

HealthMarkets, Inc.
Form 10-Q
November 09, 2012
[Table of Contents](#)

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

FORM 10-Q

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

For the quarterly period ended September 30, 2012

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: 001-14953

HEALTHMARKETS, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)
75-2044750
(I.R.S. Employer
Identification Number)
9151 Boulevard 26, North Richland Hills, Texas 76180
(Address of principal executive offices, zip code)
(817) 255-5200
(Registrant's phone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 1 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☒ (Do not check if a smaller reporting company)	Smaller reporting company	☐

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

On October 18, 2012, the registrant had 27,758,849 outstanding shares of Class A-1 Common Stock, \$.01 Par Value, and 2,735,054 outstanding shares of Class A-2 Common Stock, \$.01 Par Value.

Table of Contents

HEALTHMARKETS, INC.

and Subsidiaries

Third Quarter 2012 Form 10-Q

TABLE OF CONTENTS

	Page
PART I FINANCIAL INFORMATION	
Item 1. <u>Financial Statements (Unaudited)</u>	1
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	29
Item 4. <u>Controls and Procedures</u>	29
PART II OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	30
Item 1A. <u>Risk Factors</u>	30
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	30
Item 3. <u>Defaults Upon Senior Securities</u>	30
Item 5. <u>Other Information</u>	31
Item 6. <u>Exhibits</u>	31
<u>SIGNATURES</u>	32

Table of Contents

HEALTHMARKETS, INC.

and Subsidiaries

	Page
PART I FINANCIAL INFORMATION	
Item 1. <u>Financial Statements (Unaudited)</u>	
<u>Consolidated Condensed Balance Sheets as of September 30, 2012 and December 31, 2011 (Audited)</u>	2
<u>Consolidated Condensed Statements of Income (Loss) for the Three and Nine Months Ended September 30, 2012 and 2011</u>	3
<u>Consolidated Condensed Statements of Comprehensive Income (Loss) for the Three and Nine Months Ended September 30, 2012 and 2011</u>	4
<u>Consolidated Condensed Statements of Cash Flows for the Nine Months Ended September 30, 2012 and 2011</u>	5
<u>Notes to Consolidated Condensed Financial Statements</u>	6

Table of Contents**HEALTHMARKETS, INC.****and Subsidiaries****CONSOLIDATED CONDENSED BALANCE SHEETS****(In thousands, except per share data)**

	September 30, 2012 (Unaudited)	December 31, 2011 (As adjusted)
ASSETS		
Investments:		
Securities available for sale		
Fixed maturities, at fair value (cost: 2012 \$353,118; 2011 \$394,948)	\$ 393,924	\$ 428,199
Short-term and other investments	247,218	626,415
Total investments	641,142	1,054,614
Cash and cash equivalents	15,971	17,299
Student loan receivables	44,078	50,733
Restricted cash	12,219	14,447
Investment income due and accrued	7,401	4,007
Reinsurance recoverable ceded policy liabilities	367,265	363,139
Agent and other receivables	21,441	21,416
Deferred acquisition costs	13,415	14,639
Property and equipment	34,410	37,466
Goodwill and other intangible assets	84,998	80,255
Recoverable federal income taxes	3,424	0
Other assets	15,438	13,478
Assets Held for Sale	0	2,100
	\$ 1,261,202	\$ 1,673,593
LIABILITIES AND STOCKHOLDERS EQUITY		
Policy liabilities:		
Future policy and contract benefits	\$ 470,315	\$ 473,163
Claims	86,261	94,743
Unearned premiums	24,057	27,523
Other policy liabilities	12,970	34,167
Accounts payable and accrued expenses	29,465	30,852
Other liabilities	53,373	57,107
Current income taxes payable	0	410
Deferred federal income taxes	69,780	68,881
Debt	190,920	553,420
Student loan credit facility	53,850	60,050
Net liabilities of discontinued operations	946	1,486
	991,937	1,401,802
Commitments and Contingencies (Note 7)		
Stockholders equity:		
Preferred stock, par value \$0.01 per share authorized 10,000,000 shares, none issued	0	0
Common Stock, Class A-1, par value \$0.01 per share authorized 90,000,000 shares, 28,096,278 issued and 27,765,245 outstanding at September 30, 2012; 28,156,278 issued and 27,851,301 outstanding at December 31, 2011. Class A-2, par value \$0.01 per share authorized 20,000,000 shares, 4,026,104 issued	321	322

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

and 2,757,922 outstanding at September 30, 2012; 4,026,104 issued and 2,776,985 outstanding at December 31, 2011		
Additional paid-in capital	50,753	50,535
Accumulated other comprehensive income	26,659	21,838
Retained earnings	207,371	214,853
Treasury stock, at cost (331,033 Class A-1 common shares and 1,268,182 Class A-2 common shares at September 30, 2012; 304,977 Class A-1 common shares and 1,249,119 Class A-2 common shares at December 31, 2011)	(15,839)	(15,757)
	269,265	271,791
	\$ 1,261,202	\$ 1,673,593

See Notes to Consolidated Condensed Financial Statements.

Table of Contents**HEALTHMARKETS, INC.****and Subsidiaries****CONSOLIDATED CONDENSED STATEMENTS OF INCOME (LOSS)****(In thousands, except per share data)****(Unaudited)**

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
		2011 (As adjusted)		2011 (As adjusted)
REVENUE				
Health premiums	\$ 112,228	\$ 131,702	\$ 350,144	\$ 416,146
Life premiums and other considerations	332	357	1,167	1,213
	112,560	132,059	351,311	417,359
Investment income	5,783	6,153	18,057	22,358
Commissions and other income	21,635	20,562	63,201	62,195
Realized gains, net	257	2,546	301	8,976
	140,235	161,320	432,870	510,888
BENEFITS AND EXPENSES				
Benefits, claims, and settlement expenses	83,342	83,348	251,028	279,036
Underwriting, acquisition, and insurance expenses	16,707	21,331	55,406	74,753
Other expenses	43,310	40,517	124,120	119,856
Interest expense	2,713	4,745	9,948	17,290
	146,072	149,941	440,502	490,935
Income (loss) from continuing operations before income taxes	(5,837)	11,379	(7,632)	19,953
Federal income tax expense (benefit)	(1,796)	4,235	175	7,578
Income (loss) from continuing operations	(4,041)	7,144	(7,807)	12,375
Income from discontinued operations, (net of income tax expense of \$9 and \$175 for the three and nine months ended September 30, 2012, and \$6 and \$19 for the three and nine months ended September 30, 2011, respectively)	16	11	325	35
Net income (loss)	\$ (4,025)	\$ 7,155	\$ (7,482)	\$ 12,410
Basic earnings (loss) per share:				
Income (loss) from continuing operations	\$ (0.13)	\$ 0.23	\$ (0.26)	\$ 0.41
Income from discontinued operations	0.00	0.00	0.01	0.00
Net income (loss) per share, basic	\$ (0.13)	\$ 0.23	\$ (0.25)	\$ 0.41
Diluted earnings (loss) per share:				
Income (loss) from continuing operations	\$ (0.13)	\$ 0.23	\$ (0.26)	\$ 0.40
Income from discontinued operations	0.00	0.00	0.01	0.00

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

Net income (loss) per share, diluted	\$	(0.13)	\$	0.23	\$	(0.25)	\$	0.40
--------------------------------------	----	--------	----	------	----	--------	----	------

See Notes to Consolidated Condensed Financial Statements.

Table of Contents**HEALTHMARKETS, INC.****and Subsidiaries****CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(In thousands)****(Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011 (As adjusted)	2012	2011 (As adjusted)
Net income (loss)	\$ (4,025)	\$ 7,155	\$ (7,482)	\$ 12,410
Other comprehensive income (loss):				
Unrealized gains (losses) on securities available for sale arising during the period	2,857	6,555	7,753	8,867
Reclassification for investment (gains) losses included in net income (loss)	(257)	(2,623)	(336)	(9,053)
Effect on other comprehensive income (loss) from investment securities	2,600	3,932	7,417	(186)
Unrealized losses on derivatives used in cash flow hedging during the period	0	0	0	(4)
Reclassification adjustments included in net income (loss)	0	0	0	1,344
Effect on other comprehensive income from hedging activities	0	0	0	1,340
Other comprehensive income before tax	2,600	3,932	7,417	1,154
Income tax expense related to items of other comprehensive income (loss)	910	1,376	2,596	404
Other comprehensive income net of tax	1,690	2,556	4,821	750
Comprehensive income (loss)	\$ (2,335)	\$ 9,711	\$ (2,661)	\$ 13,160

See Notes to Consolidated Condensed Financial Statements.

Table of Contents**HEALTHMARKETS, INC.****and Subsidiaries****CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

	Nine Months Ended September 30,	
	2012	2011 (As adjusted)
Operating Activities:		
Net income (loss)	\$ (7,482)	\$ 12,410
Adjustments to reconcile net income (loss) to cash (used in) provided by operating activities:		
Income from discontinued operations	(325)	(35)
Realized gains, net	(301)	(9,054)
Change in deferred income taxes	(1,698)	(2,560)
Depreciation and amortization	9,854	13,392
Amortization of prepaid monitoring fees	9,375	9,375
Equity based compensation expense	6,291	4,347
Other items, net	5,188	2,997
Changes in assets and liabilities:		
Investment income due and accrued	(4,123)	(1,002)
Due premiums	(1)	3
Reinsurance recoverable ceded policy liabilities	(4,126)	3,436
Other receivables	(413)	10,333
Deferred acquisition costs	1,224	9,313
Prepaid monitoring fees	(12,500)	(12,500)
Current income taxes	(3,834)	6,437
Policy liabilities	(34,959)	(27,133)
Other liabilities and accrued expenses	(10,897)	(15,129)
Cash (used in) provided by continuing operations	(48,727)	4,630
Cash used in discontinued operations	(214)	(22)
Net cash (used in) provided by operating activities	(48,941)	4,608
Investing Activities:		
Student loan receivables	5,648	6,123
Securities available for sale	41,648	244,215
Short-term and other investments	377,668	(240,916)
Purchases of property and equipment	(3,693)	(6,531)
Change in restricted cash	2,228	1,824
Acquisitions and related fees	(6,065)	0
Net proceeds from sale of assets	2,100	0
Increase in agent receivables	(881)	(286)
Cash provided by continuing operations	418,653	4,429
Cash provided by discontinued operations	0	0
Net cash provided by investing activities	418,653	4,429

Financing Activities:

Repayment of long term debt	(362,500)	0
Repayment of student loan credit facility	(6,200)	(6,900)
Decrease in investment products	(1,034)	(1,064)
Change in cash overdraft	3,851	5,310
Proceeds from shares issued to agent plans and other	3,725	3,210
Proceeds from exercise of stock options	(79)	0
Purchases of treasury stock	(8,803)	(6,614)
Excess tax reduction from equity based compensation	0	(793)
Cash used in continuing operations	(371,040)	(6,851)
Cash used in discontinued operations	0	0
Net cash used in financing activities	(371,040)	(6,851)
Net change in cash and cash equivalents	(1,328)	2,186
Cash and cash equivalents at beginning of period	17,299	12,874
Cash and cash equivalents at end of period in continuing operations	\$ 15,971	\$ 15,060
Supplemental disclosures:		
Income taxes paid	\$ 5,881	\$ 6,643
Interest paid	\$ 11,886	\$ 10,375

See Notes to Consolidated Condensed Financial Statements.

