, or both. Health care regulation in its various forms could have an adverse effect on CIGNA's health care operations if it inhibits CIGNA's ability to respond to market demands or results in increased medical or administrative costs without improving the quality of care or services.

Other possible regulatory changes that could have an adverse effect on CIGNA's businesses include:

- additional mandated benefits or services that increase costs without improving the quality of care;
- legislation that would grant plan participants broader rights to sue their health plans;
- changes in ERISA regulations resulting in increased administrative burdens and costs;
- additional restrictions on the use of prescription drug formularies;
- additional privacy legislation and regulations that interfere with the proper use of medical information for research, coordination of medical care and disease and disability management;
- additional rules establishing the time periods for payment of health care provider claims that vary from state to state;
- legislation that would exempt independent physicians from antitrust laws; and
- changes in federal laws, such as amendments to income tax laws, which could affect the taxation of employer provided benefits, and pension legislation, which could increase pension cost.

The employee benefits industry remains under scrutiny by various state and federal government





agencies and could be subject to government efforts to bring criminal actions in circumstances that could previously have given rise only to civil or administrative proceedings.

***Distribution from policyholders' surplus account.*** The American Jobs Creation Act of 2004 suspends, for a two-year period commencing January 1, 2005, the tax liability of stock life insurance companies on distributions from the policyholders' surplus account. CIGNA's principal subsidiary distributed, with regulatory approval, the entire account balance of approximately \$450 million to the parent company during the nine months of 2005 without incurring federal income tax.

***Litigation and other legal matters.*** In 2004, a Florida federal court handling multi-district health care litigation against CIGNA and several health care industry competitors approved a settlement agreement between the physician class and CIGNA. In April 2005, the court approved a settlement between CIGNA and the remaining plaintiffs, a class of non-physician health care professionals. A dispute with a representative of certain physicians over administration of the settlement with the physician class is likely to be resolved in early 2006.

Beginning in 2004, various regulators, including the New York and Connecticut Attorneys General, began investigating insurance broker compensation. Some regulators have brought suit against certain insurance brokers, including Universal Life Resources (ULR), alleging, among other things, that these brokers sought rigged bids from, and steered business to, insurers with whom they had contingent compensation arrangements. CIGNA and some of its subsidiaries are included in one such lawsuit seeking injunctive relief against these types of contingent compensation arrangements. In addition, CIGNA is providing information about ULR in connection with an investigation by the U.S. Attorney's Office for the Southern District of California. CIGNA is cooperating with the inquiries and investigations by regulators and the U.S. Attorney's Office. Separately, several purported class action lawsuits have been filed against brokers and insurance companies, including CIGNA and certain of its subsidiaries, asserting that contingent commissions are unlawful. CIGNA disagrees with the assertions against it in the lawsuits. In addition, early in 2005, a shareholder filed a derivative lawsuit against certain CIGNA directors and officers alleging breach of fiduciary duty based upon allegations similar to those contained in the ULR cases.

In 2004, the New York Attorney General commenced a lawsuit against Express Scripts, Inc. and two CIGNA insurance companies. Under an agreement with the CIGNA companies, Express Scripts is responsible for administering the prescription drug benefit program under New York State's principal employee health plan, the Empire Plan. The CIGNA companies insure the prescription drug benefit program and hold the contract with the New York State Department of Civil Service. The complaint primarily focuses on administration of the prescription drug benefit program.

A purported class action lawsuit and a shareholder derivative lawsuit against CIGNA and certain of its senior officers and directors allege securities law violations and breach of fiduciary duty. These suits originated in 2002. Separately, a court has granted final approval of a settlement agreement in a purported class action lawsuit against CIGNA and certain of its officers asserting violations of ERISA based on losses in investments in CIGNA stock by CIGNA 401(k) Plan participants.

Plaintiffs representing CIGNA Pension Plan participants who earned certain Plan benefits prior to 1998 filed a class action lawsuit against CIGNA and the CIGNA Pension Plan. The plaintiffs allege, among other things, that the Plan violated ERISA by impermissibly conditioning certain post-1997 benefit accruals on the amount of pre-1998 benefit accruals, that these conditions are not adequately disclosed to Plan participants, and that the Plan's cash balance formula discriminates against older employees.

See "Unicover and other run-off reinsurance" on page 34 for a description of legal matters arising out of the run-off reinsurance operations.

CIGNA is routinely involved in numerous claims, lawsuits, regulatory audits, investigations and other legal matters arising, for the most part, in the ordinary course of the business of administering and insuring employee benefit programs. An increasing number of claims are being made for substantial non-economic, extra-contractual or

punitive damages. The outcome of litigation and other legal matters is always uncertain, and outcomes that are not justified by the evidence can occur. CIGNA believes that it has valid defenses to the legal matters pending against it and is defending itself vigorously. Nevertheless, it is possible that resolution of one or more of the legal matters currently pending or threatened could result in losses material to CIGNA's consolidated results of operations, liquidity or financial condition.

**Summary.** The eventual effect on CIGNA of the changing environment in which it operates remains uncertain. For additional information on contingencies that could affect CIGNA's results, see Note 13 to the Financial Statements.

### Accounting Pronouncements

For information on recent accounting pronouncements, see Note 2 to the Financial Statements.

### Segment Reporting

Operating segments generally reflect groups of related products, but the International segment is based on geography. CIGNA measures the financial results of its segments using "segment earnings (loss)," which is defined as income (loss) from continuing operations before realized investment gains (losses).

## HEALTH CARE

### FINANCIAL SUMMARY

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Premiums and fees	\$ 2,513	\$ 2,779	\$ 7,556	\$ 8,259
Net investment income	68	69	201	210
Other revenues	270	259	796	766
Segment revenues	2,851	3,107	8,553	9,235
Benefits and expenses	2,598	2,788	7,746	8,415
Income before taxes	253	319	807	820
Income taxes	89	113	279	287
Segment earnings	\$ 164	\$ 206	\$ 528	\$ 533
Realized investment gains, net of taxes	\$ 3	\$ 5	\$ 6	\$ 9
Special item (after-tax) included in segment earnings:				
Cost reduction charge	\$ —	\$ —	(14)	(28)

The Health Care segment provides health care and related products and services. Key product lines include medical, pharmacy, behavioral health, dental benefits, and disease management. This segment also includes group disability and life insurance products that were historically sold in connection with certain experience-rated medical accounts that continue to be managed by the health care business. CIGNA reports the results of this segment largely based on product lines.

