

HealthMarkets, Inc.
Form 10-Q
August 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 June 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 August 1, 2012, the registrant had 27,853,273 outstanding shares of Class A-1 Common Stock, \$.01 Par Value, and 2,813,122 outstanding shares of Class A-2 Common Stock, \$.01 Par Value.

Table of Contents

HEALTHMARKETS, INC.

and Subsidiaries

Second Quarter 2012 Form 10-Q

TABLE OF CONTENTS

	Page
PART I <u>FINANCIAL INFORMATION</u>	
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 <u>OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	29
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>	30
Item 6. <u>Exhibits</u>	31
<u>SIGNATURES</u>	32

Table of Contents

HEALTHMARKETS, INC.

and Subsidiaries

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

	June 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Investments:		
Securities available for sale		
Fixed maturities, at fair value (cost: 2012 \$368,439; 2011 \$394,948)	\$ 406,675	\$ 428,199
Short-term and other investments	263,442	626,415
Total investments	670,117	1,054,614
Cash and cash equivalents	16,904	17,299
Student loan receivables	46,211	50,733
Restricted cash	14,778	14,447
Investment income due and accrued	5,307	4,007
Reinsurance recoverable ceded policy liabilities	365,478	363,139
Agent and other receivables	24,916	21,416
Deferred acquisition costs	13,667	14,639
Property and equipment	34,907	37,466
Goodwill and other intangible assets	79,398	80,255
Recoverable federal income taxes	707	0
Other assets	19,135	13,478
Assets Held for Sale	0	2,100
	\$ 1,291,525	\$ 1,673,593
LIABILITIES AND STOCKHOLDERS EQUITY		
Policy liabilities:		
Future policy and contract benefits	\$ 470,551	\$ 473,163
Claims	89,282	94,743
Unearned premiums	25,804	27,523
Other policy liabilities	37,703	34,167
Accounts payable and accrued expenses	24,671	30,852
Other liabilities	54,544	57,107
Current income taxes payable	0	410
Deferred federal income taxes	68,610	68,881
Debt	190,920	553,420
Student loan credit facility	55,950	60,050
Net liabilities of discontinued operations	944	1,486
	1,018,979	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 27,853,273 outstanding at June 30, 2012; 28,156,278 issued and 27,851,301 outstanding at December 31,	321	322

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

2011. Class A-2, par value \$0.01 per share authorized 20,000,000 shares, 4,026,104 issued and 2,816,322 outstanding at June 30, 2012; 4,026,104 issued and 2,776,985 outstanding at December 31, 2011

Additional paid-in capital	50,073	50,535
Accumulated other comprehensive income	24,969	21,838
Retained earnings	211,397	214,853
Treasury stock, at cost (243,005 Class A-1 common shares and 1,209,782 Class A-2 common shares at June 30, 2012; 304,977 Class A-1 common shares and 1,249,119 Class A-2 common shares at December 31, 2011)	(14,214)	(15,757)
	272,546	271,791
	\$ 1,291,525	\$ 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 June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
REVENUE				
Health premiums	\$ 122,372	\$ 133,243	\$ 237,916	\$ 284,444
Life premiums and other considerations	364	390	835	856
	122,736	133,633	238,751	285,300
Investment income	5,813	7,240	12,274	16,205
Commissions and other income	20,638	21,099	41,566	41,633
Realized gains, net	68	2,572	44	6,430
	149,255	164,544	292,635	349,568
BENEFITS AND EXPENSES				
Benefits, claims, and settlement expenses	85,838	91,722	167,686	195,688
Underwriting, acquisition, and insurance expenses	19,255	24,375	38,699	53,422
Other expenses	39,625	40,804	80,809	79,339
Interest expense	2,688	5,434	7,235	12,545
	147,406	162,335	294,429	340,994
Income (loss) from continuing operations before income taxes	1,849	2,209	(1,794)	8,574
Federal income tax expense	3,097	912	1,971	3,343
Income (loss) from continuing operations	(1,248)	1,297	(3,765)	5,231
Income from discontinued operations, (net of income tax expense of \$15 and \$166 for the three and six months ended June 30, 2012, and \$5 and \$13 for the three and six months ended June 30, 2011, respectively)	28	10	309	24
Net income (loss)	\$ (1,220)	\$ 1,307	\$ (3,456)	\$ 5,255
Basic earnings (loss) per share:				
Income (loss) from continuing operations	\$ (0.04)	\$ 0.04	\$ (0.12)	\$ 0.17
Income from discontinued operations	0.00	0.00	0.01	0.00
Net income (loss) per share, basic	\$ (0.04)	\$ 0.04	\$ (0.11)	\$ 0.17
Diluted earnings (loss) per share:				
Income (loss) from continuing operations	\$ (0.04)	\$ 0.04	\$ (0.12)	\$ 0.17
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	\$	(0.04)	\$	0.04	\$	(0.11)	\$	0.17
--------------------------------------	----	--------	----	------	----	--------	----	------