Table of Contents

HEALTHMARKETS, INC.

and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying consolidated condensed financial statements for HealthMarkets, Inc. (the Company or HealthMarkets) and its subsidiaries have been prepared in accordance with United States generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, such financial statements do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, these financial statements include all adjustments, consisting of normal recurring adjustments and accruals, necessary for the fair presentation of the consolidated condensed balance sheets, statements of income, statements of comprehensive income and statements of cash flows for the periods presented. The accompanying December 31, 2011 consolidated condensed balance sheet was derived from audited consolidated financial statements, but does not include all disclosures required by GAAP for annual financial statement purposes. Preparing financial statements requires management to make estimates and assumptions that affect the amounts that are reported in the financial statements and the accompanying disclosures. Although these estimates are based on management's knowledge of current events and actions that HealthMarkets may undertake in the future, actual results may differ materially from the estimates. Operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2012. We have evaluated subsequent events for recognition or disclosure through the date we filed this Form 10-Q with the Securities and Exchange Commission (the SEC). For further information, refer to the consolidated financial statements and notes thereto, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

HealthMarkets, Inc., a Delaware corporation incorporated in 1984, is a holding company, the principal asset of which is its investment in its wholly owned subsidiary, HealthMarkets, LLC. HealthMarkets, LLC's principal assets are its investments in its separate operating subsidiaries, including its regulated insurance subsidiaries. HealthMarkets conducts its insurance underwriting businesses through its indirect wholly owned insurance company subsidiaries, The MEGA Life and Health Insurance Company (MEGA), Mid-West National Life Insurance Company of Tennessee (Mid-West), The Chesapeake Life Insurance Company (Chesapeake) and HealthMarkets Insurance Company (HMIC), and generally conducts its insurance distribution business through its indirect insurance agency subsidiary, Insphere Insurance Solutions, Inc. (Insphere).

Reclassification

Certain amounts in the 2011 financial statements have been reclassified to conform to the 2012 financial statement presentation.

2. RECENTLY ADOPTED AND RECENT ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2012, the Company adopted ASU 2011-05 *Presentation of Comprehensive Income*. These changes give an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements; the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. The items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income were not changed. Additionally, no changes were made to the calculation and presentation of earnings per share. Management elected to present the two-statement option which was consistent to the Company's presentation prior to adoption.

Effective January 1, 2012, the Company adopted ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. ASU No. 2011-04 provides largely identical guidance about fair value measurement and disclosure requirements issued by International Financial Reporting Standards (IFRS). Issuing these standards completes a major project of the FASB and IFRS joint work effort to improve and converge IFRS and U.S. GAAP. The new standards do not extend the use of fair value but, rather, provide guidance about how fair value should be applied where it already is required or permitted under IFRS or U.S. GAAP. For U.S. GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS. Other than the additional disclosure requirements (see Note 3), the adoption of these changes had no impact on the Consolidated Condensed Financial Statements.

Table of Contents

In October 2010, the Financial Accounting Standards Board issued ASU 2010-26, *Financial Services - Insurance (ASC Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts* (ASU 2010-26), which clarifies what costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. Costs that should be capitalized include (1) incremental direct costs of successful contract acquisition and (2) certain costs related directly to successful acquisition activities (underwriting, policy issuance and processing, medical and inspection, and sales force contract selling) performed by the insurer for the contract. Advertising costs should be included in deferred acquisition costs only if the capitalization criteria in the US GAAP direct-response advertising guidance are met. All other acquisition-related costs should be charged to expense as incurred.

The Company applied the provisions of ASU 2010-26 beginning January 1, 2012 and determined that certain underwriting and customer lead generation expenses were no longer deferrable under the new guidance. Under the transition guidance provided by ASU 2010-26, the Company has chosen to apply the retrospective method. The retrospective method requires the Company to record the cumulative effect of applying a change in accounting principle to all prior periods presented. As a result of the change in accounting principle, the Company made the following adjustments:

- (a) Adjusted the balance of the following items as of January 1, 2011: (i) reduced Deferred acquisition costs by \$7.9 million, (ii) reduced Retained earnings by \$5.1 million, and (iii) reduced Deferred federal income taxes by \$2.8 million.
- (b) Restated the Consolidated Condensed Statements of Income for the three months ended September 30, 2011 by the following amounts: (i) a decrease to Underwriting acquisition and insurance expenses in the amount of \$1.1 million, (ii) an increase to Federal income tax expense in the amount of \$374,000, (iii) an increase in Income from continuing operations and Net income in the amount of \$694,000, and (iv) an increase in diluted earnings per share in the amount of \$0.02.
- (c) Restated the Consolidated Condensed Statements of Income for the nine months ended September 30, 2011 by the following amounts: (i) a decrease to Underwriting acquisition and insurance expenses in the amount of \$3.3 million, (ii) an increase to Federal income tax expense in the amount of \$1.2 million, (iii) an increase in Income from continuing operations and Net income in the amount of \$2.1 million, and (iv) an increase in diluted earnings per share in the amount of \$0.07.

3. FAIR VALUE MEASUREMENTS

In accordance with ASC 820, the Company categorizes its investments and certain other assets and liabilities recorded at fair value into a three-level fair value hierarchy as follows:

Level 1 Unadjusted quoted market prices for identical assets or liabilities in active markets which are accessible by the Company.

Level 2 Observable prices in active markets for similar assets or liabilities. Prices for identical or similar assets or liabilities in markets which are not active. Directly observable market inputs for substantially the full term of the asset or liability, such as interest rates and yield curves at commonly quoted intervals, volatilities, prepayment speeds, default rates, and credit spreads. Market inputs that are not directly observable but are derived from or corroborated by observable market data.

Level 3 Unobservable inputs based on the Company's own judgment as to assumptions a market participant would use, including inputs derived from extrapolation and interpolation that are not corroborated by observable market data.

The Company evaluates the various types of securities in its investment portfolio to determine the appropriate level in the fair value hierarchy based upon trading activity and the observability of market inputs. The Company employs control processes to validate the reasonableness of the fair value estimates of its assets and liabilities, including those estimates based on prices and quotes obtained from independent third party sources. The Company's procedures generally include, but are not limited to, initial and ongoing evaluation of methodologies used by independent third parties and monthly analytical reviews of the prices against current pricing trends and statistics.

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

Where possible, the Company utilizes quoted market prices to measure fair value. For investments that have quoted market prices in active markets, the Company uses the quoted market price as fair value and includes these prices in the amounts disclosed in Level 1 of the fair value hierarchy. When quoted market prices in active markets are unavailable, the Company determines fair values using various valuation techniques and models based on a range of observable market inputs including pricing models, quoted market price of publicly traded securities with similar duration and yield, time

Table of Contents

value, yield curve, prepayment speeds, default rates and discounted cash flow. In most cases, these estimates are determined based on independent third party valuation information, and the amounts are disclosed in Level 2 of the fair value hierarchy. Generally, the Company obtains a single price or quote per instrument from independent third parties to assist in establishing the fair value of these investments.

If quoted market prices and independent third party valuation information are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or Level 3. On occasions when pricing service data is unavailable, the Company may rely on bid/ask spreads from dealers in determining the fair value. When dealer quotations are used to assist in establishing the fair value, the Company generally obtains one quote per instrument. The quotes obtained from dealers or brokers are generally non-binding. When dealer quotations are used, the Company uses the mid-mark as fair value. When broker or dealer quotations are used for valuation or price verification, greater priority is given to executable quotes. As part of the price verification process, valuations based on quotes are corroborated by comparison both to other quotes and to recent trading activity in the same or similar instruments.

To the extent the Company determines that a price or quote is inconsistent with actual trading activity observed in that investment or similar investments, or if the Company does not think the quote is reflective of the market value for the investment, the Company will internally develop a fair value using this observable market information and disclose the occurrence of this circumstance.

In accordance with ASC 820, the Company has categorized its available for sale securities into a three level fair value hierarchy based on the priority of inputs to the valuation techniques. The fair values of investments disclosed in Level 1 of the fair value hierarchy include money market funds and certain U.S. government securities, while the investments disclosed in Level 2 include the majority of the Company's fixed income investments. In cases where there is limited activity or less transparency around inputs to the valuation, the Company classifies the fair value estimates within Level 3 of the fair value hierarchy.

As of September 30, 2012, all of the Company's investments classified within Level 2 and Level 3 of the fair value hierarchy are valued based on quotes or prices obtained from independent third parties, except for \$109.2 million of Corporate bonds and municipals classified as Level 2, \$94.6 million of Other bonds classified as Level 2 and \$151,000 of Commercial-backed investments classified as Level 3. The Corporate bonds and municipals investments classified as Level 2 noted above is an investment grade corporate bond issued by UnitedHealth Group Inc. that was received as consideration for the sale of the Company's former Student Insurance Division in December 2006. The Other bonds investments classified as Level 2 noted above is an investment grade corporate bond received from a unit of the CIGNA Corporation as consideration for the receipt of the former Star HRG assets.

Fair Value Hierarchy on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are categorized in the tables below based upon the lowest level of significant input to the valuations.

	Assets at Fair Value at September 30, 2012			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
U.S. and U.S. Government agencies	\$ 4,482	\$ 15,018	\$ 0	\$ 19,500
Corporate bonds and municipals	0	239,415	0	239,415
Residential-backed issued by agencies	0	34,692	0	34,692
Commercial-backed issued by agencies	0	0	0	0
Commercial-backed	0	2,858	151	3,009
Asset-backed	0	2,684	0	2,684
Other bonds	0	94,624	0	94,624
Other invested assets ⁽¹⁾	0	0	1,780	1,780
Short-term investments ⁽²⁾	166,214	61,451	0	227,665
	\$ 170,696	\$ 450,742	\$ 1,931	\$ 623,369

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

- (1) Investments in entities that calculate net asset value per share
- (2) Amount excludes \$17.8 million of other investments which are not subject to fair value measurement.

	Liabilities at Fair Value at September 30, 2012			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Agent and employee compensation plans	\$ 0	\$ 0	\$ 7,328	\$ 7,328

Table of Contents

	Assets at Fair Value at December 31, 2011			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
U.S. and U.S. Government agencies	\$ 4,556	\$ 20,046	\$ 0	\$ 24,602
Corporate bonds and municipals	0	252,279	0	252,279
Residential-backed issued by agencies	0	46,315	0	46,315
Commercial-backed issued by agencies	0	625	0	625
Commercial-backed	0	10,864	485	11,349
Asset-backed	0	3,658	0	3,658
Other bonds	0	89,371	0	89,371
Other invested assets ⁽¹⁾	0	0	1,913	1,913
Short-term investments ⁽²⁾	606,485	0	0	606,485
	\$ 611,041	\$ 423,158	\$ 2,398	\$ 1,036,597

(1) Investments in entities that calculate net asset value per share

(2) Amount excludes \$18.0 million of other investments which are not subject to fair value measurement.

	Liabilities at Fair Value at December 31, 2011			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Agent and employee compensation plans	\$ 0	\$ 0	\$ 6,603	\$ 6,603

The following is a description of the valuation methodologies used for certain assets and liabilities of the Company measured at fair value on a recurring basis, including the general classification of such assets pursuant to the valuation hierarchy.

Fixed Income Investments

The Company's fixed income investments include investments in U.S. Treasury securities, U.S. Government agency bonds, corporate bonds, mortgage-backed and asset-backed securities, and municipal securities and bonds.

The Company estimates the fair value of its U.S. Treasury securities using unadjusted quoted market prices, and accordingly, discloses these investments in Level 1 of the fair value hierarchy. The fair values of the majority of non-U.S. treasury securities held by the Company are determined based on observable market inputs provided by independent third party valuation information. The market inputs utilized in the pricing evaluation include but are not limited to, benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. The Company classifies the fair value estimates based on these observable market inputs within Level 2 of the fair value hierarchy. Investments classified within Level 2 consist of U.S. government agencies bonds, corporate bonds, mortgage-backed and asset-backed securities, and municipal bonds.

The Company also holds one fixed income commercial asset-backed investment for which it estimates the fair value using an internal pricing matrix with some unobservable inputs that are significant to the valuation. Consequently, the lack of transparency in the inputs and availability of independent third party pricing information for this investment resulted in its fair value being classified within the Level 3 of the hierarchy. As of September 30, 2012, the fair value of such commercial asset-backed security which represents approximately 0.1% of the Company's total fixed income investments is reflected within the Level 3 of the fair value hierarchy.

