

HealthMarkets, Inc.  
Form 10-Q  
May 14, 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 March 31, 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** **75-2044750**  
(State or other jurisdiction of **(I.R.S. Employer**  
**incorporation or organization)** **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 May 11, 2012, the registrant had 27,919,131 outstanding shares of Class A-1 Common Stock, \$.01 Par Value, and 2,923,528 outstanding shares of Class A-2 Common Stock, \$.01 Par Value.

**Table of Contents**

**HEALTHMARKETS, INC.**

**and Subsidiaries**

**First Quarter 2012 Form 10-Q**

**TABLE OF CONTENTS**

	Page
<b>PART I</b>	
<b><u>FINANCIAL INFORMATION</u></b>	
Item 1. <u>Financial Statements (Unaudited)</u>	1
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	30
Item 4. <u>Controls and Procedures</u>	31
<b>PART II</b>	
<b><u>OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	31
Item 1A. <u>Risk Factors</u>	31
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	31
Item 3. <u>Defaults Upon Senior Securities</u>	32
Item 5. <u>Other Information</u>	32
Item 6. <u>Exhibits</u>	33
<b><u>SIGNATURES</u></b>	

**Table of Contents**

**HEALTHMARKETS, INC.**

**and Subsidiaries**

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

	<b>March 31, 2012 (Unaudited)</b>	<b>December 31, 2011</b>
<b>ASSETS</b>		
Investments:		
Securities available for sale	\$ 411,720	\$ 428,199
Fixed maturities, at fair value (cost: 2012 \$375,516; 2011 \$394,948)		
Short-term and other investments	261,879	626,415
<b>Total investments</b>	<b>673,599</b>	<b>1,054,614</b>
Cash and cash equivalents	13,024	17,299
Student loan receivables	48,271	50,733
Restricted cash	11,889	14,447
Investment income due and accrued	6,409	4,007
Reinsurance recoverable ceded policy liabilities	362,518	363,139
Agent and other receivables	23,071	21,416
Deferred acquisition costs	14,117	14,639
Property and equipment, net of accumulated depreciation of \$160,371 and \$158,222 at March 31, 2012 and December 31, 2011, respectively	35,779	37,466
Goodwill and other intangible assets	79,823	80,255
Recoverable federal income taxes	2,477	
Other assets	22,835	13,478
Assets Held for Sale		2,100
	<b>\$ 1,293,812</b>	<b>\$ 1,673,593</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Policy liabilities:		
Future policy and contract benefits	\$ 469,997	\$ 473,163
Claims	87,937	94,743
Unearned premiums	27,254	27,523
Other policy liabilities	42,092	34,167
Accounts payable and accrued expenses	22,912	30,852
Other liabilities	50,380	57,107
Current income taxes payable		410
Deferred federal income taxes	69,762	68,881
Debt	190,920	553,420
Student loan credit facility	57,700	60,050
Net liabilities of discontinued operations	981	1,486
	<b>1,019,935</b>	<b>1,401,802</b>
Commitments and Contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, par value \$0.01 per share authorized 10,000,000 shares, none issued		
Common Stock, Class A-1, par value \$0.01 per share authorized 90,000,000 shares, 28,156,278 issued and 27,921,510 outstanding at March 31, 2012; 28,156,278 issued and 27,851,301 outstanding at December 31,	322	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 2,983,647 outstanding at March 31, 2012; 4,026,104 issued and 2,776,985 outstanding at December 31, 2011		
Additional paid-in capital	49,412	50,535
Accumulated other comprehensive income	23,670	21,838
Retained earnings	212,617	214,853
Treasury stock, at cost (234,768 Class A-1 common shares and 1,042,457 Class A-2 common shares at March 31, 2012; 304,977 Class A-1 common shares and 1,249,119 Class A-2 common shares at December 31, 2011)	(12,144)	(15,757)
	273,877	271,791
	<b>\$ 1,293,812</b>	<b>\$ 1,673,593</b>