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		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Net income (loss)	\$ (1,220)	\$ 1,307	\$ (3,456)	\$ 5,255
Other comprehensive income (loss):				
Unrealized gains (losses) on securities available for sale arising during the period	2,078	4,572	4,896	2,312
Reclassification for investment (gains) losses included in net income (loss)	(79)	(2,572)	(79)	(6,430)
Effect on other comprehensive income (loss) from investment securities	1,999	2,000	4,817	(4,118)
Unrealized losses on derivatives used in cash flow hedging during the period	0	0	0	(4)
Reclassification adjustments included in net income (loss)	0	100	0	1,344
Effect on other comprehensive income from hedging activities	0	100	0	1,340
Other comprehensive income before tax	1,999	2,100	4,817	(2,778)
Income tax expense (benefit) related to items of other comprehensive income (loss)	699	735	1,686	(972)
Other comprehensive income (loss) net of tax	1,300	1,365	3,131	(1,806)
Comprehensive income (loss)	\$ 80	\$ 2,672	\$ (325)	\$ 3,449

See Notes to Consolidated Condensed Financial Statements.

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

	Six Months Ended June 30,	
	2012	2011
Operating Activities:		
Net income (loss)	\$ (3,456)	\$ 5,255
Adjustments to reconcile net income (loss) to cash used in operating activities:		
Income from discontinued operations	(309)	(24)
Realized losses (gains), net	(44)	(6,430)
Change in deferred income taxes	(1,957)	(1,880)
Depreciation and amortization	6,292	9,645
Amortization of prepaid monitoring fees	6,250	6,250
Equity based compensation expense	4,130	3,145
Other items, net	2,688	2,610
Changes in assets and liabilities:		
Investment income due and accrued	(1,822)	1,208
Due Premiums	1	2
Reinsurance recoverable ceded policy liabilities	(2,339)	2,229
Other receivables	(3,657)	8,928
Deferred acquisition costs	972	8,066
Prepaid monitoring fees	(12,500)	(12,500)
Current income taxes	(1,117)	(768)
Policy liabilities	(5,571)	(12,317)
Other liabilities and accrued expenses	(9,600)	(16,168)
Cash used in continuing operations	(22,039)	(2,749)
Cash used in discontinued operations	(233)	(108)
Net cash used in operating activities	(22,272)	(2,857)
Investing Activities:		
Student loan receivables	3,848	4,155
Securities available for sale	26,360	171,339
Short-term and other investments	362,144	(155,109)
Purchases of property and equipment	(2,020)	(3,885)
Change in restricted cash	(331)	(610)
Net proceeds from sale of assets	2,100	0
Increase in agent receivables	(745)	(704)
Cash provided by continuing operations	391,356	15,186
Cash provided by discontinued operations	0	0
Net cash provided by investing activities	391,356	15,186

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

Financing Activities:		
Repayment of long term debt	(362,500)	0
Repayment of student loan credit facility	(4,100)	(4,600)
Decrease in investment products	(684)	(705)
Change in cash overdraft	1,394	(67)
Proceeds from shares issued to agent plans and other	2,586	2,207
Proceeds from exercise of stock options	(79)	0
Purchases of treasury stock	(6,096)	(4,909)
Excess tax reduction from equity based compensation	0	(637)
Cash used in continuing operations	(369,479)	(8,711)
Cash used in discontinued operations	0	0
Net cash used in financing activities	(369,479)	(8,711)
Net change in cash and cash equivalents	(395)	3,618
Cash and cash equivalents at beginning of period	17,299	12,874
Cash and cash equivalents at end of period in continuing operations	\$ 16,904	\$ 16,492
Supplemental disclosures:		
Income taxes paid	\$ 5,211	\$ 6,643
Interest paid	\$ 4,307	\$ 8,176

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 six months ended June 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 June 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 \$366,000, (iii) an increase in Income from continuing operations and Net income in the amount of \$680,000, 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 six months ended June 30, 2011 by the following amounts: (i) a decrease to Underwriting acquisition and insurance expenses in the amount of \$2.2 million, (ii) an increase to Federal income tax expense in the amount of \$780,000, (iii) an increase in Income from continuing operations and Net income in the amount of \$1.4 million, and (iv) an increase in diluted earnings per share in the amount of \$0.05.