### Results

Segment earnings for the third quarter and nine months of 2005 include favorable prior year claim development (\$25 million after-tax for the third quarter and \$126 million after-tax for the nine months of 2005, compared with \$25 million after-tax for the third quarter and \$105 million after-tax for the nine months of 2004).

Excluding prior year claim development, segment earnings decreased for the third quarter and nine months of 2005 reflecting the effects of lower membership, partially offset by:

- higher earnings in the experience-rated business reflecting favorable underwriting and medical management results;
- lower operating expenses; and
- strong specialty health care results.

### Premiums and Fees

Health care segment premiums and fees consisted of the following:

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Commercial HMO	\$ 655	\$ 807	\$ 1,976	\$ 2,465
Experience-rated medical	694	767	2,071	2,190
Dental	222	221	672	659
Medicare and Medicaid	73	73	213	220
Other medical	349	290	1,024	860
Life and other non-medical	102	159	310	429
Total premiums	2,095	2,317	6,266	6,823
Fees	418	462	1,290	1,436
Total premiums and fees	\$ 2,513	\$ 2,779	\$ 7,556	\$ 8,259

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Premiums and fees decreased for the third quarter and nine months of 2005 primarily due to declining membership, partially offset by rate increases.

## Benefits and Expenses

Health Care segment benefits and expenses consisted of the following:

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Medical claims expense	\$ 1,579	\$ 1,671	\$ 4,633	\$ 5,044
Other benefit expenses	85	141	276	425
Other operating expenses	934	976	2,837	2,946
Total benefits and expenses	\$ 2,598	\$ 2,788	\$ 7,746	\$ 8,415

## Medical Membership

CIGNA's medical membership includes any person for whom CIGNA retains medical underwriting risk, who uses a CIGNA network for services covered under their medical coverage or for whom CIGNA administers medical claims. As of September 30, estimated medical membership was as follows:

<i>(In thousands)</i>	2005	2004
Guaranteed cost:		
Commercial HMO	801	1,003
Medicare and Medicaid	32	35
Other	194	65
Experience-rated <sup>1</sup>	1,155	1,275
Service	6,884	7,535
Total medical membership	9,066	9,913

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<sup>1</sup> Includes minimum premium membership, which has a risk profile similar to experience-rated funding arrangements. The risk portion of minimum premium revenue is reported in experience-rated medical premium whereas the self funding portion of minimum premium revenue is recorded in fees.

## Operational Improvement

CIGNA continues to focus on improving operational effectiveness and the financial results of its health care operations. Key areas of focus are:

- offering products that meet emerging market and consumer trends;
- improving medical membership results;
- lowering medical cost trends;
- continuing to deliver quality member service; and
- lowering administrative expenses.

***Offering products that meet emerging trends.*** CIGNA offers the CIGNA Choice Fund<sup>SM</sup>, which is a set of consumer-directed capabilities that includes options for health reimbursement arrangements and/or health savings accounts and enables consumers to make effective health decisions using information tools provided by CIGNA.

During the third quarter of 2005, CIGNA acquired Choicelinx, a benefits technology and services company. This acquisition adds new technology capabilities necessary for offering personalized health care products and decision support tools to consumers. The CIGNATURE<sup>SM</sup> suite of products, allows employers to choose the funding arrangement that is appropriate for the employer and level of medical management that is appropriate for their employee population.

In May 2005, CIGNA announced its strategic alliance with NationsHealth, Inc. (a distribution and services company) to jointly deliver Medicare Part D prescription drug plans. CIGNA received regulatory approval for its Medicare Part D prescription plan benefit program, which will take effect January 2006.

***Improving medical membership results.*** CIGNA is working to improve medical membership with:

- a diverse product portfolio that meets emerging consumer-directed trends;
- consistent and responsive member service delivery;
- competitive provider networks; and
- strong clinical quality in medical, specialty health care and disability management;

and by continuing to implement the other operational improvements described below. Since 2004, CIGNA has formed several strategic alliances with regional health care companies and acquired Managed Care Consultants of Nevada in the third quarter of 2005. These strategic actions are designed to:

- strengthen CIGNA's national provider network;

- enhance CIGNA's ability to provide superior medical and disease management programs;
- provide administrative ease for multi-state employers; and
- grow membership in key geographies, as well as providing a basis for lowering medical costs.

CIGNA believes that its medical management model, focus on clinical quality and ability to integrate health and related benefit solutions position the company to improve membership results.

**Lowering medical cost trend.** CIGNA operates under a centralized medical management model, which helps facilitate consistent levels of care for its members and reduce infrastructure expenses.

CIGNA is further working to reduce its medical cost trend by managing unit medical costs more effectively. To help achieve this end, CIGNA continues to focus on renegotiating contracts with certain facilities to limit increases in medical reimbursement costs.

**Continuing to deliver quality member service.** Approximately 90% of health care members are served on a service and systems platform that was introduced in 2002. Surveys of new and existing customers who have moved to this new platform since 2003 suggest satisfaction rates in the mid-90% range. Migration to this new platform will continue through 2006.

**Lowering administrative expenses.** Early in 2005 and 2004, CIGNA took additional steps to realign its organization and consolidate support functions in an effort to increase efficiency and responsiveness to customers. Reducing costs and operating more efficiently are components of CIGNA's plan to improve profitability. CIGNA continues to perform operational reviews in order to identify additional cost savings.

## DISABILITY AND LIFE

### FINANCIAL SUMMARY

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Premiums and fees	\$ 508	\$ 479	\$ 1,517	\$ 1,425
Net investment income	67	62	199	186
Other revenues	49	53	150	153
Segment revenues	624	594	1,866	1,764
Benefits and expenses	544	534	1,620	1,585
Income before taxes	80	60	246	179
Income taxes	23	19	71	51
Segment earnings	\$ 57	\$ 41	\$ 175	\$ 128
Realized investment gains, net of taxes	\$ 1	\$ 3	\$ 3	\$ 4
Special item (after-tax) included in segment earnings:				
Cost reduction charge	\$ —	\$ —	\$ —	\$ (1)

The Disability and Life segment includes group:

- disability insurance;
- disability and workers' compensation case management;
- life insurance; and
- accident and specialty association insurance.

## Results

Disability and Life segment earnings increased for the third quarter and nine months of 2005, compared with the same periods last year, primarily reflecting:

- favorable mortality experience and lower expenses in the life insurance business;
- improved results in the accident and specialty businesses; and
- continued solid disability earnings.