Other invested assets

The Company's other invested assets consist of one alternative investment that owns a portfolio of collateralized debt obligation equity investments managed by a third party management group. The Company calculates the fair market value of such investment using the net asset value per share, which is determined based on unobservable inputs. Accordingly, the fair value of this asset is reflected within Level 3 of the fair value hierarchy.

The Company has committed to fund \$5.0 million to such equity investment, of which the entire amount has been funded to date. There are no redemption opportunities, and the fund will terminate when the underlying collateralized debt obligation deals mature.

Table of Contents*Short-term investments*

The Company's short-term investments consists of highly liquid money market funds, which are reflected within Level 1 of the fair value hierarchy and highly rated and liquid corporate bonds whose maturities at the time of acquisition were one year or less. The short-term bonds are reflected within Level 2 of the fair value hierarchy.

Agent and Employee Stock Plans

The Company accounts for its agent and certain employee stock plan liabilities based on the Company's share price at the end of each reporting period. The Company's share price at the end of each reporting period is based on the prevailing fair value as determined by the Company's Board of Directors (see Note 8 of Notes to Consolidated Condensed Financial Statements). The Company largely uses unobservable inputs in deriving the fair value of its share price and the value is, therefore, reflected in Level 3 of the hierarchy.

Changes in Level 3 Assets and Liabilities

The tables below summarize the change in balance sheet carrying values associated with Level 3 financial instruments and agent and employee stock plans for the three months and nine months ended September 30, 2012.

Changes in Level 3 Assets and Liabilities Measured at Fair Value For the Three Months Ended September 30, 2012							
	Beginning Balance	Unrealized Gains or (Losses)	Sales or Redemption	Settlements (In thousands)	Realized Gains or (Losses)(1)	Transfer in/(out) of Level 3, Net	Ending Balance
ASSETS							
Commercial-backed	\$ 264	\$ (3)	\$ (111)	\$ 1	\$ 0	\$ 0	\$ 151
Other invested assets	1,793	(13)	0	0	0	0	1,780
	\$ 2,057	\$ (16)	\$ (111)	\$ 1	\$ 0	\$ 0	\$ 1,931
LIABILITIES							
Agent and employee stock plans	\$ 5,790	\$ (60)	\$ 0	\$ 1,598	\$ 0	\$ 0	\$ 7,328

(1) Realized losses for the period are included in Realized gains, net on the Company's consolidated condensed statement of income (loss).

Changes in Level 3 Assets and Liabilities Measured at Fair Value For the Nine Months Ended September 30, 2012							
	Beginning Balance	Unrealized Gains or (Losses)	Sales or Redemption	Settlements (In thousands)	Realized Gains or (Losses)(1)	Transfer in/(out) of Level 3, Net	Ending Balance
ASSETS							
Commercial-backed	\$ 485	\$ (13)	\$ (325)	\$ 4	\$ 0	\$ 0	\$ 151
Other invested assets	1,913	(131)	0	(2)	0	0	1,780
	\$ 2,398	\$ (144)	\$ (325)	\$ 2	\$ 0	\$ 0	\$ 1,931

LIABILITIES

Agent and employee stock plans	\$ 6,603	\$ 485	\$ 0	\$ 240	\$ 0	\$ 0	\$ 7,328
--------------------------------	----------	--------	------	--------	------	------	----------

(1) Realized losses for the period are included in Realized gains, net on the Company's consolidated condensed statement of income (loss). During the nine months ended September 30, 2012, the Company did not transfer securities between Level 1, Level 2 or Level 3.

Quantitative information regarding significant unobservable inputs in Level 3 fair value measurement

The Company currently holds one fixed maturity security further categorized as commercial-backed with a fair value of \$151,000. The fair value of this security is derived from the yield of the Barclays CMBS Investment Grade 1-3.5yr Index. This security matures in January 2013. Additionally, the Company currently holds one other investment asset categorized as an alternative investment with a fair value of \$1.8 million. The alternative investment consists of a portfolio of collateralized debt obligation equity investments managed by a third party management group. The Company calculates the fair market value of such investment using the net asset value per share, which is determined based on unobservable inputs.

Table of Contents

Financial Instruments Not Carried at Fair Value

In addition to the preceding disclosures on assets recorded at fair value in the consolidated balance sheets, FASB guidance also requires the disclosure of fair values for certain other financial instruments for which it is practicable to estimate fair value, whether or not such values are recognized in the consolidated balance sheets.

Non-financial instruments such as real estate, property and equipment, other current assets, deferred income taxes and intangible assets, and certain financial instruments such as policy liabilities are excluded from the fair value disclosures. Therefore, the fair value amounts cannot be aggregated to determine the underlying economic value.

The carrying value and estimated fair value classified by level of the fair value hierarchy for certain of our financial instruments at September 30, 2012 are disclosed in the table below:

		Estimated Fair Value at September 30, 2012			
	Carrying Value	Level 1	Level 2	Level 3	Total
				(In thousands)	
<i>Assets:</i>					
Other investments	\$ 17,773	\$ 0	\$ 0	\$ 17,773	\$ 17,773
Cash and cash equivalents	15,971	0	15,971	0	15,971
Student loan receivables	44,078	0	0	35,483	35,483
Restricted cash	12,219	0	12,219	0	12,219
Investment income due and accrued	7,401	0	7,401	0	7,401
<i>Liabilities:</i>					
Debt	190,920	0	0	157,262	157,262
Student loan credit facility	53,850	0	0	32,956	32,956

The carrying value and estimated fair value for certain of our financial instruments at December 31, 2011 are disclosed in the table below:

	December 31, 2011	
	Carrying Value	Estimated Fair Value
Assets:		
Other investments	\$ 18,017	\$ 18,017
Cash and cash equivalents	17,299	17,299
Student loan receivables	50,733	39,991
Restricted cash	14,447	14,447
Investment income due and accrued	4,007	4,007
Liabilities:		
Debt	553,420	505,195
Student loan credit facility	60,050	39,506

The following methods, assumptions and inputs were used to estimate the fair value of each class of financial instrument:

Other investments: Other investments primarily consist of investments in equity investees, which are accounted for under the equity method of accounting. As these investments are not actively traded and the corresponding inputs are derived from internal estimates, they are classified as Level 3.

Cash and cash equivalents and restricted cash: The carrying amounts reported in the consolidated balance sheets for these items approximate fair value because of the short term nature of these items. As these financial instruments are not actively traded, their respective fair values are classified as Level 2.

Investment income due and accrued: The carrying amounts reported in the consolidated balance sheets for this item approximate fair value because of the short term nature of this item. As this financial asset is not actively traded, the respective fair value is classified as Level 2.

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

Student loan receivables: Fair values are estimated using discounted cash flow analyses and interest rates currently being offered for similar loans to borrowers with similar credit ratings and maturities. Loans with similar characteristics are aggregated for purposes of the calculations. As these assets are not actively traded and the corresponding inputs are derived from internal estimates, they are classified as Level 3.

Table of Contents

Debt: The fair value was based on quoted market prices and yields for securities with similar characteristics, including industry, ratings, maturity and capital structure (bond or preferred stock). Adjustments to the yield were made for differences in these characteristics. As there is no HealthMarkets debt that is publicly traded to use as a comparison, all debt was classified in Level 3.

Student loan credit facility: Fair values for student loan debt are obtained from discounted cash flow analyses based on current incremental borrowing rates for similar types of borrowing arrangements. This debt is not actively traded and the corresponding inputs are derived from internal estimates or not corroborated by observable market data. As a result, Student loan debt is classified as Level 3.

4. INVESTMENTS

The Company's investments consist of the following at September 30, 2012 and December 31, 2011:

	September 30, 2012	December 31, 2011
	(In thousands)	
Securities available for sale		
Fixed maturities	\$ 393,924	\$ 428,199
Short-term and other investments	247,218	626,415
Total investments	\$ 641,142	\$ 1,054,614

Available for sale fixed maturities are reported at fair value which was derived as follows:

	September 30, 2012				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (In thousands)	Non-credit Loss Recognized in OCI	Fair Value
U.S. and U.S. Government agencies	\$ 18,916	\$ 584	\$ 0	\$ 0	\$ 19,500
Corporate bonds and municipals	217,915	21,560	(60)	0	239,415
Residential-backed issued by agencies	32,249	2,450	(7)	0	34,692
Commercial-backed issued by agencies	0	0	0	0	0
Commercial-backed	2,996	13	0	0	3,009
Asset-backed	2,646	319	0	(281)	2,684
Other bonds	78,396	16,228	0	0	94,624
Total fixed maturities	\$ 353,118	\$ 41,154	\$ (67)	\$ (281)	\$ 393,924

	December 31, 2011				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (In thousands)	Non-credit Loss Recognized in OCI	Fair Value
U.S. and U.S. Government agencies	\$ 23,876	\$ 726	\$ 0	\$ 0	\$ 24,602
Corporate bonds and municipals	233,925	19,169	(815)	0	252,279
Residential-backed issued by agencies	43,236	3,080	(1)	0	46,315
Commercial-backed issued by agencies	611	14	0	0	625

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

Commercial-backed	11,097	252	0	0	11,349
Asset-backed	3,807	145	(13)	(281)	3,658
Other bonds	78,396	10,975	0	0	89,371
Total fixed maturities	\$ 394,948	\$ 34,361	\$ (829)	\$ (281)	\$ 428,199

Table of Contents

The amortized cost and fair value of available for sale fixed maturities at September 30, 2012, by contractual maturity, are set forth in the table below. Fixed maturities subject to early or unscheduled prepayments have been included based upon their contractual maturity dates. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2012	
	Amortized Cost	Fair Value
	(In thousands)	
<i>Maturity:</i>		
One year or less	\$ 52,393	\$ 52,985
Over 1 year through 5 years	124,332	139,790
Over 5 years through 10 years	133,313	155,128
Over 10 years	5,189	5,636
	315,227	353,539
Mortgage-backed and asset-backed securities	37,891	40,385
Total fixed maturities	\$ 353,118	\$ 393,924

See Note 3 of Notes to Consolidated Condensed Financial Statements for additional disclosures on fair value measurements.

A summary of net investment income by source is set forth below:

	Three Months		Nine Months Ended	
	Ended September 30, 2012	Ended September 30, 2011	September 30, 2012	September 30, 2011
	(In thousands)			
Fixed maturities	\$ 4,522	\$ 5,509	\$ 14,021	\$ 19,163
Short-term and other investments	501	194	1,780	1,907
Agent receivables	322	59	948	232
Student loan interest income	702	799	2,156	2,461
	6,047	6,561	18,905	23,763
Less investment expenses	264	408	848	1,405
	\$ 5,783	\$ 6,153	\$ 18,057	\$ 22,358

Realized Gains and Losses

Realized gains and losses on sales of investments are recognized in net income on the specific identification basis and include write downs on those investments deemed to have other than temporary declines in fair values. Gains and losses on trading securities are reported in Realized gains, net on the consolidated condensed statements of income.

Fixed maturities

Proceeds from the sale and call of investments in fixed maturities were \$4.1 million and \$7.7 million for the three and nine months ended September 30, 2012, respectively, and \$61.3 million and \$189.4 million for the three and nine months ended September 30, 2011, respectively. Proceeds from maturities, sinking and principal reductions amounted to \$11.2 million and \$48.8 million for the three and nine months ended September 30, 2012, respectively, and \$11.6 million and \$61.1 million for the three and nine months ended September 30, 2011, respectively.

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

During the three and nine months ended September 30, 2012, the Company realized gross gains of \$257,000 and \$336,000, respectively, on the sale and call of fixed maturity investments. During the three and nine months ended September 30, 2011, the Company realized gross gains of \$2.6 million and \$9.1 million, respectively, on the sale and call of fixed maturity investments. The company realized no gross losses in 2012 and 2011 on fixed maturity investments.