*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)**

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>REVENUE</b>		
Health premiums	\$ 115,544	\$ 151,201
Life premiums and other considerations	471	466
	116,015	151,667
Investment income	6,461	8,965
Commissions and other income	20,928	20,534
Realized gains (losses), net	(24)	3,858
	143,380	185,024
<b>BENEFITS AND EXPENSES</b>		
Benefits, claims, and settlement expenses	81,848	103,966
Underwriting, acquisition, and insurance expenses	19,444	29,047
Other expenses	41,184	38,535
Interest expense	4,547	7,111
	147,023	178,659
Income (loss) from continuing operations before income taxes	(3,643)	6,365
Federal income tax expense (benefit)	(1,126)	2,431
Income (loss) from continuing operations	(2,517)	3,934
Income from discontinued operations, (net of income tax expense of \$152 for the three months ended March 31, 2012, and \$8 for the three months ended March 31, 2011, respectively)	281	14
Net income (loss)	\$ (2,236)	\$ 3,948
Basic earnings (loss) per share:		
Income (loss) from continuing operations	\$ (0.08)	\$ 0.13
Income from discontinued operations	0.01	0.00
Net income (loss) per share, basic	\$ (0.07)	\$ 0.13
Diluted earnings (loss) per share:		
Income (loss) from continuing operations	\$ (0.08)	\$ 0.13
Income from discontinued operations	0.01	0.00
Net income (loss) per share, diluted	\$ (0.07)	\$ 0.13

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

*See Notes to Consolidated Condensed Financial Statements.*



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

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
Net income (loss)	\$ (2,236)	\$ 3,948
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale arising during the period	2,818	(2,260)
Reclassification for investment (gains) losses included in net income (loss)		(3,858)
Other-than-temporary impairment losses recognized in OCI		
Effect on other comprehensive income (loss) from investment securities	2,818	(6,118)
Unrealized losses on derivatives used in cash flow hedging during the period		(4)
Reclassification adjustments included in net income (loss)		1,244
Effect on other comprehensive income from hedging activities		1,240
Other comprehensive income before tax	2,818	(4,878)
Income tax expense (benefit) related to items of other comprehensive income	986	(1,707)
Other comprehensive income (loss) net of tax	1,832	(3,171)
Comprehensive income (loss)	\$ (404)	\$ 777

*See Notes to Consolidated Condensed Financial Statements.*

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

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>Operating Activities:</b>		
Net income (loss)	\$ (2,236)	\$ 3,948
Adjustments to reconcile net income (loss) to cash used in operating activities:		
Income from discontinued operations	(281)	(14)
Realized losses (gains), net	24	(3,858)
Change in deferred income taxes	(106)	(2,242)
Depreciation and amortization	3,636	4,876
Amortization of prepaid monitoring fees	3,125	3,125
Equity based compensation expense	2,367	1,351
Other items, net	292	3,591
Changes in assets and liabilities:		
Investment income due and accrued	(2,589)	(2,224)
Reinsurance recoverable ceded policy liabilities	621	4,439
Other receivables	(1,538)	(4,561)
Deferred acquisition costs	522	6,212
Prepaid monitoring fees	(12,500)	(12,500)
Current income taxes	(2,887)	2,837
Policy liabilities	(1,135)	(9,084)
Other liabilities and accrued expenses	(12,484)	(17,017)
Cash used in continuing operations	(25,169)	(21,121)
Cash used in discontinued operations	(223)	(130)
Net cash used in operating activities	(25,392)	(21,251)
<b>Investing Activities:</b>		
Student loan receivables	1,989	2,112
Securities available for sale	19,229	84,172
Short-term and other investments, net	364,402	(61,628)
Purchases of property and equipment	(664)	(1,547)
Change in restricted cash	2,558	2,391
Net proceeds from sale of assets	2,100	
Increase in agent receivables	(407)	(2,614)
Cash provided by continuing operations	389,207	22,886
Cash provided by discontinued operations		
Net cash provided by investing activities	389,207	22,886
<b>Financing Activities:</b>		
Repayment of long term debt	(362,500)	
Repayment of student loan credit facility	(2,350)	(2,700)
Decrease in investment products	(1,181)	(354)