## Premiums and Fees

Premiums and fees increased for the third quarter and nine months of 2005, compared with the same periods last year, primarily reflecting higher new business and strong customer retention in both life and disability products.



**INTERNATIONAL****FINANCIAL SUMMARY**

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Premiums and fees	\$ 316	\$ 254	\$ 923	\$ 745
Net investment income	18	16	50	42
Other revenues	—	(2)	(3)	3
Segment revenues	334	268	970	790
Benefits and expenses	298	233	858	701
Income before taxes	36	35	112	89
Income taxes	12	12	26	31
Segment earnings	\$ 24	\$ 23	\$ 86	\$ 58
Realized investment gains, net of taxes	\$ —	\$ —	\$ —	\$ 1
Special item (after-tax) included in segment earnings:				
IRS tax settlement	\$ —	\$ —	\$ 7	\$ —

**Results**

Excluding the special item noted above, International segment earnings increased for the third quarter and nine months of 2005, compared with the same periods last year, primarily due to revenue growth in the life, accident and health insurance business, particularly, in South Korea.

The nine months of 2005 also reflect earnings growth in the expatriate employee benefits business as well as favorable tax related items.

**Premiums and Fees**

Premiums and fees increased for the third quarter and nine months of 2005, compared with the same periods last year, reflecting:

- new sales growth and improved customer retention in the life, accident and health insurance operations, particularly in South Korea; and
- higher premiums and fees for the expatriate employee benefits business resulting from membership growth.

**Other Matters**

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

**RUN-OFF RETIREMENT****FINANCIAL SUMMARY**

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004

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Premiums and fees	\$	—	\$	59	\$	1	\$	175
Net investment income		34		53		106		424
Other revenues		13		135		337		347
Segment revenues		47		247		444		946
Benefits and expenses		41		114		130		741
Income before taxes		6		133		314		205
Income taxes		4		43		114		59
Segment earnings	\$	2	\$	90	\$	200	\$	146
Realized investment gains, net of taxes	\$	—	\$	1	\$	7	\$	268
Special items (after-tax) included in segment earnings:								
Accelerated recognition of deferred gain on sale of retirement benefits business	\$	2	\$	79	\$	200	\$	79
Net charge associated with a modified coinsurance arrangement	\$	—	\$	(9)	\$	(8)	\$	(9)
Effect of new accounting pronouncement (see <u>Note 2</u> to the Financial Statements)	\$	—	\$	—	\$	—	\$	(11)

Segment earnings for Run-off Retirement include:

- gain recognition related to the sale of the retirement benefits business;
- results of modified coinsurance arrangements;
- expenses associated with the run-off of this business; and
- results of the retirement benefits business prior to the April 2004 sale.

Upon completing the sale of the retirement benefits business on April 1, 2004, net investment income represents amounts associated with the portion of the retirement benefits business reinsured under modified coinsurance arrangements and are offset by amounts included in benefits and expenses.

## Results

Run-off Retirement segment earnings include the special items noted in the table above. Excluding these items, segment earnings decreased for the third quarter of 2005, compared with the same period last year, due to lower normal deferred gain amortization reflecting significant acceleration of gain in previous quarters. This acceleration was triggered by transfers of underlying contracts to the buyer of the retirement benefits business. Segment earnings decreased for the nine months of 2005 reflecting the absence of earnings after the sale of this business in 2004 and lower normal deferred gain amortization.

## Other Revenues

Other revenues include:

<i>(In millions, pre-tax)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Normal deferred gain amortization	\$ 3	\$ 28	\$ 21	\$ 57
Accelerated deferred gain amortization	\$ 10	\$ 122	\$ 315	\$ 126*
Changes in fair value of securities supporting experience-rated pension policyholder contracts	\$ -	\$ -	\$ -	\$ 165

\*Of this amount, \$122 million is noted as a special item.

## RUN-OFF REINSURANCE

### FINANCIAL SUMMARY

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Premiums and fees	\$ 20	\$ 16	\$ 65	\$ 56
Net investment income	25	22	73	70
Other revenues	(45)	34	(28)	(24)
Segment revenues	—	72	110	102
Benefits and expenses	1	125	146	183
Loss before income tax benefits	(1)	(53)	(36)	(81)
Income taxes (benefits)	2	1	(7)	(4)
Segment loss	\$ (3)	\$ (54)	\$ (29)	\$ (77)
Realized investment gains, net of taxes	\$ 1	\$ 2	\$ 2	\$ —

## Results

Segment loss for Run-off Reinsurance for the third quarter and nine months of 2005, compared with the same periods last year, reflects lower reserve increases for personal accident and workers' compensation lines of business.

The nine months of 2005 also reflect:

- settlements with reinsurers for amounts greater than the net recorded amount; and
- the absence of a charge recorded in 2004 related to credit risk.

These factors were partially offset by an after-tax charge of \$11 million in the first quarter of 2005 to increase reserves for guaranteed minimum death benefit contracts (see below).

### **Other Revenues**

CIGNA maintains a program to substantially reduce the equity market exposures relating to guaranteed minimum death benefit contracts by entering into exchange-traded futures contracts. CIGNA expects to adjust these contract positions and may enter into other contract positions over time, to reflect changing equity market levels and changes in the investment mix of the underlying variable annuity investments. During the first quarter of 2005, CIGNA began using foreign currency futures contracts in place of foreign currency forward contracts as part of its program to reduce

international equity market risks associated with this business.

Other revenues included pre-tax losses of \$45 million for the third quarter and \$28 million for the nine months of 2005, compared with pre-tax gains of \$33 million for the third quarter and pre-tax losses of \$27 million for the nine months of 2004 from these contracts. Expense offsets reflecting corresponding changes in liabilities for these guaranteed minimum death benefit contracts were included in benefits and expenses. The notional amount of the futures contract positions held by CIGNA at September 30, 2005 was \$1.2 billion.