Other than temporary impairment (OTTI)

During the nine months ended September 30, 2012 and September 30, 2011, the Company recognized no OTTI losses.

Table of Contents

Set forth below is a summary of cumulative OTTI losses on debt securities held by the Company at September 30, 2012, a portion of which have been recognized in Net impairment losses recognized in earnings on the consolidated condensed statement of income and a portion of which have been recognized in Accumulated other comprehensive income on the consolidated condensed balance sheet:

Cumulative OTTI		Additions for OTTI securities		Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security	Cumulative OTTI credit losses recognized for securities still held at September 30, 2012
credit losses	Recognized for securities still held at January 1, 2012	Additions to OTTI securities where no credit losses were recognized prior to January 1, 2012	where credit losses have been recognized prior to January 1, 2012	Reductions for securities sold during the period (Realized)	
			(In thousands)		
\$ 3,518	\$ 0	\$ 0	\$ 0	\$ 0	\$ 3,518
<i>Unrealized Gains and Losses</i>					

Fixed maturities

Set forth below is a summary of gross unrealized losses in its fixed maturities as of September 30, 2012 and December 31, 2011:

Description of Securities	Unrealized Loss Less Than 12 Months		Unrealized Loss 12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. and U.S. Government agencies	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Corporate bonds and municipals	4,915	1	2,939	59	7,854	60
Residential-backed issued by agencies	973	7	0	0	973	7
Commercial-backed issued by agencies	0	0	0	0	0	0
Residential-backed	0	0	0	0	0	0
Commercial-backed	0	0	0	0	0	0
Asset-backed	0	0	1,072	0	1,072	0
Other bonds	0	0	0	0	0	0
Total	\$ 5,888	\$ 8	\$ 4,011	\$ 59	\$ 9,899	\$ 67

Description of Securities	Unrealized Loss Less Than 12 Months		Unrealized Loss 12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. and U.S. Government agencies	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Corporate bonds and municipals	6,291	122	20,160	693	26,451	815

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

Residential-backed issued by agencies	989	1	0	0	989	1
Commercial-backed issued by agencies	0	0	0	0	0	0
Residential-backed	0	0	0	0	0	0
Commercial-backed	0	0	0	0	0	0
Asset-backed	264	13	924	0	1,188	13
Other bonds	0	0	0	0	0	0
Total	\$ 7,544	\$ 136	\$ 21,084	\$ 693	\$ 28,628	\$ 829

Unrealized Losses Less Than 12 Months

Of the \$8,000 in unrealized losses that had existed for less than twelve months at September 30, 2012, no security had an unrealized loss in excess of 10% of the security's cost.

Of the \$136,000 in unrealized losses that had existed for less than twelve months at December 31, 2011, no security had an unrealized loss in excess of 10% of the security's cost.

Unrealized Losses 12 Months or Longer

Of the \$59,000 in unrealized losses that had existed for twelve months or longer at September 30, 2012, no security had an unrealized loss in excess of 10% of the security's cost.

Table of Contents

Of the \$693,000 in unrealized losses that had existed for twelve months or longer at December 31, 2011, no security had an unrealized loss in excess of 10% of the security's cost.

All issuers of securities we own remain current on all contractual payments. The Company continually monitors investments with unrealized losses that have existed for twelve months or longer and considers such factors as the current financial condition of the issuer, credit ratings, performance of underlying collateral, and effective yields. Additionally, HealthMarkets considers whether it has the intent to sell the security and whether it is more likely than not that the Company will be required to sell the debt security before the fair value reverts to its cost basis, which may be at maturity of the security. Based on such review, the Company believes that, as of September 30, 2012, the unrealized losses in these investments were caused by an increase in market interest rates and tighter liquidity conditions in the current markets than when the securities were purchased and therefore is temporary.

It is at least reasonably probable that the Company's assessment of whether the unrealized losses are other than temporary may change over time, given, among other things, the dynamic nature of markets and changes in the Company's assessment of its ability or intent to hold impaired investment securities, which could result in the Company recognizing other-than-temporary impairment charges or realized losses on the sale of such investments in the future.

5. DEBT

The following table sets forth detail of the Company's debt and interest expense:

	Principal Amount at		Interest Rate(a)	Interest Expense			
	September 30, 2012	Maturity Date		Three Months Ended		Nine Months Ended	
	September 30, 2012			September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
<i>2006 credit agreement:</i>							
Term loan	\$ 0	2012	n/a	\$ 0	\$ 1,159	\$ 998	\$ 4,830
\$75 Million revolver (non-use fee)	0	2011	n/a	0		0	50
Grapevine Note	72,350	2021	6.7%	1,224	1,226	3,645	3,638
<i>Trust preferred securities:</i>							
UICI Capital Trust I	15,470	2034	4.0%	156	149	468	444
HealthMarkets Capital Trust I	51,550	2036	3.5%	462	436	1,388	1,305
HealthMarkets Capital Trust II	51,550	2036	3.5%	462	436	1,388	2,496
<i>Other:</i>							
Interest on Deferred Tax Gain	0		3.0%	402	514	1,193	1,566
Amortization of financing fees	0			2	825	858	2,961
Other interest expense	0			5	0	10	0
Total	\$ 190,920			\$ 2,713	\$ 4,745	\$ 9,948	\$ 17,290
Student Loan Credit Facility	53,850	(b)	0.000% (c)	0	0	0	0
Total	\$ 244,770			\$ 2,713	\$ 4,745	\$ 9,948	\$ 17,290

(a) Represents the interest rate at September 30, 2012.

(b) The Series 2001A-1 Notes and Series 2001A-2 Notes have a final stated maturity of July 1, 2036; the Series 2002A Notes have a final stated maturity of July 1, 2037 (see Note 9 - Debt and Student Loan Credit Facility in the Company's Annual Report on Form 10-K for the Year Ended December 31, 2011).

(c) The interest rate on each series of SPE Notes resets monthly in a Dutch auction process and is capped by several interest rate triggers. It is currently capped at zero by a Net Loan Rate calculation driven by the rate of return of the student loans less certain allowed note fees.

In April 2006, HealthMarkets, LLC entered into a credit agreement, providing for a \$500.0 million term loan facility and a \$75.0 million revolving credit facility (which includes a \$35.0 million letter of credit sub-facility). The revolving credit facility expired on April 5, 2011. At

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

December 31, 2011, \$362.5 million remained outstanding under the term loan facility and bore interest at LIBOR plus 1%. The maturity date of the term loan was April 5, 2012. On February 29, 2012, the Company paid in full the remaining principal and interest on the term loan in an amount of \$363.3 million.

Table of Contents**6. NET INCOME (LOSS) PER SHARE**

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
(In thousands, except per share amounts)				
Income (loss) from continuing operations	\$ (4,041)	\$ 7,144	\$ (7,807)	\$ 12,375
Income from discontinued operations	16	11	325	35
Net income (loss) available to common shareholders	\$ (4,025)	\$ 7,155	\$ (7,482)	\$ 12,410
Weighted average shares outstanding, basic	30,376	30,570	30,378	30,402
Dilutive effect of stock options and other shares	0	828	0	821
Weighted average shares outstanding, dilutive	30,376	31,398	30,378	31,223
Basic earnings (loss) per share:				
From continuing operations	\$ (0.13)	\$ 0.23	\$ (0.26)	\$ 0.41
From discontinued operations	0.00	0.00	0.01	0.00
Net income (loss) per share, basic	\$ (0.13)	\$ 0.23	\$ (0.25)	\$ 0.41
Diluted earnings (loss) per share:				
From continuing operations	\$ (0.13)	\$ 0.23	\$ (0.26)	\$ 0.40
From discontinued operations	0.00	0.00	0.01	0.00
Net income (loss) per share, basic	\$ (0.13)	\$ 0.23	\$ (0.25)	\$ 0.40

7. COMMITMENTS AND CONTINGENCIES***Litigation and Regulatory Matters******Litigation Matters***

As previously disclosed, on October 23, 2006, MEGA was named as a defendant in an action filed by the Massachusetts Attorney General on behalf of the Commonwealth of Massachusetts (*Commonwealth of Massachusetts v. The MEGA Life and Health Insurance Company*), pending in the Superior Court of Suffolk County, Massachusetts, Case Number 06-4411-F. HealthMarkets, Inc. and Mid-West (together with MEGA, the

Defendants) were added as defendants on August 22, 2007. Plaintiff alleged, among other things, that Defendants engaged in unfair and deceptive practices and illegal association membership practices, imposed illegal waiting periods and restrictions on coverage of pre-existing conditions and failed to comply with Massachusetts law regarding mandatory benefits. On August 31, 2009, the Defendants and the Commonwealth of Massachusetts agreed to settle this matter by executing a Final Judgment by Consent (the Consent), which the Court approved on September 3, 2009. By entering into the Consent, the Defendants did not admit to any violation of law or liability. The settlement terms include a collective total payment of \$15.0 million, subject to certain credits for payments made under the August 26, 2009 Regulatory Settlement Agreement with the Massachusetts Division of Insurance (the Settlement Agreement). Each Defendant paid \$5.0 million, comprised of (i) \$1.0 million to be paid as civil penalties (the Penalties Payment); (ii) \$250,000 to be paid as attorneys' fees and costs; and (iii) \$3.75 million to be paid for consumer compensatory damages and other consumer relief (the Consumer Relief Payments). The Consent acknowledges the obligations of MEGA and Mid-West under the Settlement Agreement to pay \$2.0 million, together with amounts pursuant to a claims reassessment process. The Consent provides credits as follows: (i) the \$2.0 million payment under the Settlement Agreement will be credited towards the \$2.0 million in Penalties Payments that MEGA and Mid-West would otherwise be required to collectively pay and (ii) based on amounts to be paid by MEGA and Mid-West under the Settlement Agreement for claims reassessment, the Attorney General will provide a preliminary credit of \$400,000 toward the Consumer Relief Payments due collectively from MEGA and Mid-West. If the total amount

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

of such claims reassessment payments is less than \$400,000, MEGA and Mid-West must pay the difference. The Company paid \$12.6 million in September 2009 in accordance with the terms of the Consent. On July 2, 2012, MEGA and Mid-West collectively paid an additional \$288,184 to the Massachusetts Attorney General. These payments represent, collectively, the difference between the claims reassessment payments made and \$400,000, and effectively close all outstanding matters under the Consent. The resolution of this matter, after consideration of applicable reserves and/or potentially available insurance coverage benefits, did not have a material adverse effect on the Company's consolidated financial condition or results of operations.

The Company and its subsidiaries are parties to various other pending and threatened legal proceedings, claims, demands, disputes and other matters arising in the ordinary course of business, including some asserting significant liabilities arising from claims, demands, disputes and other matters with respect to insurance policies, relationships with agents, relationships with former or current employees and other matters.

Table of Contents

Given the expense and inherent risks and uncertainties of litigation, we regularly evaluate litigation matters pending against us, including those described in Note 16 of Notes to the Company's Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, to determine if settlement of such matters would be in the best interests of the Company and its stockholders. The costs associated with any such settlement could be substantial and, in certain cases, could result in an earnings charge in any particular quarter in which we enter into a settlement agreement. Although we have recorded litigation reserves which represent our best estimate on probable losses, our recorded reserves might prove to be inadequate to cover an adverse result or settlement for extraordinary matters. Therefore, costs associated with the various litigation matters to which we are subject and any earnings charge recorded in connection with a settlement agreement could have a material adverse effect on our consolidated results of operations in a period, depending on the results of our operations for the particular period.