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

Change in cash overdraft	(631)	(393)
Proceeds from shares issued to agent plans and other	1,410	1,149
Purchases of treasury stock	(2,838)	(2,612)
Excess tax reduction from equity based compensation		(361)
Cash used in continuing operations	(368,090)	(5,271)
Cash used in discontinued operations		
Net cash used in financing activities	(368,090)	(5,271)
Net change in cash and cash equivalents	(4,275)	(3,636)
Cash and cash equivalents at beginning of period	17,299	12,874
Cash and cash equivalents at end of period in continuing operations	\$ 13,024	\$ 9,238
Supplemental disclosures:		
Income taxes paid	\$ 2,018	\$ 2,207
Interest paid	\$ 3,224	\$ 5,342

*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 months ended March 31, 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 March 31, 2011 by the following amounts: (i) a decrease to Underwriting acquisition and insurance expenses in the amount of \$1.2 million, (ii) an increase to Federal income tax expense in the amount of \$414,000, (iii) an increase in Income from continuing operations and Net income in the amount of \$770,000, and (iv) an increase in diluted earnings per share in the amount of \$0.03.

**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.

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 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.

**Table of Contents**

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 March 31, 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 \$110.2 million of Corporate bonds and municipals classified as Level 2, \$91.2 million of Other bonds classified as Level 2 and \$375,000 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 March 31, 2012			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
U.S. and U.S. Government agencies	\$ 4,530	\$ 20,459	\$	\$ 24,989
Corporate bonds and municipals		237,950		237,950
Residential-backed issued by agencies		43,703		43,703
Commercial-backed issued by agencies		435		435
Commercial-backed		9,750	375	10,125
Asset-backed		3,343		3,343
Other bonds		91,175		91,175
Other invested assets <sup>(1)</sup>			1,776	1,776
Short-term investments <sup>(2)</sup>	241,643			241,643
	\$ 246,173	\$ 406,815	\$ 2,151	\$ 655,139

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

(2) Amount excludes \$18.5 million of other investments which are not subject to fair value measurement.



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

	Liabilities at Fair Value at March 31, 2012			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Agent and employee compensation plans	\$	\$	\$ 4,777	\$ 4,777

**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	\$	\$ 24,602
Corporate bonds and municipals		252,279		252,279
Residential-backed issued by agencies		46,315		46,315
Commercial-backed issued by agencies		625		625
Commercial-backed		10,864	485	11,349
Asset-backed		3,658		3,658
Other bonds		89,371		89,371
Other invested assets <sup>(1)</sup>			1,913	1,913
Short-term investments <sup>(2)</sup>	606,485			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	\$	\$	\$ 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**Available for sale 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 March 31, 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.

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

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 primarily consist of highly liquid money market funds, which are reflected within Level 1 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 March 31, 2012.

<b>Changes in Level 3 Assets and Liabilities Measured at Fair Value For the Year Ended March 31, 2012</b>							
	<b>Beginning Balance</b>	<b>Unrealized Gains or (Losses)</b>	<b>Sales or Redemption</b>	<b>Settlements (In thousands)</b>	<b>Realized Gains or (Losses)(1)</b>	<b>Transfer in/(out) of Level 3, Net</b>	<b>Ending Balance</b>
<b>ASSETS</b>							
Commercial-backed	\$ 485	\$ (5)	\$ (107)	\$ 2	\$	\$	\$ 375
Other invested assets	1,913	(135)		(2)			1,776
	\$ 2,398	\$ (140)	\$ (107)	\$	\$	\$	\$ 2,151
<b>LIABILITIES</b>							
Agent and employee stock plans	\$ 6,603	\$ 571	\$	\$ (2,397)	\$	\$	\$ 4,777

(1) Realized losses for the period are included in Realized gains, net on the Company's consolidated condensed statement of income (loss). During the three months ended March 31, 2012, the Company did not transfer securities between Level 1, Level 2 and 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 \$375,000. 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.

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

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.

**Table of Contents**

The carrying value and estimated fair value classified by level of the fair value hierarchy for certain of our financial instruments at March 31, 2012 are disclosed in the table below:

	Carrying Value	Estimated Fair Value at March 31, 2012			Total
		Level 1	Level 2	Level 3	
(In thousands)					
<i>Assets:</i>					
Other investments	\$ 18,460	\$	\$	\$ 18,460	\$ 18,460
Cash and cash equivalents	13,024		13,024		13,024
Student loan receivables	48,271			42,540	42,540
Restricted cash	11,889		11,889		11,889
Investment income due and accrued	6,409		6,409		6,409
<i>Liabilities:</i>					
Debt	190,920			154,224	154,224
Student loan credit facility	57,700			37,603	37,603

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.