## Other Matters

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

The determination of reserves for guaranteed minimum death benefits requires CIGNA to make critical accounting estimates. CIGNA describes the assumptions used to develop the reserves for these death benefits, and provides the effects of hypothetical changes in those assumptions on page 22 of CIGNA's 2004 Annual Report to Shareholders. CIGNA regularly evaluates the assumptions used in establishing reserves and changes its estimates if actual experience or other evidence suggests that earlier assumptions should be revised. If actual experience differs from the assumptions and other considerations (including lapse, partial surrender, mortality, interest rates and volatility) used in estimating these reserves, the resulting change could have a material adverse effect on CIGNA's consolidated results of operations, and in certain situations, could have a material adverse effect on CIGNA's financial condition. During the first quarter of 2005, CIGNA completed its normal quarterly review of assumptions and recorded an after-tax charge of \$11 million (\$17 million pre-tax). This charge primarily resulted from an update to lapse assumptions based on emerging experience. The charge also reflects updates to partial surrender assumptions, reflecting the impact of stock market declines, as well as other assumptions. See Note 6 to the Financial Statements for additional information about the assumptions used to calculate reserves for these contracts. CIGNA had future policy benefit reserves for guaranteed minimum death benefit contracts of approximately \$1.0 billion as of September 30, 2005 and December 31, 2004.

As of September 30, 2005, the aggregate fair value of the underlying mutual fund investments was approximately \$41.5 billion. The death benefit coverage in force as of that date (representing the amount that CIGNA would have to pay if all 1.1 million contractholders had died on that date) was approximately \$7.5 billion. The death benefit coverage in force represents the excess of the guaranteed benefit amount over the fair value of the underlying mutual fund investments.

For further information and details on these contracts and the program adopted to reduce related equity market risk, refer to Note 6 of CIGNA's 2004 Annual Report to Shareholders.

**Guaranteed minimum income benefit contracts.** CIGNA has also written reinsurance contracts with issuers of variable annuity contracts that provide annuitants with certain guarantees related to minimum income benefits. See page 40 for further information.

**Unicover and other run-off reinsurance.** The Run-off Reinsurance operations participate in a workers' compensation reinsurance pool, which ceased accepting new risks in early 1999. This pool was formerly managed by Unicover Managers, Inc. Although an arbitration over the most significant reinsurance (retrocessional) contracts for the pool was completed in 2002, some disputes over collection of amounts due CIGNA from those retrocessionaires continue and may require further arbitration actions to resolve. Disputes and arbitrations regarding other reinsurance (retrocessional) contracts for the pool are likely to be substantially resolved by the end of 2006.

Run-off Reinsurance also includes other (non-Unicover) workers' compensation reinsurance contracts, as well as personal accident reinsurance contracts, including contracts assumed in the London market. CIGNA is in dispute and

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arbitration with some ceding companies over the amount of liabilities assumed under their contracts, and expects that these disputes and arbitrations will be substantially resolved by the end of 2007. CIGNA obtained retrocessional reinsurance coverage for a significant portion of its liabilities under these contracts, and some of these retrocessionaires have disputed the validity of their contracts with CIGNA. Several of these disputes with retrocessionaires were settled in 2004 and 2005 and several remain in arbitration. These arbitrations are expected to be substantially resolved by the end of 2006.

CIGNA bears the risk of the financial condition of its retrocessionaires and their ability to meet their reinsurance obligations to CIGNA.

Unfavorable claims experience related to workers' compensation and personal accident exposures is possible and could result in future losses, including losses attributable to the inability to recover amounts from retrocessionaires (either due to disputes with the retrocessionaires or their financial condition).

**Summary.** CIGNA's reserves for amounts recoverable from retrocessionaires, as well as reserves associated with underlying reinsurance exposures assumed by CIGNA, are considered appropriate as of September 30, 2005, based on current information. However, it is possible that future developments could have a material adverse effect on CIGNA's consolidated results of operations and, in certain situations, could have a material adverse effect on CIGNA's financial condition.

## OTHER OPERATIONS

### FINANCIAL SUMMARY

<i>(In millions)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2005	2004	2005	2004
Premiums and fees	\$ 24	\$ 31	\$ 89	\$ 94
Net investment income	110	114	336	358
Other revenues	23	35	76	124
Segment revenues	157	180	501	576
Benefits and expenses	121	145	376	485
Income before taxes	36	35	125	91
Income taxes	11	12	30	32
Segment earnings	\$ 25	\$ 23	\$ 95	\$ 59
Realized investment gains (losses), net of taxes	\$ 1	\$ (3)	\$ —	\$ 9
Special item (after-tax) included in segment earnings:				
IRS tax settlement	\$ —	\$ —	\$ 11	\$ —

Other Operations consist of:

- gain recognition related to the 1998 sale of the individual life insurance and annuity business;
- corporate life insurance (including policies on which loans are outstanding);
- settlement annuity business; and
- certain investment management services (a significant portion of which was sold during the fourth quarter of 2004).

### Results

Excluding the special item noted above, segment earnings for Other Operations for the third quarter and nine months of 2005, compared to the same periods last year, reflect the absence of an adjustment recorded in 2004 related to participating corporate life insurance policies.

The nine months of 2005 also reflect:

- the absence of severance and employee retention costs recorded in 2004 associated with the investment operations supporting the sold retirement benefits business; and
- higher earnings in the corporate life insurance business primarily due to continued favorable mortality experience.

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**Other Matters**

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

**CORPORATE****FINANCIAL SUMMARY**

<i>(In millions)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Segment loss	\$ (16)	\$ (29)	\$ (7)	\$ (119)
Special items (after-tax) included in segment loss:				
IRS tax settlement	\$ —	\$ —	\$ 63	\$ —
Cost reduction charge	\$ —	\$ —	\$ (19)	\$ (20)

Corporate reflects amounts not allocated to segments, such as interest expense on corporate debt, net investment income on unallocated investments, intersegment eliminations, compensation cost for stock options and certain corporate overhead expenses.

Excluding the special items noted above, the reduced loss for the third quarter and nine months of 2005, compared with the same periods last year reflects:

- lower stock compensation expense due to fewer awards in 2005 and accelerated vesting in 2004 and;
- an additional tax benefit of \$7 million related to the completion of a federal tax audit.

The nine months of 2005 also reflect lower stock compensation expense due to higher forfeitures and the absence of:

- overhead costs included in 2004 associated with the sold retirement benefits business; and
- costs recorded in 2004 associated with retiring \$76 million of long-term debt.

**DISCONTINUED OPERATIONS****FINANCIAL SUMMARY**

<i>(In millions)</i>	Nine Months Ended September 30, 2005	
Income tax benefits:		
Property and Casualty insurance business	\$	287
Brazilian Health Care operations		62
Income from discontinued operations	\$	349

Income from discontinued operations represents tax benefits recognized in the second quarter of 2005 from past divestitures. See page 22 for additional information.