Regulatory Matters

The Company's insurance subsidiaries are subject to various pending market conduct or regulatory examinations, inquiries or proceedings arising in the ordinary course of business. Reference is made to the discussion of these and other matters contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 under the caption "Item 3 Legal Proceedings" and in Note 16 of Notes to Consolidated Financial Statements included in such report. State insurance regulatory agencies have authority to levy significant fines and penalties and require remedial action resulting from findings made during the course of such matters. Market conduct or other regulatory examinations, inquiries or proceedings could result in, among other things, changes in business practices that require the Company to incur substantial costs. Such results, individually or in combination, could injure our reputation, cause negative publicity, adversely affect our debt and financial strength ratings, place us at a competitive disadvantage in marketing or administering our products or impair our ability to sell insurance policies or retain customers, thereby adversely affecting our business, and potentially materially adversely affecting the results of operations in a period, depending on the results of operations for the particular period. Determination by regulatory authorities that we have engaged in improper conduct could also adversely affect our defense of various lawsuits.

In March 2010, the Patient Protection and Affordable Care Act and a reconciliation measure, the Health Care and Education Reconciliation Act of 2010 (collectively, the "Health Care Reform Legislation") were signed into law. The Health Care Reform Legislation has, and is expected to continue to, significantly impact the Company's business, including but not limited to the minimum medical loss ratio requirements applicable to its insurance subsidiaries as well to health insurance carriers doing business with Insphere. Provisions of the Health Care Reform Legislation become effective at various dates over the next several years and a number of additional steps are required to implement these requirements, including, without limitation, further guidance and clarification in the form of final implementing regulations for certain key aspects of the legislation.

We have dedicated material resources, have made material changes to our business, and incurred material expenses (including, but not limited to, additional claims expenses) as a result of the Health Care Reform Legislation. These changes include the adjustments to our in-force block of business issued prior to March 24, 2010, including but not limited to removal of lifetime caps on benefits, extension of dependent coverage through age 26, meeting new HHS reporting requirements and adopting limitations on most policy rescissions. These changes generally became effective on January 1, 2011 (for most of our plans the effective date of the new plan year), although certain states required an earlier effective date. Plans issued on or after March 24, 2010 are subject to more extensive benefit changes, including but not limited to first dollar preventive care benefits and no annual limits on essential benefits covered by the policies. The Company made all state form and rate filings necessary to include these new requirements and, effective in September 2011, made required rate and form changes for new policies marketed after that date.

With respect to the minimum loss ratio requirements effective beginning in 2011, a mandated minimum loss ratio of 80% for the individual and small group markets is expected to have a significant impact on the revenues of our insurance subsidiaries and our business generally. In addition, beginning in 2011, the mandated medical loss ratio requirements have adversely affected the level of base commissions and override commissions that Insphere receives from the Company's insurance subsidiaries and third party insurance carriers.

The Company's review of the requirements of the Health Care Reform Legislation, and its potential impact on the Company's health insurance product offerings, is ongoing. Due to the complexity of the Health Care Reform Legislation, gradual implementation and the pending status of certain guidance and regulations, the impact of Health Care Reform Legislation on the Company's business is not yet fully known. Depending on the outcome of certain potential developments

Table of Contents

with respect to the Health Care Reform Legislation, this legislation could, in the future, have a material adverse effect on the Company's financial condition and results of operations, including but not limited to, impairment of goodwill and intangible assets. For additional information, see the caption entitled "Regulatory and Legislative Matters - *National Health Care Reform Legislation*" in Part I, Item 1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

8. STOCKHOLDERS' EQUITY

The Company's Board of Directors determines the prevailing fair market value of the HealthMarkets Class A-1 and A-2 common stock in good faith, considering factors it deems appropriate. Since the de-listing of the Company's stock in 2006, the Company has generally retained several independent investment firms to value its common stock on an annual basis, or more frequently if circumstances warrant. When setting the fair market value of the Company's common stock, the Board considers among other factors it deems appropriate, each independent investment firm's valuation for reasonableness in light of known and expected circumstances.

As of September 30, 2012, the fair market value of the Company's Class A-1 and Class A-2 common stock, as determined by the Board of Directors, was \$10.15.

9. SEGMENT AND OTHER FINANCIAL INFORMATION

The Company operates four business segments: Commercial Health, Insphere, Corporate, and Disposed Operations. Through our Commercial Health Division, we underwrite and administer a broad range of health insurance and supplemental insurance products. Insphere includes net commission revenue, agent incentives, marketing costs and other agency administration costs. Corporate includes investment income not allocated to the other segments, realized gains or losses, interest expense on corporate debt, the Company's student loan business, general expenses relating to corporate operations and operations that do not constitute reportable operating segments. Disposed Operations includes the remaining run out of residual operations from the disposition and wind down of other businesses prior to 2011.

Allocations of investment income and certain general expenses are based on a number of assumptions and estimates, and the business segments reported operating results would change if different allocation methods were applied. Certain assets are not individually identifiable by segment and, accordingly, have been allocated by formulas. Segment revenues include premiums and other policy charges and considerations, net investment income, commission revenue, fees and other income. Management does not allocate income taxes to segments. Transactions between reportable segments are accounted for under respective agreements, which provide for such transactions generally at cost.

Property and equipment is stated at cost, less accumulated depreciation of \$136.0 million and \$158.2 million as of September 30, 2012 and December 31, 2011, respectively. Property and equipment is depreciated on a straight-line basis over their estimated useful lives.

The Company recorded \$2.8 million of certain claims expenses relating to the first and second quarter of 2012 during the third quarter which is related to formulary rebates on prescription drug benefits.

Revenue from continuing operations, income (loss) from continuing operations before income taxes, and assets by operating segment are set forth in the tables below:

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	2011		2011	
	(In thousands)			
Revenue from continuing operations:				
Commercial Health Division:	\$ 119,912	\$ 141,867	\$ 376,165	\$ 448,538
Insphere:	23,421	18,423	65,548	52,687
Corporate:	4,186	5,573	10,783	21,640
Intersegment Eliminations:	(7,314)	(4,934)	(19,755)	(13,185)
Total revenues excluding disposed operations	140,205	160,929	432,741	509,680

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

Disposed Operations:	30	391	129	1,208
Total revenue from continuing operations	\$ 140,235	\$ 161,320	\$ 432,870	\$ 510,888

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
<i>Income (loss) from continuing operations before federal income taxes:</i>				
Commercial Health Division:	\$ 12,431	\$ 31,411	\$ 48,778	\$ 79,223
Insphere:	(11,362)	(12,400)	(32,935)	(39,614)
Corporate:	(6,934)	(8,299)	(23,948)	(20,949)
Total operating income (loss) excluding disposed operations	(5,865)	10,712	(8,105)	18,660
Disposed Operations	28	667	473	1,293
Total income (loss) from continuing operations before federal income taxes	\$ (5,837)	\$ 11,379	\$ (7,632)	\$ 19,953

Table of Contents

Assets by operating segment at September 30, 2012 and December 31, 2011 are set forth in the table below:

	September 30, 2012	December 31, 2011
	(In thousands)	
<i>Assets:</i>		
Commercial Health Division:	\$ 363,190	\$ 400,908
Insphere:	55,017	62,194
Corporate:	462,179	830,253
 Total assets excluding assets of Disposed Operations	 880,386	 1,293,355
Disposed Operations	380,816	380,238
 Total assets	 \$ 1,261,202	 \$ 1,673,593

Disposed Operations assets at September 30, 2012 and December 31, 2011 primarily represent reinsurance recoverables for the ceding of the former Life Insurance Division business as a result of coinsurance agreements entered into in 2008.

Concentrations

Insphere maintains marketing agreements for the distribution of insurance products with a number of non-affiliated insurance carriers as well as the Company's own insurance subsidiaries. The non-affiliated carriers include, among others, UnitedHealthcare's Golden Rule Insurance Company, Humana, ING and Aetna. The products offered by these third-party carriers and the Company's insurance subsidiaries offer coverage and benefit variations that may fit one consumer better than another. In the markets where Insphere has commenced distribution of these third-party carrier products, these products have, to a great extent, replaced the sale of the Company's own health benefit plans. During the nine months ended September 30, 2012, approximately 84% of Insphere product sales were underwritten by these four third-party carriers.

Minimum Loss Ratio Rebate

Effective in 2011, if the medical loss ratios of our fully insured health products (calculated in accordance with the Health Care Reform Legislation and implementing regulations) fall below certain targets, our insurance subsidiaries will be required to rebate ratable portions of their premiums annually. The Company processed all \$26.0 million of the 2011 rebates in July 2012. Additionally, as of September 30, 2012, the Company had accrued \$6.0 million for the 2012 medical loss ratio rebate to be paid in 2013. As a result, the decrease in earned premium reflects the recording of an accrual for the estimated medical loss ratio rebate. The accrual is recorded in Other policy liabilities on the Company's consolidated balance sheet.

Federal Income Taxes

The federal income tax expense with respect to continuing operations for the nine months ended September 30, 2012 of \$175,000 varies from an anticipated 35% federal tax benefit for the period of \$2.7 million due primarily to the write-off of deferred tax assets totaling \$2.5 million associated with expiring unexercised stock options that were out-of-the-money at the expiration date.

Business Combination

On July 17, 2012, the Company's Insphere subsidiary closed an asset purchase agreement with Repp Gartner Financial, Inc. (Repp Gartner) - a San Diego, California based insurance agency call center - pursuant to which Insphere acquired certain assets of Repp Gartner. This transaction enables Insphere to add a call center distribution channel to its business. The initial purchase price for the purchased assets was approximately \$6.1 million, with additional earn-out payments possible based on the achievement of commission revenue targets attributable to such new call center distribution channel. In addition to the purchase price, Insphere recorded a liability for unearned revenue in the amount of \$925,000 and intangible assets in the amount of \$7.0 million. The intangible assets may increase in the future as the Company refines its estimate for the acquisition date fair value of the contingent consideration of the additional earn-out payments discussed above. The Company anticipates to have this complete in the fourth quarter ending December 31, 2012.

Table of Contents

10. AGENT AND EMPLOYEE STOCK-BASED COMPENSATION PLANS

The Company offers certain eligible insurance agents and designated eligible employees the opportunity to participate in the HealthMarkets, Inc. InVest Stock Ownership Plan (ISOP). For financial reporting purposes, the Company accounts for the Company-match feature of the ISOP for nonemployee agents by recognizing compensation expense over the vesting period in an amount equal to the fair market value of vested shares at the date of their vesting and distribution to the agent-participant. The Company accounts for the Company-match feature of the ISOP for employees by recognizing compensation expense over the vesting period in an amount equal to the fair market value of each award at the date of grant, or, in the case of outstanding awards transferred from the Predecessor Plans, the fair market value at the date of employment.

Expense on awards granted after January 1, 2010 is recognized on a straight-line basis based on the Company's policy adopted in 2006 for new plans effective after January 1, 2006. Expense on awards from plans effective prior to January 1, 2006 will continue to be recognized on a graded basis. Employee awards are equity-classified and changes in values and expense are offset to the Company's Additional Paid-in Capital account on its balance sheet. Nonemployee awards are liability-classified and changes are reflected in the Other Liabilities account on the balance sheet. The liability for nonemployee awards is based on (i) the number of unvested credits, (ii) the prevailing fair market value of the Company's common stock as determined by the Company's Board of Directors and (iii) an estimate of the percentage of the vesting period that has elapsed.

The accounting treatment of matching credits for nonemployee agent-participants results in unpredictable stock-based compensation charges, dependent upon fluctuations in the fair market value of the Company's common stock, as determined by the Company's Board of Directors. In periods of decline in the fair market value of HealthMarkets' common stock, the Company will recognize less stock-based compensation expense than in periods of appreciation. In addition, in circumstances where increases in the fair market value of the Company's common stock are followed by declines, negative stock-based compensation expense may result as the cumulative liability for unvested stock-based compensation expense is adjusted.

The Company recognized \$1.7 million and \$4.8 million of expense for the three and nine months ended September 30, 2012, respectively, in connection with the ISOP. The Company recognized \$1.3 million and \$3.9 million of expense for the three and nine months ended September 30, 2011, respectively, in connection with the ISOP. The liability for nonemployee participation in the ISOP increased \$166,000 for the nine months ended September 30, 2012. Changes in the Company's liability were primarily the result of 2012 expenses partially offset by the vesting of awards in the first quarter of 2012.