*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.

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

*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.

**Table of Contents****4. INVESTMENTS**

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

	March 31, 2012 (In thousands)	December 31, 2011
Securities available for sale		
Fixed maturities	\$ 411,720	\$ 428,199
Short-term and other investments	261,879	626,415
Total investments	\$ 673,599	\$ 1,054,614

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

	March 31, 2012				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (In thousands)	Non-credit Loss Recognized in OCI	Fair Value
U.S. and U.S. Government agencies	\$ 24,364	\$ 626	\$ (1)	\$	\$ 24,989
Corporate bonds and municipals	218,129	20,333	(512)		237,950
Residential-backed issued by agencies	40,780	2,925	(2)		43,703
Commercial-backed issued by agencies	426	9			435
Commercial-backed	9,951	174			10,125
Asset-backed	3,470	157	(3)	(281)	3,343
Other bonds	78,396	12,779			91,175
Total fixed maturities	\$ 375,516	\$ 37,003	\$ (518)	\$ (281)	\$ 411,720

	December 31, 2011				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (In thousands)	Non-credit Loss Recognized in OCI	Fair Value
U.S. and U.S. Government agencies	\$ 23,876	\$ 726	\$	\$	\$ 24,602
Corporate bonds and municipals	233,925	19,169	(815)		252,279
Residential-backed issued by agencies	43,236	3,080	(1)		46,315
Commercial-backed issued by agencies	611	14			625
Commercial-backed	11,097	252			11,349
Asset-backed	3,807	145	(13)	(281)	3,658
Other bonds	78,396	10,975			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 March 31, 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



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

maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<b>March 31, 2012</b>	
	<b>Amortized Cost</b>	<b>Fair Value</b>
	<b>(In thousands)</b>	
<b>Maturity:</b>		
One year or less	\$ 35,950	\$ 36,436
Over 1 year through 5 years	141,267	156,012
Over 5 years through 10 years	133,564	151,361
Over 10 years	10,108	10,305
	<b>320,889</b>	<b>354,114</b>
Mortgage-backed and asset-backed securities	54,627	57,606
<b>Total fixed maturities</b>	<b>\$ 375,516</b>	<b>\$ 411,720</b>

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 March 31,	
	2012	2011
(In thousands)		
Fixed maturities	\$ 4,833	\$ 7,270
Short-term and other investments	889	1,265
Agent receivables	314	91
Student loan interest income	735	841
	6,771	9,467
Less investment expenses	310	502
	\$ 6,461	\$ 8,965

*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 \$837,000 and \$61.6 million for the three months ended March 31, 2012 and 2011, respectively. Proceeds from maturities, sinking and principal reductions amounted to \$22.7 million and \$22.6 million for the three months ended March 31, 2012 and 2011, respectively. During the 3 months ended March 31, 2012 the company recognized no realized gains or losses on the sale and call of fixed maturity investments. During the 3 months ended March 31, 2011, the Company realized gross gains of \$3.9 million and no losses on the sale and call of fixed maturity investments.

*Other than temporary impairment ( OTTI )*

During the three months ended March 31, 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 March 31, 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 January 1, 2012	Additions to OTTI securities where no credit losses were recognized prior to January 1, 2012	Additions for OTTI securities where credit losses have been recognized prior to January 1, 2012 (In thousands)	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 March 31, 2012
\$ 3,518	\$	\$	\$	\$	\$ 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 March 31, 2012 and December 31, 2011:

Description of Securities	Unrealized Loss Less Than 12 Months		March 31, 2012 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	\$ 523	\$ 1	\$	\$	\$ 523	\$ 1
Corporate bonds and municipals	4,358	39	10,842	473	15,200	512
Residential-backed issued by agencies	1,390	2			1,390	2
Commercial-backed issued by agencies						
Residential-backed						
Commercial-backed	69				69	
Asset-backed			1,179	3	1,179	3
Other bonds						
<b>Total</b>	<b>\$ 6,340</b>	<b>\$ 42</b>	<b>\$ 12,021</b>	<b>\$ 476</b>	<b>\$ 18,361</b>	<b>\$ 518</b>