**LIQUIDITY AND CAPITAL RESOURCES****Liquidity**

CIGNA normally meets its operating requirements by:

- maintaining appropriate levels of liquidity in its investment portfolio;
- using cash flows from operating activities; and
- matching investment maturities to the estimated duration of the related insurance and contractholder liabilities.

Cash flows from continuing operations for the nine months ended September 30, are as follows:

<i>(In millions)</i>		2005		2004
Operating activities	\$	253	\$	1,204
Investing activities	\$	(277)	\$	1,657
Financing activities	\$	(1,246)	\$	(1,328)

Cash and cash equivalents decreased \$1.3 billion as of September 30, 2005 and increased \$1.5 billion as of the same period in 2004. Cash flows from operating activities consist of cash receipts and disbursements for premiums and fees, gains (losses) recognized in connection with CIGNA's program to manage equity market risk related to reinsured guaranteed minimum death benefit contracts, investment income, taxes, and benefits and expenses.

2005:

·The change in cash flows from operating activities was affected by the following significant items in 2005 and 2004:  
§ 2004 net proceeds from sales and maturities of securities supporting experience-rated pension policyholder contracts of \$1.0 billion. Such proceeds were used to fund most of the 2004 withdrawals from contractholder deposit funds discussed below under financing;

§ 2005 voluntary pension contributions of \$440 million; and

§ Lower tax payments in 2005 compared with 2004 of \$325 million, primarily due to the taxes paid in 2004 related to the sale of the retirement benefits business.

Excluding these items, cash flow from operating activities increased, as the decline in cash revenues received in 2005 resulting from membership losses in the health care operations were more than offset by lower paid benefit expenses and lower operating expenses.

·Cash used in investing activities primarily consisted of net purchases of investments (\$227 million) and net purchases of property and equipment (\$32 million).

·Cash used in financing activities primarily consisted of dividends on and repurchases of common stock (\$1.0 billion), net withdrawals from contractholder deposit funds (\$284 million) and change in cash overdraft position (\$219 million), partially offset by proceeds from issuances of common stock under CIGNA's stock plans (\$301 million).

2004:

·Cash provided by investing activities primarily consisted of proceeds from the sale of the retirement benefits business of \$2.1 billion, partially offset by net purchases of investments (\$390 million) and property and equipment (\$32 million).

·Cash used in financing activities consisted primarily of repurchases of and payments of dividends on common stock (\$580 million), net withdrawals from contractholder deposit funds (\$673 million), repayment of debt (\$76 million), and change in cash overdraft position (\$23 million).

**Interest Expense**

Interest expense was \$26 million for the third quarter and \$79 million for the nine months of 2005, and \$26 million for the third quarter and \$81 million for the nine months of 2004.

**Capital Resources**

CIGNA's capital resources (primarily retained earnings and the proceeds from the issuance of long-term debt and equity securities) provide protection for policyholders, furnish the financial strength to underwrite insurance risks and facilitate continued business growth.

Senior management, guided by regulatory requirements and rating agency capital guidelines, determines the amount of capital resources that CIGNA maintains. Management allocates resources to new long-term business commitments when returns, considering the risks, look promising and when the resources available to support existing business are adequate.

CIGNA has sufficient capital resources to:

- provide capital necessary to support growth and maintain or improve the financial strength ratings of subsidiaries;
- consider acquisitions that are strategically and economically advantageous; and
- return capital to investors through share repurchase.

CIGNA maintains a share repurchase program. From January 1, 2005 through November 2, 2005, CIGNA repurchased 11.5 million shares through this program at an average price of \$102.62 per share for an aggregate cost of

\$1.2 billion. On October 26, 2005, CIGNA's Board of Directors increased the share repurchase authorization by an additional \$500 million. The total remaining authorization as of November 2, 2005, was \$698 million. See also the table in Part II, Item 2 of CIGNA's Form 10-Q for more information on share repurchase activity for the third quarter ended September 30, 2005.

CIGNA has \$500 million remaining under an effective shelf registration statement filed with the Securities and Exchange Commission, which may be issued as debt securities, equity securities or both. Management and the Board of Directors will consider market conditions and internal capital requirements when deciding whether CIGNA should issue new securities.

In May 2004, CIGNA entered into a three-year syndicated revolving credit and letter of credit agreement for \$1.0 billion. Of this amount, no more than \$600 million may be used to support an internal reinsurance arrangement.

### Liquidity and Capital Resources Outlook

The availability of resources at the parent/holding company level is dependent on dividends from CIGNA's subsidiaries, most of which are subject to regulatory restrictions and rating agency capital guidelines. CIGNA expects, based on current projections for cash activity (including projections for dividends from subsidiaries), to have sufficient liquidity to meet its obligations including to:

- meet debt service requirements and pay dividends to CIGNA shareholders; and
- satisfy pension plan funding requirements.

However, if CIGNA's projections are not realized, the demand for funds could exceed available cash if:

- management uses cash for investment opportunities;
- a substantial insurance or contractholder liability becomes due before related investment assets mature;
- a substantial increase in funding is required for CIGNA's program to reduce the equity market risks associated with the guaranteed minimum death benefit contracts; or
- regulatory restrictions prevent the insurance and HMO subsidiaries from distributing cash to the parent company.

In those cases, CIGNA has the flexibility to satisfy liquidity needs through short-term borrowings, such as a line of credit.

See page 27 for information on the accelerated contributions in 2005 to CIGNA's pension plans.

### Ratings

CIGNA and certain of its insurance subsidiaries are rated by nationally recognized rating agencies. Ratings are always subject to change and there can be no assurance that CIGNA's current ratings will continue for any given period of time. As of November 2, 2005, the ratings of CIGNA and CG Life (CIGNA's principal subsidiary) were as follows:

	CG Life Insurance Ratings	CIGNA Corporation Debt Ratings	
		Senior Debt	Commercial Paper
A.M. Best	A-	—	—
Moody's	A3	Baa3	P3
S&P	A-	BBB	A2
Fitch	A	BBB	F2

CIGNA is committed to maintaining appropriate levels of capital in its subsidiaries to support ratings that meet customers' expectations, and to improving the earnings of the health care business. Ratings downgrades of CG Life could adversely affect new sales and retention of current business. Lower ratings at the parent company level would increase the cost to borrow funds.