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 June 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 \$110.5 million of Corporate bonds and municipals classified as Level 2, \$93.5 million of Other bonds classified as Level 2 and \$264,000 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 June 30, 2012			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
U.S. and U.S. Government agencies	\$ 4,505	\$ 15,055	\$ 0	\$ 19,560
Corporate bonds and municipals	0	243,370	0	243,370
Residential-backed issued by agencies	0	39,735	0	39,735
Commercial-backed issued by agencies	0	0	0	0
Commercial-backed	0	7,108	264	7,372
Asset-backed	0	3,112	0	3,112
Other bonds	0	93,526	0	93,526
Other invested assets ⁽¹⁾	0	0	1,793	1,793
Short-term investments ⁽²⁾	168,971	74,905	0	243,876
	\$ 173,476	\$ 476,811	\$ 2,057	\$ 652,344

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 June 30, 2012			
	Level 1	Level 2	Level 3	Total
Agent and employee compensation plans	\$ 0	\$ 0	\$ 5,790	\$ 5,790

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 June 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 ended June 30, 2012.

**Changes in Level 3 Assets and Liabilities Measured at Fair Value
For the Three Months Ended June 30, 2012**

	Beginning Balance	Unrealized Gains or (Losses)	Sales or Redemption	Settlements	Realized Gains or (Losses)(1)	Transfer in/(out) of Level 3, Net	Ending Balance
	(In thousands)						
ASSETS							
Commercial-backed	\$ 375	\$ (5)	\$ (108)	\$ 2	\$ 0	\$ 0	\$ 264
Other invested assets	1,776	17	0	0	0	0	1,793
	\$ 2,151	\$ 12	\$ (108)	\$ 2	\$ 0	\$ 0	\$ 2,057
LIABILITIES							
Agent and employee stock plans	\$ 4,777	\$ (26)	\$ 0	\$ 1,039	\$ 0	\$ 0	\$ 5,790

(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 Six Months Ended June 30, 2012**

	Beginning Balance	Unrealized Gains or (Losses)	Sales or Redemption	Settlements	Realized Gains or (Losses)(1)	Transfer in/(out) of Level 3, Net	Ending Balance
	(In thousands)						
ASSETS							
Commercial-backed	\$ 485	\$ (10)	\$ (216)	\$ 5	\$ 0	\$ 0	\$ 264
Other invested assets	1,913	(118)	0	(2)	0	0	1,793
	\$ 2,398	\$ (128)	\$ (216)	\$ 3	\$ 0	\$ 0	\$ 2,057

LIABILITIES

Agent and employee stock plans	\$	6,603	\$	545	\$	0	\$	(1,358)	\$	0	\$	0	\$	5,790
--------------------------------	----	-------	----	-----	----	---	----	---------	----	---	----	---	----	-------

(1) Realized losses for the period are included in Realized gains, net on the Company's consolidated condensed statement of income (loss). During the six months ended June 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 \$264,000. 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 further 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.

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.

Table of Contents

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 June 30, 2012 are disclosed in the table below:

	Carrying Value	Estimated Fair Value at June 30, 2012			Total
		Level 1	Level 2	Level 3	
(In thousands)					
<i>Assets:</i>					
Other investments	\$ 17,773	\$ 0	\$ 0	\$ 17,773	\$ 17,773
Cash and cash equivalents	16,904	0	16,904	0	16,904
Student loan receivables	46,211	0	0	39,616	39,616
Restricted cash	14,778	0	14,778	0	14,778
Investment income due and accrued	5,307	0	5,307	0	5,307
<i>Liabilities:</i>					
Debt	190,920	0	0	157,523	157,523
Student loan credit facility	55,950	0	0	34,735	34,735

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
<i>Assets:</i>		
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
<i>Liabilities:</i>		
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.

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.

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

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.

Table of Contents

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 June 30, 2012 and December 31, 2011:

	June 30, 2012	December 31, 2011
	(In thousands)	
Securities available for sale		
Fixed maturities	\$ 406,675	\$ 428,199
Short-term and other investments	263,442	626,415
 Total investments	 \$ 670,117	 \$ 1,054,614

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

	June 30, 2012				
	Amortized	Gross	Gross	Non-credit	Fair Value
	Cost	Gains	Losses	Loss	
	(In thousands)				
				in OCI	
U.S. and U.S. Government agencies	\$ 18,963	\$ 597	\$ 0	\$ 0	\$ 19,560
Corporate bonds and municipals	223,423	20,163	(216)	0	243,370
Residential-backed issued by agencies	37,152	2,589	(6)	0	39,735
Commercial-backed issued by agencies	0	0	0	0	0
Commercial-backed	7,306	66	0	0	7,372
Asset-backed	3,199	194	0	(281)	3,112
Other bonds	78,396	15,130	0	0	93,526
 Total fixed maturities	 \$ 368,439	 \$ 38,739	 \$ (222)	 \$ (281)	 \$ 406,675

	December 31, 2011				
	Amortized	Gross	Gross	Non-credit	Fair Value
	Cost	Gains	Losses	Loss	
	(In thousands)				
				in OCI	
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
Commercial-backed	11,097	252	0	0	11,349
Asset-backed	3,807	145	(13)	(281)	3,658

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

Other bonds	78,396	10,975	0	0	89,371
Total fixed maturities	\$ 394,948	\$ 34,361	\$ (829)	\$ (281)	\$ 428,199

The amortized cost and fair value of available for sale fixed maturities at June 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.