11. TRANSACTIONS WITH RELATED PARTIES

As of September 30, 2012, affiliates of The Blackstone Group, Goldman Sachs Capital Partners and DLJ Merchant Banking Partners (the Private Equity Investors) held 54.0%, 22.1% and 11.1%, respectively, of the Company's outstanding equity securities. Certain members of the Board of Directors of the Company are affiliated with the Private Equity Investors.

Transactions with the Private Equity Investors

Transaction and Monitoring Fee Agreements

Each of the Private Equity Investors provides to the Company ongoing monitoring, advisory and consulting services pursuant to Transaction and Monitoring Fee Agreements, for which the Company pays The Blackstone Group, Goldman Sachs Capital Partners and DLJ Merchant Banking Partners, in the aggregate, annual monitoring fees of at least \$12.5 million. The annual monitoring fees are, in each case, subject to an upward adjustment in each year based on the ratio of the Company's earnings before interest, taxes, depreciation and amortization (EBITDA) in such year to EBITDA in the prior year, provided that the aggregate monitoring fees paid to all advisors pursuant to the Transaction and Monitoring Fee Agreements in any year shall not exceed the greater of \$15.0 million or 3% of EBITDA in such year. Of the aggregate annual monitoring fees of \$12.5 million paid in January 2012, \$7.7 million was paid to The Blackstone Group, \$3.2 million was paid to Goldman Sachs Capital Partners and \$1.6 million was paid to DLJ Merchant Banking Partners. The Company has expensed \$9.4 million through September 30, 2012.

Table of Contents

Investment in Certain Funds Affiliated with the Private Equity Investors

On April 20, 2007, the Company's Board of Directors approved a \$10.0 million investment by Mid-West in Goldman Sachs Real Estate Partners, L.P., a commercial real estate fund managed by an affiliate of Goldman Sachs Capital Partners. The Company has committed such investment to be funded over a series of capital calls. As of September 30, 2012, the Company had a remaining commitment to Goldman Sachs Real Estate Partners, L.P. of \$1.6 million.

On April 20, 2007, the Company's Board of Directors approved a \$10.0 million investment by MEGA in Blackstone Strategic Alliance Fund L.P., a hedge fund of funds managed by an affiliate of The Blackstone Group. The Company has committed such investment to be funded over a series of capital calls. As of September 30, 2012, the Company had a remaining commitment to The Blackstone Strategic Alliance Fund L.P. of \$407,000.

12. CREDIT QUALITY

The Company monitors the credit quality of its student loan receivables by evaluating various factors and utilizing such information in the assessment of the adequacy of the allowance for credit losses. The key credit quality indicators the Company generally uses are net charge-offs to gross student loan receivables and student loan receivable aging trends. During the nine months ended September 30, 2012, the net charge-offs were \$931,000 or 1.85% of the total outstanding balance of student loans. This percentage is down 3 basis points from 1.88% as of December 31, 2011. Additionally, the Company analyzes receivable aging trends and as of September 30, 2012, the amount of loans in repayment that were more than ninety days past due was \$1.4 million compared to \$1.5 million at December 31, 2011. Although the total amount of loans in repayment that were more than ninety days past due decreased during this period, the percentage of loans more than ninety days past due relative to total loans in repayment increased 19 basis points from 3.56% as of December 31, 2011 to 3.75% as of September 30, 2012. While the above indicators show mixed results for the current period, based on current repayment trends, charge-off rates and other student loan receivables data, the Company's provision for loan losses of \$7.0 million appears sufficient absent significant deterioration in the economy.

Table of Contents**ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Cautionary Statements Regarding Forward-Looking Statements**

In this report, unless the context otherwise requires, the terms *Company*, *HealthMarkets*, *we*, *us*, or *our* refer to HealthMarkets, Inc. and its subsidiaries. This report and other documents or oral presentations prepared or delivered by and on behalf of the Company contain or may contain *forward-looking statements* within the meaning of the safe harbor provisions of the United States Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements based upon management's expectations at the time such statements are made. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Forward-looking statements are subject to risks and uncertainties that could cause the Company's actual results to differ materially from those contemplated in the statements. Readers are cautioned not to place undue reliance on the forward-looking statements. All statements, other than statements of historical information provided or incorporated by reference herein, may be deemed to be forward-looking statements. Without limiting the foregoing, when used in written documents or oral presentations, the terms *anticipate*, *believe*, *estimate*, *expect*, *may*, *objective*, *plan*, *possible*, *potential*, *project*, *will* and similar expressions are intended to identify forward-looking statements. In addition to the assumptions and other factors referred to specifically in connection with such statements, factors that could impact the Company's business and financial prospects include, but are not limited to, those discussed in our Annual Report on Form 10-K for the year ended December 31, 2011 under the caption *Item 1 Business*, *Item 1A. Risk Factors* and *Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations* and those discussed from time to time in the Company's various filings with the Securities and Exchange Commission or in other publicly disseminated written documents.

Introduction

HealthMarkets, Inc., a Delaware corporation incorporated in 1984, is a holding company, the principal asset of which is its investment in its wholly owned subsidiary, HealthMarkets, LLC. HealthMarkets, LLC's principal assets are its investments in its separate operating subsidiaries, including its regulated insurance subsidiaries. HealthMarkets conducts its insurance underwriting businesses through its indirect wholly owned insurance company subsidiaries, The MEGA Life and Health Insurance Company (*MEGA*), Mid-West National Life Insurance Company of Tennessee (*Mid-West*), The Chesapeake Life Insurance Company (*Chesapeake*) and HealthMarkets Insurance Company (*HMIC*), and generally conducts its insurance distribution business primarily through its indirect insurance agency subsidiary, Insphere Insurance Solutions, Inc. (*Insphere*).

The Company is generally focused on business opportunities that allow us to maximize the value of the Insphere independent agent sales force, with particular focus on the sale of supplemental insurance products underwritten by the Company's insurance subsidiaries and third-party health insurance products underwritten by non-affiliated insurance companies. In 2010, we discontinued the sale of the Company's traditional scheduled benefit health insurance products and discontinued marketing all health benefit plans underwritten by our insurance subsidiaries in all but a limited number of states in which Insphere does not have access to third-party health insurance products. We believe that this shift better positions the Company for the future, particularly in light of changes resulting from the enactment, in March 2010, of the Patient Protection and Affordable Care Act and a reconciliation measure, the Health Care and Education Reconciliation Act of 2010 (collectively, the *Health Care Reform Legislation*). The Company continues to maintain a significant in-force block of health benefits plans and evaluates on an ongoing basis the impact of Health Care Reform Legislation on this block.

Through our Commercial Health Division, we underwrite and administer a broad range of health insurance and supplemental insurance products for individuals, families, the self-employed and small businesses. Our plans are designed to accommodate individual needs and include basic hospital-medical expense plans, plans with preferred provider organization features, catastrophic hospital expense plans, as well as other supplemental types of coverage. We currently market these products through independent agents contracted with Insphere. As stated above, the Company discontinued marketing all of its health benefit plans in all but a limited number of states in which Insphere does not currently have access to third-party health benefit plans.

Through our Commercial Health Division we also offer supplemental product lines designed to further protect against risks to which our customer is typically exposed. These products are sold to purchasers of the Company's health benefit plans, as well as to purchasers of third party products underwritten by non-affiliated insurance carriers. They are also sold on a stand-alone basis (primarily underwritten by Chesapeake). In late 2010, Chesapeake introduced an extensive supplemental product portfolio currently available in 46 states. Chesapeake's supplemental products are marketed primarily under the SureBridge Insurance brand and distributed by Insphere agents as well as other independent, third party producers.

Insphere is a distribution company that specializes in meeting the life, health, long-term care, Medicare and retirement insurance needs of small businesses and middle-income individuals and families through its portfolio of products from nationally recognized insurance carriers. Insphere is an authorized agency in all 50 states and the District of Columbia. As of September 30, 2012, Insphere had approximately 2,900 independent

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

agents, of which approximately 1,800 on average write health insurance applications each month, and offices in over 35 states. Insphere distributes products underwritten by the Company's insurance company subsidiaries, as well as non-affiliated insurance companies. Insphere has marketing agreements with a number of non-affiliated life, health, long-term care and retirement insurance carriers, including, but not limited to, Aetna, Humana, ING and UnitedHealthcare's Golden Rule Insurance.

Table of Contents**Results of Operations**

The table below sets forth certain summary information about the Company's operating results for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
		2011	2012	2011
	(Dollars in thousands)			
REVENUE				
Health premiums	\$ 112,228	\$ 131,702	\$ 350,144	\$ 416,146
Life premiums and other considerations	332	357	1,167	1,213
	112,560	132,059	351,311	417,359
Investment income	5,783	6,153	18,057	22,358
Other income	21,635	20,562	63,201	62,195
Realized gains, net	257	2,546	301	8,976
	140,235	161,320	432,870	510,888
BENEFITS AND EXPENSES				
Benefits, claims, and settlement expenses	83,342	83,348	251,028	279,036
Underwriting, acquisition, and insurance expenses	16,707	21,331	55,406	74,753
Other expenses	43,310	40,517	124,120	119,856
Interest expense	2,713	4,745	9,948	17,290
	146,072	149,941	440,502	490,935
Income (loss) from continuing operations before income taxes	(5,837)	11,379	(7,632)	19,953
Federal income tax expense	(1,796)	4,235	175	7,578
	(4,041)	7,144	(7,807)	12,375
Income (loss) from continuing operations	(4,041)	7,144	(7,807)	12,375
Income from discontinued operations, net	16	11	325	35
Net income (loss)	\$ (4,025)	\$ 7,155	\$ (7,482)	\$ 12,410

National Health Care Reform Legislation

In March 2010, Health Care Reform Legislation was signed into law, which will result in broad-based material changes to the United States health care system. The Health Care Reform Legislation has, and is expected to continue to, significantly impact our business, including but not limited to the minimum medical loss ratio requirements applicable to our insurance subsidiaries as well as third party health insurance carriers doing business with Insphere. Provisions of the Health Care Reform Legislation become effective at various dates over the next several years and a number of additional steps are required to implement these requirements, including, without limitation, further guidance and clarification in the form of final implementing regulations for certain key aspects of the legislation. We have dedicated material resources, made material changes to our business, and incurred material expenses (including but not limited to additional claims expenses) as a result of Health Care Reform Legislation.

With respect to the minimum loss ratio requirements effective beginning in 2011, a mandated minimum loss ratio of 80% for the individual and small group markets is expected to have a significant impact on the revenues of our insurance subsidiaries and our business generally, and has required us to issue rebates to customers. (See Note 9 *Minimum Loss Ratio Rebate* of the Notes to Consolidated Condensed Financial Statements included herein.) The 80% minimum medical loss ratio could, at an appropriate time in the future, compel us to discontinue the underwriting and marketing of individual health insurance and/or to non-renew coverage of our existing individual health customers in one or more states pursuant to applicable state and federal requirements.

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

In addition, beginning in 2011, the mandated medical loss ratio requirements have adversely affected the level of base commissions and override commissions that Insphere receives from the Company's insurance subsidiaries and third

Table of Contents

party insurance carriers. In order to comply with the 80% minimum medical loss ratio requirement, many of these carriers, including the Company's insurance subsidiaries, have reduced commissions and overrides. In the fourth quarter of 2010, Insphere received notice from a number of its third-party health insurance carriers that compensation levels in 2011 would be significantly lower than 2010 levels. As a result of these reductions, Insphere has lowered the level of commissions paid to its agents for the sale of products underwritten by these carriers. At this time, we are not able to project with certainty the full extent to which the minimum medical loss ratio requirement will impact our revenues and results of operations, but the impact may be material.