## **Guarantees and Contractual Obligations**

CIGNA, through its subsidiaries, is contingently liable for various financial guarantees provided and contractual obligations incurred in the ordinary course of business.

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

CIGNA guarantees that separate account assets will be sufficient to pay certain retiree and life benefits. The sponsoring employers are primarily responsible for ensuring that assets are sufficient to pay these benefits and are required to maintain assets that

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exceed a certain percentage of benefit obligations. This percentage varies depending on the asset class within a sponsoring employer's portfolio (for example, a bond fund would require a lower percentage than a riskier equity fund) and thus will vary as the composition of the portfolio changes. If employers do not maintain the required levels of separate account assets, CIGNA or the affiliate of the buyer has the right to redirect the management of the related assets to provide for benefit payments. As of September 30, 2005, employers maintained assets that exceeded the benefit obligations. Benefit obligations under these arrangements were \$2.1 billion as of September 30, 2005. As of September 30, 2005, approximately 80% of these guarantees were associated with the sold retirement benefits business and reinsured by the affiliate of the buyer of the retirement benefits business. There were no additional liabilities required for these guarantees as of September 30, 2005.

CIGNA guarantees that separate account assets, primarily fixed income investments, will be sufficient to pay retiree benefits for participants under a certain group annuity contract. These guarantees are fully reinsured by an affiliate of the buyer of the retirement benefits business. This guaranteed benefit obligation was \$36 million as of September 30, 2005. CIGNA had no additional liabilities for these guarantees as of September 30, 2005.

**Other financial guarantees.** CIGNA had indemnification obligations to lenders up to \$331 million as of September 30, 2005 related to borrowings by certain real estate joint ventures, which CIGNA either records as an investment or consolidates. These borrowings, which are nonrecourse to CIGNA, are secured by the joint ventures' real estate properties with fair values in excess of the loan amounts and mature at various dates beginning in 2006 through 2017. CIGNA's indemnification obligations would require payment to lenders for any actual damages resulting from certain acts such as unauthorized ownership transfers, misappropriation of rental payments by others or environmental damages. Based on initial and ongoing reviews of property management and operations, CIGNA does not expect that payments will be required under these indemnification obligations. Any payments that might be required could be recovered through a refinancing or sale of the assets. In some cases, CIGNA also has recourse to partners for their proportionate share of amounts paid. There were no liabilities required for these indemnification obligations as of September 30, 2005.

To increase investment returns through credit exposure, CIGNA guaranteed principal payments for groups of investment grade corporate debt issuers by entering Dow Jones indexed credit default swaps with notional amounts of \$290 million as of September 30, 2005. Under these contracts, CIGNA receives periodic fees to provide future payment if an issuer of an underlying corporate bond defaults on scheduled payments or files for bankruptcy through 2010. If a default or bankruptcy occurs, CIGNA will make payment for par value of the underlying corporate bond and may subsequently sell or hold that bond as an invested asset. CIGNA has recorded liabilities of less than \$1 million for the fair value of these indexed credit default swaps as of September 30, 2005.

As of September 30, 2005, CIGNA guaranteed that it would compensate the lessor for a shortfall of up to \$49 million in the market value of leased equipment at the end of the lease. Guarantees of \$21 million expire in 2006 and \$28 million expire in 2012. CIGNA had additional liabilities for these guarantees of \$3 million as of September 30, 2005.

CIGNA guaranteed construction loans of \$24 million as of September 30, 2005, related to real estate joint venture investments. The loans are secured by joint venture real estate property with fair values in excess of the loan amounts and mature by 2008, including extension options. CIGNA would be required to repay the construction loans if permanent financing could not be obtained. There were no liabilities required for these guarantees as of September 30, 2005.

CIGNA had indemnification obligations as of September 30, 2005, in connection with acquisition and disposition transactions. These indemnification obligations are triggered by the breach of representations or covenants provided by CIGNA, such as representations for the presentation of financial statements, the filing of tax returns, compliance with law or the identification of outstanding litigation. These obligations are typically subject to various time limitations, defined by the contract or by operation

of law, such as statutes of limitation. In some cases, the maximum potential amount due is subject to contractual limitations based on a percentage of the transaction purchase price, while in other cases limitations are not specified or applicable. CIGNA does not believe that it is possible to determine the maximum potential amount due under these guarantees, since not all amounts due under these indemnification obligations are subject to limitation. There were no liabilities required for these indemnification obligations as of September 30, 2005.

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

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

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

CIGNA regularly evaluates the assumptions used in establishing these assets and liabilities and changes its estimates if actual experience or other evidence suggests that earlier assumptions should be revised. CIGNA describes these assumptions and provides an estimate of the effects of the hypothetical changes in those assumptions on page 23 of CIGNA's 2004 Annual Report to Shareholders. If actual experience differs from the assumptions and other considerations used in estimating these assets and liabilities, the resulting change could have a material adverse effect on CIGNA's consolidated results of operations, and in certain situations, could have a material adverse effect on CIGNA's financial condition. See Note 13 to the Financial Statements for additional information on these assumptions.

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

- No annuitants surrendered their accounts; and
- All annuitants lived to elect their benefits; and
- All annuitants elected to receive their benefit on the first available date (2005 through 2014); and
- All underlying mutual fund investment values remained at the September 30, 2005 value of \$3.3 billion, with no future returns.

The maximum potential undiscounted payments that CIGNA would make under those assumptions would aggregate \$1.4 billion before reinsurance recoveries. CIGNA believes the likelihood of such payment is remote and expects the amount of actual payments to be significantly less than this hypothetical undiscounted aggregate amount. CIGNA has purchased reinsurance from third parties which cover 55% of the exposures on these contracts.

As of September 30, 2005, CIGNA had liabilities of \$78 million related to these contracts and amounts recoverable from reinsurers of \$43 million. CIGNA had an additional liability of \$39 million associated with the cost of reinsurance as of September 30, 2005. As of December 31, 2004, CIGNA had liabilities of \$71 million related to these contracts and amounts recoverable from reinsurers of \$39 million. CIGNA had an additional liability of \$41 million associated with the cost of reinsurance as of December 31, 2004. Management believes the current assumptions used to estimate reserves for these liabilities are appropriate.

**Contractual obligations.** As of September 30, 2005, CIGNA's contractual obligations included commitments to:

- purchase \$91 million of fixed maturities;



- extend credit under commercial mortgage loans agreements of \$360 million, most of which were at a fixed market rate of interest; and
- contribute \$350 million to real estate joint ventures and security partnerships.