	June 30, 2012	
	Amortized Cost	Fair Value
	(In thousands)	
<i>Maturity:</i>		
One year or less	\$ 49,966	\$ 50,697
Over 1 year through 5 years	127,928	142,186
Over 5 years through 10 years	134,494	154,746
Over 10 years	8,394	8,827
	320,782	356,456
Mortgage-backed and asset-backed securities	47,657	50,219
Total fixed maturities	\$ 368,439	\$ 406,675

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

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)			
Fixed maturities	\$ 4,666	\$ 6,384	\$ 9,499	\$ 13,654
Short-term and other investments	397	448	1,279	1,713
Agent receivables	312	82	626	173
Student loan interest income	719	821	1,454	1,662
	6,094	7,735	12,858	17,202
Less investment expenses	281	495	584	997
	\$ 5,813	\$ 7,240	\$ 12,274	\$ 16,205

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 \$2.7 and \$3.5 million for the three and six months ended June 30, 2012, respectively, and \$66.5 million and \$128.1 million for the three and six months ended June 30, 2011, respectively. Proceeds from maturities, sinking and principal reductions amounted to \$15.0 million and \$37.7 million for the three and six months ended June 30, 2012, respectively, and \$26.9 million and \$49.5 million for the three and six months ended June 30, 2011, respectively. During both the three and six months ended June 30, 2012, the Company realized gross gains of \$79,000, on the sale and call of fixed maturity investments. During the three and six months ended June 30, 2011, the Company realized gross gains of \$2.6 million and \$6.4 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 six months ended June 30, 2012, the Company recognized no OTTI losses.

Set forth below is a summary of cumulative OTTI losses on debt securities held by the Company at June 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 credit losses recognized for securities still held at	Additions to OTTI securities where no credit losses were recognized prior to	Additions for OTTI securities where credit losses have been recognized prior to	Reductions for securities sold during the period (Realized)	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
January 1, 2012	January 1, 2012	January 1, 2012			June 30, 2012

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

(In thousands)

\$ 3,518	\$	0	\$	0	\$	0	\$	0	\$	3,518
----------	----	---	----	---	----	---	----	---	----	-------

Table of Contents*Unrealized Gains and Losses**Fixed maturities*

Set forth below is a summary of gross unrealized losses in its fixed maturities as of June 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	9,411	2	8,971	214	18,382	216
Residential-backed issued by agencies	1,179	6	0	0	1,179	6
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	1,181	0	1,181	0
Other bonds	0	0	0	0	0	0
Total	\$ 10,590	\$ 8	\$ 10,152	\$ 214	\$ 20,742	\$ 222

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
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 June 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

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

Of the \$214,000 in unrealized losses that had existed for twelve months or longer at June 30, 2012, no security had an unrealized loss in excess of 10% of the security's cost.

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 June 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.

Table of Contents**5. DEBT**

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

	Principal Amount			Interest Expense			
				Three Months Ended		Six Months Ended	
	at June 30, 2012	Maturity Date	Interest Rate(a)	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
<i>2006 credit agreement:</i>							
Term loan	\$ 0	2012	n/a	\$ 0	\$ 1,313	\$ 998	\$ 3,671
\$75 Million revolver (non-use fee)	0	2011	n/a	0	2	0	50
Grapevine Note	72,350	2021	6.7%	1,210	1,215	2,421	2,412
<i>Trust preferred securities:</i>							
UICI Capital Trust I	15,470	2034	4.0%	155	148	311	295
HealthMarkets Capital Trust I	51,550	2036	3.5%	459	436	926	868
HealthMarkets Capital Trust II	51,550	2036	3.5%	459	982	926	2,060
<i>Other:</i>							
Interest on Deferred Tax Gain	0		3.0%	398	528	791	1,053
Amortization of financing fees	0			3	810	856	2,136
Other interest expense	0			4	0	6	0
Total	\$ 190,920			\$ 2,688	\$ 5,434	\$ 7,235	\$ 12,545
Student Loan Credit Facility	55,950	(b)	0.000%(c)	0	0	0	0
Total	\$ 246,870			\$ 2,688	\$ 5,434	\$ 7,235	\$ 12,545

(a) Represents the interest rate at June 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 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.