Description of Securities	Unrealized Loss Less Than 12 Months		December 31, 2011 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	\$	\$	\$	\$	\$	\$
Corporate bonds and municipals	6,291	122	20,160	693	26,451	815
Residential-backed issued by agencies	989	1			989	1
Commercial-backed issued by agencies						
Residential-backed						
Commercial-backed						
Asset-backed	264	13	924		1,188	13
Other bonds						
<b>Total</b>	<b>\$ 7,544</b>	<b>\$ 136</b>	<b>\$ 21,084</b>	<b>\$ 693</b>	<b>\$ 28,628</b>	<b>\$ 829</b>

*Unrealized Losses Less Than 12 Months*

Of the \$42,000 in unrealized losses that had existed for less than twelve months at March 31, 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 \$476,000 in unrealized losses that had existed for twelve months or longer at March 31, 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 March 31, 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 at March 31, 2012	Maturity Date	Interest Rate(a)	Interest Expense Three Months Ended March 31,	
				2012	2011
<i>2006 credit agreement:</i>					
Term loan	\$	2012		\$ 998	\$ 2,358
\$75 Million revolver (non-use fee)		2011			48
Grapevine Note	72,350	2021	6.712%	1,211	1,197
<i>Trust preferred securities:</i>					
UICI Capital Trust I	15,470	2034	4.003%	156	147
HealthMarkets Capital Trust I	51,550	2036	3.524%	467	432
HealthMarkets Capital Trust II	51,550	2036	3.524%	467	1,078
<i>Other:</i>					
Interest on Deferred Tax Gain			3.000%	393	525
Amortization of financing fees				853	1,326
Other interest expense				2	
<b>Total</b>	<b>\$ 190,920</b>			<b>\$ 4,547</b>	<b>\$ 7,111</b>
Student Loan Credit Facility	57,700	(b)	0.000%(c)		
<b>Total</b>	<b>\$ 248,620</b>			<b>\$ 4,547</b>	<b>\$ 7,111</b>

(a) Represents the interest rate at March 31, 2012.

(b) The Series 2001A-1 Notes and Series 2001A-2 Notes have a final stated maturity of July 1, 2037 (see *Student Loan Credit Facility* discussion below).

(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.

In addition, on April 5, 2006, HealthMarkets Capital Trust I and HealthMarkets Capital Trust II (two Delaware statutory business trusts, collectively the Trusts) issued \$100.0 million of floating rate trust preferred securities (the Trust Securities) and \$3.1 million of floating rate common securities. The Trusts invested the proceeds from the sale of the Trust Securities, together with the proceeds from the issuance to HealthMarkets, LLC by the Trusts of the common securities, in \$100.0 million principal amount of HealthMarkets, LLC's Floating Rate Junior Subordinated Notes due June 15, 2036 (the Notes), which accrue interest at a floating rate equal to three-month LIBOR plus 3.05%.

On April 29, 2004, UICI Capital Trust I (a Delaware statutory business trust, the 2004 Trust) completed the private placement of \$15.0 million aggregate issuance amount of floating rate trust preferred securities with an aggregate liquidation value of \$15.0 million (the 2004 Trust Preferred Securities). The 2004 Trust invested the \$15.0 million proceeds from the sale of the 2004 Trust Preferred Securities, together with the proceeds from the issuance to the Company by the 2004 Trust of its floating rate common securities in the amount of \$470,000 (the Common Securities and, collectively with the 2004 Trust Preferred Securities, the 2004 Trust Securities), in an equivalent face amount of the Company's Floating Rate Junior Subordinated Notes due 2034 (the 2004 Notes). The 2004 Notes will mature on April 29, 2034. The 2004 Notes accrue interest at a floating rate equal to three-month LIBOR plus 3.50%, payable quarterly.