CIGNA expects to disburse approximately \$475 million of these committed amounts in the fourth quarter of 2005.

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For additional information on CIGNA's contractual obligations, see page 38 of the 2004 Annual Report to Shareholders.

## INVESTMENT ASSETS

CIGNA's investment assets do not include separate account assets. Additional information regarding CIGNA's investment assets and related accounting policies is included in Notes 2, 7, 8 and 9 to the Financial Statements in CIGNA's 2004 Annual Report to Shareholders and Form 10-K.

Investments in fixed maturities (bonds) include publicly traded and privately placed debt securities, mortgage-backed and other asset-backed securities and certain redeemable preferred stocks.

CIGNA's mortgage loans are diversified by property type, location and borrower to reduce exposure to potential losses.

### Problem and Potential Problem Investments

"Problem" bonds and mortgage loans are either delinquent or have been restructured as to terms (interest rate or maturity date). "Potential problem" bonds and mortgage loans are fully current, but management believes they have certain characteristics that increase the likelihood that they will become "problems." For example, CIGNA considers mortgage loans to be potential problems if the borrower has requested restructuring, or principal or interest payments are past due by more than 30 but fewer than 60 days.

CIGNA recognizes interest income on "problem" bonds and mortgage loans only when payment is actually received because of the risk profile of the underlying investment. This resulted in lower net income of \$1 million for the third quarter and \$5 million for the nine months of 2005, compared to \$3 million for the third quarter and \$10 million for the nine months of 2004. These amounts would have been recorded if interest on problem investments had been recognized in accordance with the original terms of these investments.

The following table shows problem and potential problem investments, net of valuation reserves and write-downs:

	September	December
	30,	31,
<i>(In millions)</i>	2005	2004
Problem bonds	\$16	\$37
Potential problem bonds	\$34	\$44
Problem mortgage loans	\$10	\$65
Potential problem mortgage loans	\$53	\$72
Foreclosed real estate	\$11	\$10

Foreclosed real estate represents an investment in a real estate joint venture classified in other long-term investments.

### Summary

CIGNA recorded \$8 million after-tax for the nine months of 2005, compared to \$9 million after-tax for the third quarter and \$20 million after-tax for the nine months of 2004 in realized investment losses for investment asset write-downs and changes in valuation reserves.

The weakness in certain sectors of the economy and rising interest rates may cause additional investment losses. These investment losses could materially affect future results of operations, although CIGNA does not currently

expect them to have a material effect on its liquidity or financial condition, or to result in a significant decline in the aggregate carrying value of its assets.

## **MARKET RISK**

### **Market Risk of Financial Instruments**

CIGNA's assets and liabilities include financial instruments subject to the risk of potential losses from adverse changes in market rates and prices. The primary market risk exposures are interest rate risk, foreign currency exchange rate risk and equity price risk.

CIGNA uses futures contracts as part of a program to substantially reduce the effect of equity market changes on certain reinsurance contracts that guarantee minimum death benefits based on unfavorable changes in variable annuity account values. At September 30, 2005, futures were used to reduce exposure to various domestic and foreign equity indices (the S&P 500, Russell 2000, NASDAQ, TOPIX, FTSE 100 and euro STOXX 50)

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as well as to the British pound, euro and Japanese yen. The hypothetical effect of a 10% increase in domestic and foreign equity indices and a 10% weakening in the U.S. dollar to the British pound, euro and Japanese yen would have been a decrease of approximately \$110 million in the fair value of the futures contracts outstanding under this program as of September 30, 2005. A corresponding decrease in liabilities for these guaranteed minimum death benefit contracts would result from this hypothetical 10% increase in these equity indices and 10% weakening in the U.S. dollar. See Note 6 to the Financial Statements for further discussion of this program and the related guaranteed minimum death benefit contracts.

In addition, CIGNA reports the effects of an embedded derivative under a modified coinsurance arrangement that transfers to the buyer of the retirement benefits business certain unrealized changes in fair value due to interest rate and credit risks of the underlying invested assets, primarily fixed maturities and mortgage loans. As of September 30, 2005, a hypothetical 100 basis point decline in interest rates would decrease net income by approximately \$40 million for the effects of this embedded derivative. A hypothetical 200 basis point decline in interest rates would decrease net income by approximately \$130 million for the effect of this embedded derivative. Associated increases in the fair values of the underlying fixed maturities would be reflected in shareholders' equity.

### **Stock Market Performance**

The performance of equity markets can have a significant effect on CIGNA's businesses including on:

- risks and exposures associated with guaranteed minimum death benefit (see page 34) or income benefit contracts (see page 40); and
- minimum pension liabilities since equity securities comprise a significant portion of the assets of CIGNA's employee pension plans.

**CAUTIONARY STATEMENT FOR PURPOSES OF THE “SAFE HARBOR” PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

CIGNA and its representatives may from time to time make written and oral forward-looking statements, including statements contained in press releases, in CIGNA’s filings with the Securities and Exchange Commission, in its reports to shareholders and in meetings with analysts and investors. Forward-looking statements may contain information about financial prospects, economic conditions, trends and other uncertainties. For example, this Management’s Discussion and Analysis includes forward-looking information regarding, among other things, CIGNA’s restructuring programs and activities, litigation and other legal matters, operational improvement in the health care operations, and the outlook for CIGNA’s full years 2005 and 2006 results. You should not place undue reliance on these forward-looking statements. CIGNA cautions that actual results could differ materially from those that management expects, depending on the outcome of certain factors. Some factors that could cause actual results to differ materially from the forward-looking statements include:

1. increased medical costs that are higher than anticipated in establishing premium rates in CIGNA’s health care operations, including increased use and costs of medical services;
2. increased medical, administrative, technology or other costs resulting from new legislative and regulatory requirements imposed on CIGNA’s employee benefits businesses (see Employee benefits regulation on page 27 for more information);
3. challenges and risks associated with implementing the improvement initiatives in the health care operations, the organizational realignment and the reduction of overall CIGNA and health care cost structure, including that operational efficiencies and medical cost benefits do not emerge as expected and that membership does not stabilize and begin to grow, resulting in significantly greater than expected reductions in medical membership;
4. risks associated with the amount and timing of gain recognition on the sale of CIGNA’s retirement benefits business;
5. risks associated with pending and potential state and federal class action lawsuits, purported securities class action lawsuits, disputes regarding reinsurance arrangements, other litigation and regulatory actions challenging CIGNA’s businesses and the outcome of pending government proceedings;
6. heightened competition, particularly price competition, which could reduce product margins and constrain growth in CIGNA’s businesses, primarily the health care business;
7. significant changes in interest rates;
8. downgrades in the financial strength ratings of CIGNA’s insurance subsidiaries, which could, among other things, adversely affect new sales and retention of current business;
9. limitations on the ability of CIGNA’s insurance subsidiaries to dividend capital to the parent company as a result of downgrades in the subsidiaries’ financial strength ratings, changes in statutory reserve or capital requirements or other financial constraints;
10. inability of the program adopted by CIGNA to substantially reduce equity market risks for reinsurance contracts that guarantee minimum death benefits under certain variable annuities (including possible market difficulties in entering into appropriate futures and forward contracts and in matching such contracts to the underlying equity risk);
11. adjustments to the reserve assumptions and other considerations (including lapse, partial surrender, mortality, interest rates and volatility) used in estimating CIGNA’s liabilities for reinsurance contracts that guarantee minimum death benefits under certain variable annuities;
12. adjustments to the assumptions (including annuity election rates and reinsurance recoverables) used in estimating CIGNA’s assets and liabilities for reinsurance contracts that guarantee minimum income benefits under certain variable annuities;
13. significant stock market declines, which could, among other things, result in increased pension expenses in CIGNA’s pension plan in future periods and the recognition of additional pension obligations;

14. unfavorable claims experience related to workers' compensation and personal accident exposures of the run-off reinsurance business, including losses attributable to the inability to recover claims from retrocessionaires;
15. significant deterioration in economic conditions, which could have an adverse effect on CIGNA's operations and investments;
16. changes in federal laws, such as amendments to income tax laws, which could affect the taxation of employer provided benefits, and pension legislation, which could increase pension cost;
17. potential public health epidemics and bio-terrorist activity, which could, among other things, cause our covered medical expenses and mortality experience to rise significantly, depending on the severity of the event and number of individuals affected who are covered under CIGNA's insurance products;
18. risks associated with security or interruption of information systems, which could among other things cause operational disruption; and
19. risk factors detailed in CIGNA's Form 10-K for the fiscal year ended December 31, 2004, including the Cautionary Statement in Management's Discussion and Analysis.

This list of important factors is not intended to be exhaustive. There may be other risk factors that would preclude CIGNA from realizing the forward-looking statements. While CIGNA may periodically update this discussion of risk factors, CIGNA does not undertake to update any forward-looking statement that may be made by or on behalf of CIGNA prior to its next required filing with the Securities and Exchange Commission.

Item Quantitative and Qualitative Disclosures About Market Risk

3.

Information responsive to this Item 3 is included in Item 2 above, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item Controls and Procedures

4.

Based on an evaluation of the effectiveness of CIGNA's disclosure controls and procedures, CIGNA's Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, CIGNA's disclosure controls and procedures are effective to ensure that information required to be disclosed by CIGNA in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms.

There have been no changes in CIGNA's internal control over financial reporting identified in connection with the evaluation described in the above paragraph that have materially affected, or are reasonably likely to materially affect, CIGNA's internal control over financial reporting.



Part OTHER INFORMATION

II.

Item Legal Proceedings

1.

In its Form 10-K for the year ended December 31, 2004 and Form 10-Q for the quarter ended June 30, 2005, CIGNA described *In re CIGNA Corp. ERISA Litigation*. In September 2005, the court granted final approval of a settlement agreement that resolves for CIGNA defendants and the plaintiffs all claims reflected in the litigation.

In its Form 10-K for the year ended December 31, 2004 and its Forms 10-Q for the quarters ended March 31, 2005 and June 30, 2005, CIGNA described various litigation brought in conjunction with compensation, including commissions, paid to brokers. CIGNA received a subpoena in October, 2005 and is providing information about broker Universal Life Resources to the U.S. Attorney's Office for the Southern District of California.

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

Item Unregistered Sales of Equity Securities and Use of Proceeds

2.

## (c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table provides information about CIGNA's share repurchase activity for the quarter ended September 30, 2005:

Period	Issuer Purchases of Equity Securities			Approximate dollar value of shares that may yet be purchased as part of publicly announced program (3)
	Total # of shares purchased (1)	Average price paid per share	Total # of shares purchased as part of publicly announced program (2)	
July 1-31, 2005	594,883	\$108.74	589,600	\$227,111,373
August 1-31, 2005	1,485,933	\$113.28	1,479,500	\$559,519,832
September 1-30, 2005	2,036,322	\$114.69	2,031,400	\$326,382,998
Total	4,117,138	\$113.32	4,100,500	N/A

- (1) Includes shares tendered by employees as payment of taxes withheld on the exercise of stock options and the vesting of restricted stock granted under the Company's equity compensation plans. Employees tendered 5,283 shares in July, 6,433 shares in August, and 4,922 shares in September.
- (2) CIGNA has had a repurchase program for many years, and has had varying levels of repurchase authority and activity under this program. The program has no expiration date. CIGNA suspends activity under this program from time to time, generally without public announcement. Remaining authorization under the program was approximately \$326 million as of September 30, 2005 and \$698 million as of November 2, 2005.
- (3) Approximate dollar value of shares is as of the last date of the applicable month.

Item Exhibits

6.

(a) See Exhibit Index.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CIGNA CORPORATION

By: /s/ Michael W. Bell  
Michael W. Bell  
Executive Vice President and  
Chief Financial Officer

Date: November 2, 2005

Exhibit Index

<u>Number</u>	<u>Description</u>	<u>Method of Filing</u>
<u>12</u>	Computation of Ratio of Earnings to Fixed Charges	Filed <u>herewith</u> .
<u>31.1</u>	Certification of Chief Executive Officer of CIGNA Corporation pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934	Filed <u>herewith</u> .
<u>31.2</u>	Certification of Chief Financial Officer of CIGNA Corporation pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934	Filed <u>herewith</u> .
<u>32.1</u>	Certification of Chief Executive Officer of CIGNA Corporation pursuant to Rule 13a-14(b) or Rule 15d-14(b) and 18 U.S.C. Section 1350	Furnished <u>herewith</u> .
<u>32.2</u>	Certification of Chief Financial Officer of CIGNA Corporation pursuant to Rule 13a-14(b) or Rule 15d-14(b) and 18 U.S.C. Section 1350	Furnished <u>herewith</u> .