6. NET INCOME (LOSS) PER SHARE

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
	(In thousands, except per share amounts)			
Income (loss) from continuing operations	\$ (1,248)	\$ 1,297	\$ (3,765)	\$ 5,231
Income from discontinued operations	28	10	309	24

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

Net income (loss) available to common shareholders	\$ (1,220)	\$ 1,307	\$ (3,456)	\$ 5,255
Weighted average shares outstanding, basic	30,487	30,568	30,387	30,335
Dilutive effect of stock options and other shares	0	733	0	788
Weighted average shares outstanding, dilutive	30,487	31,301	30,387	31,123
<i>Basic earnings (loss) per share:</i>				
From continuing operations	\$ (0.04)	\$ 0.04	\$ (0.12)	\$ 0.17
From discontinued operations	0.00	0.00	0.01	0.00
Net income (loss) per share, basic	\$ (0.04)	\$ 0.04	\$ (0.11)	\$ 0.17
<i>Diluted earnings (loss) per share:</i>				
From continuing operations	\$ (0.04)	\$ 0.04	\$ (0.12)	\$ 0.17
From discontinued operations	0.00	0.00	0.01	0.00
Net income (loss) per share, basic	\$ (0.04)	\$ 0.04	\$ (0.11)	\$ 0.17

Table of Contents
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 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.

As previously disclosed, on July 6, 2010, HealthMarkets, Inc., MEGA and Mid-West were named as defendants in a putative class action (*Jeffrey Cutter, Rina Discepolo, on behalf of themselves and others similarly situated v. HealthMarkets, Inc. et al.*) pending in the Norfolk County Superior Court, Commonwealth of Massachusetts, Case No. 1:10-cv:11488-JLT. On August 13, 2010, this matter was removed to the United States District Court for the District of Massachusetts. The complaint alleges that the named plaintiffs (former district sales leaders contracted with the Company s insurance subsidiaries) were employees (rather than independent contractors) under Massachusetts law and are therefore entitled, among other relief, to recover certain business costs under the Massachusetts Wage Act. On July 21, 2011, the Court certified the class and on September 26, 2011, the First Circuit Court of Appeals denied defendants motion to appeal the class certification. Following a mediation held on July 31, 2012, the parties reached a preliminary agreement in principle to settle this matter on terms that, after consideration of applicable reserves and/or potentially available insurance coverage benefits, will 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. From time to time, some such matters, where appropriate, may be the subject of internal investigation by management, the Board of Directors, or a committee of the Board of Directors.

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, both known and incurred but not reported, 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

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

As previously disclosed, in March 2005, the Company received notification that the Market Analysis Working Group of the NAIC had chosen the states of Washington and Alaska to lead a multi-state market conduct examination (the "Multistate Examination") of The MEGA Life and Health Insurance Company, Mid-West National Life Insurance Company of Tennessee and The Chesapeake Life Insurance Company (the "Insurance Companies"). On May 29, 2008, the Insurance Companies entered into a regulatory settlement agreement ("RSA") with the states of Washington and Alaska, as lead regulators, and three other states - Oklahoma, Texas and California (collectively, the "Monitoring Regulators"). The RSA provided, among other things, for a monetary penalty in the amount of \$20 million, a potential additional monetary penalty up to an additional \$10 million if the Insurance Companies were found not to comply with the requirements of the RSA when re-examined, and an Outreach Program to be administered by the Insurance Companies with certain existing insureds. The Insurance Companies' compliance with the RSA was monitored by the Monitoring Regulators, through semi-annual reports from the Insurance Companies. The Monitoring Regulators were responsible for determining the amount of

Table of Contents

the additional penalty for any failure to comply with the requirements of the RSA through a re-examination. As previously disclosed, following a re-examination by the Monitoring Regulators to assess the Insurance Companies' performance with respect to RSA Standards for Performance Measurement, effective June 26, 2012, the Insurance Companies entered into an agreement with the Monitoring Regulators which completes and closes the Multistate Examination (the Agreement) on terms that that, after consideration of applicable reserves, did not have a material adverse effect on the Company's consolidated financial condition and results of operations.

The Agreement provides, among other things, as follows:

1. With respect to the potential additional penalty of up to \$10 million for failure to comply with the requirements of the RSA when re-examined, the Insurance Companies will pay a monetary penalty of \$325,000 (the Penalty) to settle the re-examination, including the re-examination findings described in the re-examination report (the Second Examination Report).
2. The Penalty is payable within ten business days of the effective date of the Agreement. The Penalty must be paid consistently with the pro rata state allocation used to pay the original RSA penalty.
3. The Penalty is the sole and exclusive remedy provided to the Participating Regulators (defined as each of the state insurance regulators who signed onto the RSA, other than the Monitoring Regulators) with regard to non-compliance by the Insurance Companies with the RSA's Standards for Performance Measurement, as reflected in the Second Examination Report.
4. By entering into the Agreement, the Monitoring Regulators and the Insurance Companies intend to resolve all of the findings in the Second Examination Report, including any violations of law and regulations, and to conclude and close all proceedings related to the Multistate Examination.
5. Each Signatory Regulator (defined as the Monitoring Regulators and the Participating Regulators collectively) releases and forever discharges the Insurance Companies and all officers, directors, agents and representatives from all civil or administrative causes, actions, claims, damages, fines, sanctions, losses, demands or other liabilities that the Signatory Regulators could pursue or seek for matters set forth in the RSA, the Scope of Examination set forth in the Second Examination Report, and the findings contained in the Second Examination Report.