To the extent required by the Health Care Reform Legislation, the Company has made the adjustments to its in-force block of business issued prior to March 24, 2010, including but not limited to removal of lifetime maximums on benefits, extension of dependent coverage through age 26, meeting new HHS reporting requirements and adopting limitations on most policy rescissions. These changes generally became effective on January 1, 2011 (for most of our plans - the effective date of the new plan year), although certain states may require an earlier effective date. In addition to the changes discussed above, plans issued on or after March 24, 2010 are subject to more extensive benefit changes, including but not limited to first dollar preventive care benefits and no annual limits on essential benefits covered by the policies. The Company has made all state form and rate filings necessary to include these new requirements and effective in September 2011, made required rate and form changes for new policies marketed after that date.

The Company's review of the requirements of the Health Care Reform Legislation, and its potential impact on the Company's health insurance product offerings, is ongoing. Due to the complexity of the Health Care Reform Legislation, gradual implementation and the pending status of certain guidance and regulations, the full impact of Health Care Reform Legislation on our business is not yet fully known. Depending on the outcome of certain potential developments with respect to the Health Care Reform Legislation, including but not limited to those mentioned above, certain elements of this legislation could, in the future, have a material adverse effect on our financial condition and results of operations, including but not limited to, impairment of goodwill and intangible assets. In addition, a number of state legislatures have enacted or are contemplating significant health insurance reforms, either in response to the Health Care Reform Legislation or independently (to the extent not addressed by federal legislation). The Health Care Reform Legislation, as well as state health insurance reforms, could further increase our costs, require us to further revise the way in which we conduct business, result in the elimination of certain products or business lines (including, potentially, non-renewal of our existing health benefit plan business in one or more states subject to applicable state and federal requirements), lead to lower revenues and expose us to an increased risk of liability. Any delay or failure to conform our business to the requirements of the Health Care Reform Legislation and state health insurance reforms could disrupt our operations, lead to regulatory issues, damage our relationship with existing customers and our reputation generally, adversely affect our ability to attract new customers and result in other adverse consequences.

For additional information, see the caption entitled "Regulatory and Legislative Matters - *National Health Care Reform Legislation*" in Part I, Item I of the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Business Segments

We operate four business segments: Commercial Health, Insphere, Corporate, and Disposed Operations. Through our Commercial Health Division, we underwrite and administer a broad range of health insurance and supplemental insurance products. Insphere includes net commission revenue, agent incentives, marketing costs and other agency administration costs. Corporate includes investment income not allocated to the other segments, realized gains or losses, interest expense on corporate debt, our student loan business, general expenses relating to corporate operations and operations that do not constitute reportable operating segments. Disposed Operations includes the remaining run out of residual operations from the disposition and wind down of other businesses prior to 2011.

Allocations of investment income and certain general expenses are based on a number of assumptions and estimates, and the business segments reported operating results would change if different allocation methods were applied. Certain assets are not individually identifiable by segment and, accordingly, have been allocated by formulas. Segment revenues include premiums and other policy charges and considerations, net investment income, commission revenue, fees and other income. Management does not allocate income taxes to segments. Transactions between reportable segments are accounted for under respective agreements, which provide for such transactions generally at cost.

Revenue from continuing operations and income (loss) from continuing operations before income taxes are set forth in the tables below:

Three Months Ended		Nine Months Ended	
September 30,		September 30,	
2012	2011	2012	2011

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

	(In thousands)			
<i>Revenue from continuing operations:</i>				
Commercial Health Division:	\$ 119,912	\$ 141,867	\$ 376,165	\$ 448,538
Insphere:	23,421	18,423	65,548	52,687
Corporate:	4,186	5,573	10,783	21,640
Intersegment Eliminations:	(7,314)	(4,934)	(19,755)	(13,185)
Total revenues excluding disposed operations	140,205	160,929	432,741	509,680
Disposed Operations:	30	391	129	1,208
Total revenue from continuing operations	\$ 140,235	\$ 161,320	\$ 432,870	\$ 510,888

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
<i>Income (loss) from continuing operations before federal income taxes:</i>				
Commercial Health Division:	\$ 12,431	\$ 31,411	\$ 48,778	\$ 79,223
Inspire:	(11,362)	(12,400)	(32,935)	(39,614)
Corporate:	(6,934)	(8,299)	(23,948)	(20,949)
Total operating income (loss) excluding disposed operations	(5,865)	10,712	(8,105)	18,660
Disposed Operations:	28	667	473	1,293
Total income (loss) from continuing operations before federal income taxes	\$ (5,837)	\$ 11,379	\$ (7,632)	\$ 19,953

Commercial Health Division

Set forth below is certain summary financial and operating data for the Company's Commercial Health Division for the three months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Revenue				
Earned premium revenue	\$ 112,559	\$ 132,068	\$ 351,284	\$ 417,366
Investment income	2,251	3,422	8,755	10,564
Other income	5,102	6,377	16,126	20,608
Total revenue	119,912	141,867	376,165	448,538
Benefits and Expenses				
Benefit expenses	83,350	83,801	251,579	279,525
Underwriting, acquisition and insurance expenses	23,075	25,015	72,114	84,104
Other expenses	1,056	1,640	3,694	5,686
Total expenses	107,481	110,456	327,387	369,315
Operating income	\$ 12,431	\$ 31,411	\$ 48,778	\$ 79,223
<i>Other operating data:</i>				
Loss ratio	74.0%	63.5%	71.6%	67.0%
Expense ratio	20.5%	18.9%	20.5%	20.2%
Combined ratio	94.5%	82.4%	92.1%	87.2%

Loss Ratio. The loss ratio is defined as benefits expense as a percentage of earned premium revenue.

Expense Ratio. The expense ratio is defined as underwriting, acquisition and insurance expenses as a percentage of earned premium revenue.

Through our Commercial Health Division, we issue a broad range of health and supplemental insurance products for individuals, families, the self-employed and small businesses. Our plans are designed to accommodate individual needs and include basic hospital-medical expense plans, plans with preferred provider organization features, catastrophic hospital expense plans, as well as other supplemental types of coverage.

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

The Commercial Health Division continues to report a decrease in earned premium revenue for both the three-months and nine-months ended September 30, 2012 compared to the same periods in the prior year, due to the continued decrease in policies in force. Since 2010, the Company's emphasis has been primarily on the distribution of health insurance products underwritten by non-affiliated carriers and growing its supplemental insurance product sales underwritten primarily by The Chesapeake Life Insurance Company.

The Commercial Health Division reported a decrease in operating income which is generally attributable to the decrease in revenue as well as the increase in the loss ratio. The increase in the loss ratio is primarily the result of the minimum loss ratio (MLR) requirements as enacted by Health Care Reform Legislation. During the third quarter of 2011, the Company updated its completion factors and the impact on the three months ended September 30, 2011 was approximately \$7.8 million recorded as a reduction in the claim liability. During the second quarter of 2012, the Company updated its loss reserve analysis including an update of the completion factors resulting in an increase in claim reserves of \$2.1 million. The Company recorded \$2.8 million of certain claims expenses relating to the first and second quarter of 2012 during the third quarter which is related to formulary rebates on prescription drug benefits.

The decrease in underwriting, acquisition and insurance expense reflects the variable nature of commission expenses and premium taxes included in these amounts which generally vary in proportion to earned premium revenue. Additionally, the Company continues to address other cost saving measures to reduce fixed costs associated with this segment.

Other income and other expenses both decreased in the current period compared to the prior year period. Other income largely consists of fee and other income received for sales of association memberships prior to the formation of Insphere, for which other expenses are incurred for bonuses and other compensation provided to the agents. The majority of these association memberships were sold along with health policies and as premium continues to decrease we expect the revenue and expense generated from these association memberships to also decrease.

Table of Contents***Insphere***

Insphere is an insurance agency authorized in 50 states and the District of Columbia specializing in small business and middle-income market life, health, long-term care and retirement insurance. Insphere distributes products underwritten by our insurance subsidiaries, as well as non-affiliated insurance companies.

Set forth below is certain summary financial and operating data for Insphere for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	2012	2011	2012	2011
	(Dollars in thousands)			
Revenue				
Commission revenue from non-affiliates	\$ 13,751	\$ 10,858	\$ 37,952	\$ 32,238
Commission revenue from affiliates	6,427	3,838	17,178	9,916
Commission revenue from association memberships	2,684	3,205	8,844	9,042
Investment income	298	257	859	752
Other income	261	265	715	739
Total revenue	23,421	18,423	65,548	52,687
Expenses				
Commission expenses	12,191	9,514	34,123	28,001
Agent incentives	6,793	6,885	19,869	19,519
Other expenses	15,799	14,424	44,491	44,781
Total expenses	34,783	30,823	98,483	92,301
Operating loss	\$ (11,362)	\$ (12,400)	\$ (32,935)	\$ (39,614)

Insphere continues to report an increase in commission revenue with the majority of the increase attributable from the sale of our supplemental insurance products. Commission revenue from non-affiliates continues to increase over prior year primarily as a result of the increased renewal business.

Insphere also reported increases in commission expenses and agent incentives which is due primarily to the corresponding increases in commission revenues, especially on the supplemental insurance business. Commission expense as a percentage of commission revenue is generally higher on the supplemental products compared to health products during the first year. Commission expense includes commissions and overrides paid to our independent agents. Commissions are generally based on a percentage of the premiums paid by the insured to the carrier. Agent incentives primarily include production and agent recruiting bonuses paid to our independent agents as well as lead generation costs incurred to facilitate the production of commission revenue. These generally increase in tandem with commission revenue.

Other expenses associated with Insphere are related to home office employee compensation, costs associated with our field offices, depreciation and amortization, and other administrative expenses. These costs increased from the prior year primarily as a result of administrative expenses associated with the purchase and ongoing activities of the insurance agency call center discussed below.

On July 17, 2012, the Company's Insphere subsidiary closed an asset purchase agreement with Repp Gartner Financial, Inc. ("Repp Gartner") - a San Diego, California based insurance agency call center - pursuant to which Insphere acquired certain assets of Repp Gartner. This transaction enables Insphere to add a call center distribution channel to its business. The initial purchase price for the purchased assets was approximately \$6.1 million, with additional earn-out payments possible based on the achievement of commission revenue targets attributable to such new call center distribution channel. In addition to the purchase price, Insphere recorded a liability for unearned revenue in the amount of \$925,000 and intangible assets in the amount of \$7.0 million. The intangible assets may increase in the future as the Company refines its estimate for the acquisition date fair value of the contingent consideration of the additional earn-out payments discussed above. The Company anticipates to have this complete in the fourth quarter ending December 31, 2012.

Corporate

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

Corporate includes investment income not otherwise allocated to the other segments, realized gains and losses on sales, interest expense on corporate debt, the Company's student loan business, general expense relating to corporate operations and operations that do not constitute reportable operating segments.

Table of Contents

Set forth below is a summary of the components of operating loss at Corporate for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
<i>Operating loss:</i>				
Investment income on equity	\$ 2,589	\$ 1,603	\$ 6,359	\$ 8,312
Realized gains, net	257	2,546	336	8,976
Interest expense on corporate debt	(2,709)	(4,742)	(9,939)	(17,287)
Student loan operations	(43)	(56)	(165)	(112)
General corporate expenses and other	(7,028)	(7,650)	(20,539)	(20,838)
Operating loss	\$ (6,934)	\$ (8,299)	\$ (23,948)	\$ (20,949)

The change in operating loss is primarily due to the following items:

The increase in investment income for the quarter resulted from a reduction in the amount allocated to the other segments. The reduction in the allocation was based on a decrease in the interest rates used in the allocation model.

The decrease in investment income and realized gains for the year resulted from the sales of various fixed maturities throughout 2011 as a result of cash requirements needed for the then pending maturity of our term loan.

Interest expense on corporate debt decreased as a result of the repayment of the Company's term loan in February 2012. Additionally, the Company had an interest rate swap agreement that expired on April 11, 2011 which caused the Company to pay a fixed rate higher than the current variable rate incurred on the debt during the first quarter of 2011.