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

On August 16, 2006, Grapevine issued \$72.4 million of its senior secured notes (the Grapevine Notes ) to an institutional purchaser. The net proceeds from the Grapevine Notes of \$71.9 million were distributed to HealthMarkets, LLC. The Grapevine Notes bear interest at an annual rate of 6.712%. The interest is to be paid semi-annually on January 15<sup>th</sup> and July 15<sup>th</sup> of each year beginning on January 15, 2007. The principal payment is due at maturity on July 15, 2021. The Grapevine Notes are collateralized by Grapevine s assets including a note receivable in the amount of \$78.4 million from a unit of CIGNA Corporation ( the CIGNA Note ). Grapevine services its debt primarily from cash receipts from the CIGNA Note. All cash receipts from the CIGNA Note are paid into a debt service coverage account maintained and held by an institutional trustee (the Grapevine Trustee ) for the benefit of the holder of the Grapevine Notes. Pursuant to an indenture and direction notices from Grapevine, the Grapevine Trustee uses the proceeds in the debt service coverage account to (i) make interest payments on the Grapevine Notes, (ii) pay for certain Grapevine expenses and (iii) distribute cash to HealthMarkets, subject to satisfaction of certain restricted payment tests.

**Table of Contents**

The fair value of the Company's debt, exclusive of indebtedness outstanding under the secured student loan credit facility, was \$154.2 million and \$505.2 million at March 31, 2012 and December 31, 2011, respectively. The fair value of such debt is estimated using discounted cash flow analyses, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

*Student Loan Credit Facility*

At March 31, 2012, and December 31, 2011, the Company had an aggregate of \$57.8 million and \$60.1 million, respectively, of indebtedness outstanding under a secured student loan credit facility (the "Student Loan Credit Facility"), which indebtedness is represented by Student Loan Asset-Backed Notes issued by a bankruptcy-remote special purpose entity (the "SPE Notes"). The indebtedness outstanding under the Student Loan Credit Facility is secured by student loans and accrued interest and by a pledge of cash, cash equivalents and other qualified investments.

The SPE Notes represent obligations solely of the SPE, and not of the Company or any other subsidiary of the Company. For financial reporting and accounting purposes, the Student Loan Credit Facility has been classified as a financing as opposed to a sale. Accordingly, in connection with the financing, the Company recorded no gain on sale of the assets transferred to the SPE.

The SPE Notes were issued by the SPE in three \$50.0 million tranches. Two tranches were issued on April 27, 2001 with a final maturity of July 1, 2036, and one tranche was issued on April 10, 2002 with a final maturity of July 1, 2037. The interest rate on each series of SPE Notes resets monthly in a Dutch auction process. Beginning in 2005, the SPE Notes were also subject to mandatory redemption in whole or in part on each interest payment date from any monies received as a recovery of the principal amount of any student loan securing payment of the SPE Notes, including scheduled, delinquent and advance payments, payouts or prepayments. During the three months ended March 31 2012, the Company made principal payments of approximately \$2.4 million on the SPE notes.

**6. NET INCOME (LOSS) PER SHARE**

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

	<b>Three Months Ended March 31, 2012                      2011 (In thousands, except per share amounts)</b>	
Income (loss) from continuing operations	\$ (2,517)	\$ 3,934
Income from discontinued operations	281	14
<b>Net income (loss) available to common shareholders</b>	<b>\$ (2,236)</b>	<b>\$ 3,948</b>
Weighted average shares outstanding, basic	30,325	30,144
Dilutive effect of stock options and other shares		786
Weighted average shares outstanding, dilutive	30,325	30,930
<i>Basic earnings (loss) per share:</i>		
From continuing operations	\$ (0.08)	\$ 0.13
From discontinued operations	0.01	0.00
Net income (loss) per share, basic	\$ (0.07)	\$ 0.13
<i>Diluted earnings (loss) per share:</i>		
From continuing operations	\$ (0.08)	\$ 0.13
From discontinued operations	0.01	0.00
Net income (loss) per share, basic	\$ (0.07)	\$ 0.13