The Company's insurance subsidiaries are subject to various other 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.

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

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 the Company's business is not yet fully known. However, we have dedicated material resources and, in the future, expect to dedicate additional material resources and to incur material expenses (including but not limited to additional claims expenses), and have made material changes to our business, 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,

Table of Contents

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. Depending on the outcome of certain potential developments with respect to the Health Care Reform Legislation, this legislation could 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 June 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 \$10.29.

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 \$135.2 million and \$158.2 million as of June 30, 2012 and December 31, 2011, respectively. Property and equipment is depreciated on a straight-line basis over their estimated useful lives.

Table of Contents

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 June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)			
Revenue from continuing operations:				
Commercial Health Division:	\$ 131,363	\$ 144,148	\$ 256,253	\$ 306,671
Insphere:	21,279	17,877	42,127	34,264
Corporate:	3,066	6,538	6,597	16,067
Intersegment Eliminations:	(6,513)	(4,432)	(12,441)	(8,251)
Total revenues excluding disposed operations	149,195	164,131	292,536	348,751
Disposed Operations:	60	413	99	817
Total revenue from continuing operations	\$ 149,255	\$ 164,544	\$ 292,635	\$ 349,568

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)			
Income (loss) from continuing operations before federal income taxes:				
Commercial Health Division:	\$ 19,171	\$ 23,282	\$ 36,347	\$ 47,812
Insphere:	(10,369)	(14,388)	(21,573)	(27,214)
Corporate:	(7,293)	(6,650)	(17,014)	(12,650)
Total operating income (loss) excluding disposed operations	1,509	2,244	(2,240)	7,948
Disposed Operations	340	(35)	446	626
Total income (loss) from continuing operations before federal income taxes	\$ 1,849	\$ 2,209	\$ (1,794)	\$ 8,574

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

	June 30, 2012	December 31, 2011
	(In thousands)	
Assets:		
Commercial Health Division:	\$ 393,321	\$ 400,908
Insphere:	54,227	62,194
Corporate:	463,127	830,253
Total assets excluding assets of Disposed Operations	910,675	1,293,355
Disposed Operations	380,850	380,238
Total assets	\$ 1,291,525	\$ 1,673,593

Disposed Operations assets at June 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 six months ended June 30, 2012, approximately 85% 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. As of June 30, 2012 the Company had accrued \$26.0 million for the 2011 medical loss ratio rebate for a decrease of approximately \$1.0 million from the amount accrued as of December 31, 2011. The Company processed all \$26.0 million of the 2011 rebates in July 2012. Additionally, as of June 30, 2012, the Company had accrued \$4.7 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 three and six months ended June 30, 2012 of \$3.1 million and \$2.0 million, respectively, varies from an anticipated 35% federal tax expense (benefit) for these periods of \$647,000 and \$(628,000), respectively, 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.

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 \$1.3 million and \$3.1 million of expense for the three and six months ended June 30, 2012, respectively, in connection with the ISOP. The Company recognized \$1.5 million and \$2.6 million of expense for the three and six months ended June 30, 2011, respectively, in connection with the ISOP. The liability for nonemployee participation in the ISOP decreased \$538,000 for the six months ended June 30, 2012. Decreases in the Company's liability were primarily the result of vesting of awards in the first quarter of 2012 offset by the 2012 expenses.

11. TRANSACTIONS WITH RELATED PARTIES

As of June 30, 2012, affiliates of The Blackstone Group, Goldman Sachs Capital Partners and DLJ Merchant Banking Partners (the Private Equity Investors) held 53.8%, 22.0% and 11.0%, 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 consolidated earnings before interest, taxes, depreciation and amortization (EBITDA) in such year to consolidated 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 consolidated 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 \$6.3 million through June 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 June 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. During the three months ended June 30, 2012, the Company received a Manager Profit Interest Distribution of \$119,000. As of June 30, 2012, the Company had a remaining commitment to The Blackstone Strategic Alliance Fund L.P. of \$407,000.

12. SUBSEQUENT EVENTS

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.

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

Table of Contents

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 June 30, 2012, Insphere had approximately 2,900 independent 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.

Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
REVENUE				
Health premiums	\$ 122,372	\$ 133,243	\$ 237,916	\$ 284,444
Life premiums and other considerations	364	390	835	856
	122,736	133,633	238,751	285,300
Investment income	5,813	7,240	12,274	16,205
Other income	20,638	21,099	41,566	41,633
Realized gains, net	68	2,572	44	6,430
	149,255	164,544	292,635	349,568
BENEFITS AND EXPENSES				
Benefits, claims, and settlement expenses	85,838	91,722	167,686	195,688
Underwriting, acquisition, and insurance expenses	19,255	24,375	38,699	53,422
Other expenses	39,625	40,804	80,809	79,339
Interest expense	2,688	5,434	7,235	12,545
	147,406	162,335	294,429	340,994
Income (loss) from continuing operations before income taxes	1,849	2,209	(1,794)	8,574
Federal income tax expense	3,097	912	1,971	3,343
Income (loss) from continuing operations	(1,248)	1,297	(3,765)	5,231
Income from discontinued operations, net	28	10	309	24
Net income (loss)	\$ (1,220)	\$ 1,307	\$ (3,456)	\$ 5,255

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 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. Due to the complexity of the Health Care Reform Legislation, the

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

pending status of certain implementing regulations and interpretive guidance, and gradual implementation, the full impact of Health Care Reform Legislation on our business is not yet fully known. However, we have dedicated material resources and, in the future, expect to dedicate additional material resources and to incur material expenses (including but not limited to additional claims expenses) as a result of Health Care Reform Legislation.

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 have a material adverse effect on our financial condition and results of operations. 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 increase our costs, require us to 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.

Table of Contents

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.

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. 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 health 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 is expected to 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.

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.

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
(In thousands)				
Revenue from continuing operations:				
Commercial Health Division:	\$ 131,363	\$ 144,148	\$ 256,253	\$ 306,671
Inspire:	21,279	17,877	42,127	34,264
Corporate:	3,066	6,538	6,597	16,067
Intersegment Eliminations:	(6,513)	(4,432)	(12,441)	(8,251)
Total revenues excluding disposed operations	149,195	164,131	292,536	348,751
Disposed Operations:	60	413	99	817
Total revenue from continuing operations	\$ 149,255	\$ 164,544	\$ 292,635	\$ 349,568

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
(In thousands)				
Income (loss) from continuing operations before federal income taxes:				
Commercial Health Division:	\$ 19,171	\$ 23,282	\$ 36,347	\$ 47,812
Inspire:	(10,369)	(14,388)	(21,573)	(27,214)
Corporate:	(7,293)	(6,650)	(17,014)	(12,650)
Total operating income (loss) excluding disposed operations	1,509	2,244	(2,240)	7,948
Disposed Operations:	340	(35)	446	626
Total income (loss) from continuing operations before federal income taxes	\$ 1,849	\$ 2,209	\$ (1,794)	\$ 8,574

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 June 30, 2012 and 2011:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
(Dollars in thousands)				
Revenue				
Earned premium revenue	\$ 122,709	\$ 133,631	\$ 238,724	\$ 285,298
Investment income	3,204	3,564	6,505	7,142
Other income	5,450	6,953	11,024	14,231
Total revenue	131,363	144,148	256,253	306,671
Benefits and Expenses				
Benefit expenses	86,246	91,324	168,229	195,724

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

Underwriting, acquisition and insurance expenses	24,769	27,620	49,039	59,089
Other expenses	1,177	1,922	2,638	4,046
Total expenses	112,192	120,866	219,906	258,859
Operating income	\$ 19,171	\$ 23,282	\$ 36,347	\$ 47,812
<i>Other operating data:</i>				
Loss ratio	70.3%	68.3%	70.5%	68.6%
Expense ratio	20.2%	20.7%	20.5%	20.7%
Combined ratio	90.5%	89.0%	91.0%	89.3%

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.

The Commercial Health Division continues to report a decrease in earned premium revenue for both the three-months and six-months ended June 30, 2012 compared to the same periods in the prior year, due to the continued decrease in policies in force. Beginning in 2010, the Company's emphasis has been primarily on the distribution of health insurance products underwritten by non-affiliated carriers and the Company has largely discontinued marketing health benefit plans underwritten by its insurance subsidiaries. The Company continues to focus efforts on 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. Additionally, the Company updated its loss reserve analysis for the three months and six months ended June 30, 2012. This update included revisions to the 2012 MLR rebate estimates resulting in a decrease in the MLR rebate reserves of \$2.0 million and revisions to the 2011 MLR rebate based on the report submitted to HHS in the second quarter resulting in reductions of the MLR rebate reserves for the three months and six months ended June 30, 2012 of \$1.1 million and \$1.0 million, respectively. These decreases were partially offset by revised completion factors resulting in an increase in claim reserves of \$2.1 million.

Table of Contents

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.