Liquidity and Capital Resources**Consolidated Operations**

Historically, the Company's primary sources of cash on a consolidated basis have been premium revenue from policies issued, investment income, and fees and other income. The primary uses of cash have been payments for benefits, claims and commissions under those policies, servicing of the Company's debt obligations, and operating expenses.

The following table also sets forth additional information with respect to the Company's debt:

	Maturity Date	Interest Rate at September 30, 2012	September 30, 2012	December 31, 2011
			(In thousands)	
Term loan	2012	n/a	\$ 0	\$ 362,500
Grapevine Note	2021	6.7%	72,350	72,350
<i>Trust preferred securities:</i>				
UICI Capital Trust I	2034	4.0%	15,470	15,470
HealthMarkets Capital Trust I	2036	3.5%	51,550	51,550
HealthMarkets Capital Trust II	2036	3.5%	51,550	51,550

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

Total			\$ 190,920	\$ 553,420
Student Loan Credit Facility	(a)	0.000%(b)	53,850	60,050
Total			\$ 244,770	\$ 613,470

- (a) The Series 2001A-1 Notes and Series 2001A-2 Notes have a final stated maturity of July 1, 2036; the Series 2002A Notes have a final stated maturity of July 1, 2037.
- (b) The interest rate on each series of notes resets monthly in a Dutch auction process.
- We regularly monitor our liquidity position, including cash levels, principal investment commitments, interest and principal payments on debt, capital expenditures and matters relating to liquidity and to compliance with regulatory requirements.

Holding Company

HealthMarkets, Inc. is a holding company, the principal asset of which is its investment in its wholly owned subsidiary, HealthMarkets, LLC (collectively referred to as the holding company). The holding company's ability to fund its cash requirements is largely dependent upon its ability to access cash, by means of dividends or other means, from its separate operating subsidiaries, including its regulated insurance subsidiaries and Insphere.

Table of Contents

Domestic insurance companies require prior approval by insurance regulatory authorities for the payment of dividends that exceed certain limitations based on statutory surplus and net income. In January 2012, the Company's Mid-West insurance subsidiary paid an extraordinary dividend in the amount of \$30.0 million. As a result, during the remainder of 2012, the Company's domestic insurance subsidiaries are eligible to pay additional aggregate dividends in the ordinary course of business to HealthMarkets, LLC of approximately \$48.1 million without prior approval by statutory entities.

As it has done in the past, the Company will continue to assess the results of operations of the regulated domestic insurance companies to determine the prudent dividend paying capability of the subsidiaries. This is consistent with our practice of maintaining risk-based capital ratios at each of our domestic insurance subsidiaries in excess of minimum requirements.

HealthMarkets, LLC provides working capital to its wholly-owned subsidiary, Insphere, pursuant to a \$100 million Loan Agreement. As of September 30, 2012 and December 31, 2011, Insphere had an outstanding balance owed to HealthMarkets, LLC of \$25.3 million and \$6.9 million, respectively.

At September 30, 2012, HealthMarkets, Inc. and HealthMarkets, LLC, in the aggregate, held cash and short-term investments in the amount of \$90.6 million.

Contractual Obligations and Off Balance Sheet Arrangements

A summary of HealthMarkets' contractual obligations is included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. There have been no material changes in the Company's contractual obligations or off balance sheet commitments since December 31, 2011.

Critical Accounting Policies and Estimates

The Company's discussion and analysis of its financial condition and results of operations are based on its consolidated condensed financial statements, which have been prepared in accordance with United States generally accepted accounting principles. The preparation of these consolidated condensed financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to the valuation of assets and liabilities requiring fair value estimates, including investments and allowance for bad debts, the amount of health and life insurance claims and liabilities, the realization of deferred acquisition costs, the carrying value of goodwill and intangible assets, the amortization period of intangible assets, stock-based compensation plan forfeitures, the realization of deferred taxes, reserves for contingencies, including reserves for losses in connection with unresolved legal matters and other matters that affect the reported amounts and disclosure of contingencies in the financial statements. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Reference is made to the discussion of these critical accounting policies and estimates contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 under the caption *Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates*.

The Company applied the provisions of ASU 2010-26 beginning January 1, 2012 and determined that certain underwriting and customer lead generation expenses were no longer deferrable under the new guidance. Under the transition guidance provided by ASU 2010-26, the Company has chosen to apply the retrospective method. The retrospective method requires the Company to record the cumulative effect of applying a change in accounting principle to all prior periods presented. As a result of the change in accounting principle, the Company made the following adjustments:

- (a) Adjusted the balance of the following items as of January 1, 2011: (i) reduced Deferred acquisition costs by \$7.9 million, (ii) reduced Retained earnings by \$5.1 million, and (iii) reduced Deferred federal income taxes by \$2.8 million.
- (b) Restated the Consolidated Condensed Statements of Income for the three months ended September 30, 2011 by the following amounts: (i) a decrease to Underwriting acquisition and insurance expenses in the amount of \$1.1 million, (ii) an increase to Federal income tax expense in the amount of \$374,000, (iii) an increase in Income from continuing operations and Net income in the amount of \$694,000, and (iv) an increase in diluted earnings per share in the amount of \$0.02.

Table of Contents

- (c) Restated the Consolidated Condensed Statements of Income for the nine months ended September 30, 2011 by the following amounts: (i) a decrease to Underwriting acquisition and insurance expenses in the amount of \$3.3 million, (ii) an increase to Federal income tax expense in the amount of \$1.2 million, (iii) an increase in Income from continuing operations and Net income in the amount of \$2.1 million, and (iv) an increase in diluted earnings per share in the amount of \$0.07.

Effective in 2011, if the medical loss ratios of our fully insured health products (calculated in accordance with the Health Care Reform Legislation and implementing regulations) fall below certain targets, our insurance subsidiaries will be required to rebate ratable portions of their premiums annually. The Company processed all \$26.0 million of the 2011 rebates in July 2012. Additionally, as of September 30, 2012, the Company had accrued \$6.0 million for the 2012 medical loss ratio rebate to be paid in 2013. As a result, the decrease in earned premium reflects the recording of an accrual for the estimated medical loss ratio rebate. The accrual is recorded in Other policy liabilities on the Company's consolidated balance sheet.

Regulatory and Legislative Matters

The business of insurance is primarily regulated by the states and is also affected by a range of legislative developments at the state and federal levels. Recently adopted legislation and regulations may have a significant impact on the Company's business and future results of operations. Reference is made to the discussion under the caption Business Regulatory and Legislative Matters in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. See Note 7 of Notes to Consolidated Condensed Financial Statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has not experienced significant changes related to its market risk exposures during the quarter ended September 30, 2012. Reference is made to the information contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 in Item 7A *Quantitative and Qualitative Disclosures about Market Risk*.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed in reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. In addition, the disclosure controls and procedures ensure that information required to be disclosed is accumulated and communicated to management, including the principal executive officer and principal financial officer, allowing timely decisions regarding required disclosure. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Exchange Act. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

Change in Internal Control over Financial Reporting

There has been no change in the Company's internal control over financial reporting during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents**PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

The Company is a party to various material legal proceedings, which are described in Note 7 of Notes to Consolidated Condensed Financial Statements included herein and/or in the Company's Annual Report on Form 10-K filed for the year ended December 31, 2011 under the caption *Item 3. Legal Proceedings*. The Company and its subsidiaries are parties to various other pending legal proceedings arising in the ordinary course of business, including some asserting significant damages arising from claims under insurance policies, disputes with agents and other matters. Based in part upon the opinion of counsel as to the ultimate disposition of such lawsuits and claims, management believes that the liability, if any, resulting from the disposition of such proceedings, after consideration of applicable reserves and/or potentially available insurance coverage benefits, will not be material to the Company's consolidated financial condition or results of operations. Except as discussed in Note 7 of the Notes to Consolidated Condensed Financial Statements included herein, during the three month period covered by this Quarterly Report on Form 10-Q, the Company has not been named in any new material legal proceeding, and there have been no material developments in the previously reported legal proceedings.

ITEM 1A. RISK FACTORS

Reference is made to the risk factors discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 in Part I, Item 1A. Risk Factors, which could materially affect the Company's business, financial condition or future results. The risks described in the Company's Annual Report on Form 10-K, as updated by the Quarterly Reports, are not the only risks the Company faces. Additional risks and uncertainties not currently known to the Company or that the Company currently deems to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

The Company has not experienced material changes to the risk factors disclosed in its Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the quarter ended September 30, 2012, the Company issued an aggregate of 17,998 unregistered shares of its Class A-1 common stock. In particular, employee participants in the HealthMarkets, Inc. InVest Stock Ownership Plan purchased 17,998 shares of the Company's Class A-1 common stock for aggregate consideration of \$185,000 (or \$10.29 per share). Such sale of securities was made in reliance upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended (and/or Regulation D promulgated thereunder) for transactions by an issuer not involving a public offering. The proceeds of such sale were used for general corporate purposes.

Issuer Purchases of Equity Securities

The following table sets forth the Company's purchases of HealthMarkets, Inc. Class A-1 common stock during each of the months in the three months ended September 30, 2012:

Period	Total Number of Shares Purchased ⁽¹⁾	Average Price Paid per Share (\$)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under The Plan or Program
7/1/12 to 7/31/12	0	\$ 0	0	0
8/1/12 to 8/31/12	61,262	10.29	0	0
9/1/12 to 9/30/12	44,763	10.29	0	0
Totals	106,025	\$ 10.29	0	0

(1) The number of shares purchased other than through a publicly announced plan or program includes 106,025 shares purchased from former or current employees of the Company.

The following table sets forth the Company's purchases of HealthMarkets, Inc. Class A-2 common stock during each of the months in the three months ended September 30, 2012:

Edgar Filing: HealthMarkets, Inc. - Form 10-Q

Period	Total Number of Shares Purchased⁽¹⁾	Average Price Paid per Share (\$)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under The Plan or Program
7/1/12 to 7/31/12	3,200	\$ 10.33	0	0
8/1/12 to 8/31/12	100,203	10.29	0	0
9/1/12 to 9/30/12	53,583	10.29	0	0
Totals	156,986	\$ 10.29	0	0

- (1) The number of shares purchased other than through a publicly announced plan or program includes 156,986 shares purchased from former or current participants of the stock accumulation plan established for the benefit of the Company's insurance agents.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

Table of Contents

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits.

Exhibit No.	Description
10.1	Employment Agreement, effective as of November 1, 2012, between HealthMarkets, Inc. and R. Scott Donovan filed as Exhibit 10.1 to the Current Report on Form 8-K dated November 1, 2012, File No. 001-14953, and incorporated by reference herein.
31.1	Rule 13a-14(a)/15d-14(a) Certification, executed by Kenneth J. Fasola, Chief Executive Officer of HealthMarkets, Inc.
31.2	Rule 13a-14(a)/15d-14(a) Certification, executed by R. Scott Donovan, Executive Vice President and Chief Financial Officer of HealthMarkets, Inc.
32	Certifications required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350), executed by Kenneth J. Fasola, Chief Executive Officer of HealthMarkets, Inc. and R. Scott Donovan, Executive Vice President and Chief Financial Officer of HealthMarkets, Inc.
101	The following materials from HealthMarkets' Form 10-Q for the period ended September 30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Condensed Balance Sheets, (ii) Consolidated Condensed Statements of Income, (iii) Consolidated Condensed Statement of Comprehensive Income, (iv) Consolidated Condensed Statements of Cash Flows, and (v) Notes to the Consolidated Condensed Financial Statements.

Table of Contents

SIGNATURES

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.

HEALTHMARKETS, INC

(Registrant)

Date: November 8, 2012

/s/ Kenneth J. Fasola
Kenneth J. Fasola
Chief Executive Officer

Date: November 8, 2012

/s/ R. Scott Donovan
R. Scott Donovan
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)