Insphere

In 2009 we formed Insphere, an authorized insurance agency 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 six months ended June 30, 2012 and 2011:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Revenue				
Commission revenue from non-affiliates	\$ 12,036	\$ 10,961	\$ 24,201	\$ 21,380
Commission revenue from affiliates	5,663	3,340	10,751	6,078
Commission revenue from association memberships	3,060	3,081	6,160	5,837
Investment income	284	255	561	495
Other income	236	240	454	474
Total revenue	21,279	17,877	42,127	34,264
Expenses				
Commission expenses	11,004	9,929	21,932	18,487
Agent incentives	6,749	6,767	13,076	12,634
Other expenses	13,895	15,569	28,692	30,357
Total expenses	31,648	32,265	63,700	61,478
Operating loss	\$ (10,369)	\$ (14,388)	\$ (21,573)	\$ (27,214)

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 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 decreased from the prior year as we continue to reduce our overhead expenses.

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 six months ended June 30, 2012 and 2011:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
(In thousands)				
<i>Operating loss:</i>				
Investment income on equity	\$ 1,622	\$ 2,540	\$ 3,770	\$ 6,709
Realized gains, net	79	2,572	79	6,430
Interest expense on corporate debt	(2,684)	(5,434)	(7,230)	(12,545)
Student loan operations	(6)	(65)	(122)	(56)
General corporate expenses and other	(6,304)	(6,263)	(13,511)	(13,188)
Operating loss	\$ (7,293)	\$ (6,650)	\$ (17,014)	\$ (12,650)

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

The decrease in investment income and realized gains 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.

General corporate expenses increased during the current year primarily as a result of additional costs incurred related to the workforce reductions and the previously announced departure of the Company's Chief Financial Officer during the second quarter.

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	June 30,	December 31,
		June 30,	2012	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)	55,950	60,050
Total			\$ 246,870	\$ 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 capability of the subsidiaries. This is consistent with our practice of maintaining risk-based capital ratios at each of our domestic insurance subsidiaries significantly 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 June 30, 2012 and December 31, 2011, Insphere had an outstanding balance owed to HealthMarkets, LLC of \$15.3 million and \$6.9 million, respectively.

At June 30, 2012, HealthMarkets, Inc. and HealthMarkets, LLC, in the aggregate, held cash and short-term investments in the amount of \$94.2 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 June 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 \$366,000, (iii) an increase in Income from continuing operations and Net income in the amount of \$680,000, 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 six months ended June 30, 2011 by the following amounts: (i) a decrease to Underwriting acquisition and insurance expenses in the amount of \$2.2 million, (ii) an increase to Federal income tax expense in the amount of \$780,000, (iii) an increase in Income from continuing operations and Net income in the amount of \$1.4 million, and (iv) an increase in diluted earnings per share in the amount of \$0.05.

Table of Contents

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. As of June 30, 2012 the Company had accrued \$26.0 million for the 2011 medical loss ratio for a decrease of approximately \$1.0 million from the amount accrued as of December 31, 2011. The Company processed all \$26.0 million of the 2011 rebates in July 2012. Additionally, as of June 30, 2012, the Company had accrued \$4.7 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 June 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.

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

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

in Note 7 of the Notes to Consolidated Condensed Financial Statements included

Table of Contents

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 June 30, 2012, the Company issued an aggregate of 20,305 unregistered shares of its Class A-1 common stock. In particular, employee participants in the HealthMarkets, Inc. InVest Stock Ownership Plan purchased 20,305 shares of the Company's Class A-1 common stock for aggregate consideration of \$210,000 (or \$10.33 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 June 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
4/1/12 to 4/30/12	2,380	\$ 10.40	0	0
5/1/12 to 5/31/12	20,212	10.33	0	0
6/1/12 to 6/30/12	27,288	10.33	0	0
Totals	49,880	\$ 10.33	0	0

(1) The number of shares purchased other than through a publicly announced plan or program includes 49,880 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 June 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
4/1/12 to 4/30/12	60,119	\$ 10.40	0	0

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

5/1/12 to 5/31/12	80,145	10.33	0	0
6/1/12 to 6/30/12	124,798	10.33	0	0
Totals	265,062	\$ 10.33	0	0

- (1) The number of shares purchased other than through a publicly announced plan or program includes 265,062 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.

ITEM 5. OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

(a) Exhibits.

Exhibit No.	Description
10.1	Agreement Completing and Closing Multistate Examination dated June 26, 2012, filed as Exhibit 10.1 to the Current Report on Form 8-K dated June 29, 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 Derrick A. Duke, Senior Vice President, Interim Chief Financial Officer, Treasurer and Chief Insurance Operating 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 Derrick A. Duke, Senior Vice President, Interim Chief Financial Officer, Treasurer and Chief Insurance Operating Officer of HealthMarkets, Inc.
101	The following materials from HealthMarkets Form 10-Q for the period ended June 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: August 9, 2012

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

Date: August 9, 2012

/s/ Derrick A. Duke
Derrick A. Duke
Senior Vice President, Interim Chief Financial Officer, Treasurer
and Chief Insurance Operating Officer
(Principal Financial Officer)