**7. COMMITMENTS AND CONTINGENCIES**

***Litigation and Regulatory Matters***

*Litigation Matters*

As previously disclosed, on October 20, 2010, HealthMarkets, Inc., MEGA, Mid-West and certain of the Company's private equity investors were named as defendants in an action filed by the City Attorney for Los Angeles on behalf of the State of California (*People of the State of California v. HealthMarkets et al.*) in the Superior Court for the State of California, Los Angeles County Central District, Case No. BC447836. Plaintiff alleges, among other things, that the

**Table of Contents**

insurance company defendants violated the California Unfair Competition Law by improperly marketing limited forms of health insurance for which coverage was allegedly misrepresented as being comprehensive in nature. Plaintiff further alleges that the insurance company defendants violated the California False Advertising Law by using various forms of false advertising in connection with the sale and distribution of their insurance coverage. Plaintiff seeks civil penalties under California Law in the amount of \$2,500 for each violation, as well as equitable relief in the form of restitution for the value of all money or property that the defendants allegedly acquired by means of unfair competition, deceptive marketing and false advertising. In August 2011, the Court dismissed The Blackstone Group and Goldman Sachs defendants from this matter on the basis that the plaintiff had not plead facts with sufficient specificity to constitute a valid cause of action against these parties. On February 29, 2012, plaintiff filed an amended complaint that once again named The Blackstone Group as a party defendant. Discovery in this matter is ongoing. The Company is mounting a vigorous defense of this action. However, given the early stage of this matter, the Company is unable to determine at this time what, if any, impact it may have on the Company's consolidated financial condition or results of operations.

As previously disclosed, on December 18, 2008, HealthMarkets and MEGA were named as defendants in a putative class action (*Jerry T. Hopkins, individually and on behalf all those others similarly situated v. HealthMarkets, Inc. et al.*) pending in the Superior Court of Los Angeles County, California, Case No. BC404133. Plaintiff alleges invasion of privacy in violation of California Penal Code § 630, et seq., negligence and the violation of common law privacy arising from allegations that the defendants monitored and/or recorded the telephone conversations of California residents without providing them with notice or obtaining their consent. Plaintiff seeks an order certifying the suit as a California class action and seeks compensatory and punitive damages. On December 3, 2009, plaintiff Jerry Hopkins was dismissed as the class plaintiff and Jerry Buszek was substituted in his place. On March 10, 2010, defendants' motion for summary judgment was denied. On August 16, 2010, plaintiff filed a motion for class certification, which motion was denied on November 30, 2011, leaving plaintiff's individual claims as the only matters remaining to be addressed in this action. In February 2012, the parties settled this matter on terms that, after consideration of applicable reserves and potentially available insurance coverage benefits, did not have a material adverse effect on the Company's consolidated financial condition and 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*

As previously disclosed, in March 2005, HealthMarkets 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 of 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 provides for the settlement of the examination on the following terms:

- (1) A monetary penalty in the amount of \$20 million, payable within ten business days of the effective date of the RSA. This amount was paid in August 2008 and recognized in the Company's results of operations for the year ending December 31, 2007;

**Table of Contents**

- (2) A monetary penalty of up to an additional \$10 million if the Insurance Companies are found not to comply with the requirements of the RSA when re-examined. Compliance will be monitored by the Monitoring Regulators, who will determine the amount, if any, of the penalty for failure to comply with the requirements of the RSA through a follow-up examination. At this time, the Company has not recognized any expense associated with this contingent penalty;
- (3) An Outreach Program to be administered by the Insurance Companies with certain existing insureds, which was implemented by December 31, 2008. The Insurance Companies sent a notice to all existing insureds whose medical coverage was issued by the Insurance Companies prior to August 1, 2005. The notice included contact information for insureds to obtain information about their coverage and the address of a website responsive to coverage questions; and
- (4) Ongoing monitoring of the Insurance Companies' compliance with the RSA by the Monitoring Regulators, through semi-annual reports from the Insurance Companies. The Insurance Companies will be required to continue their implementation of certain corrective actions, the standards of which must be met by December 31, 2009. The Insurance Companies will bear the reasonable costs of monitoring by the Monitoring Regulators and their designees. In the event that the Monitoring Regulators find that the Insurance Companies have intentionally breached the terms of the RSA, resulting penalties and fines as a result of such finding will not be limited to the monetary penalties of the RSA.

All states and the District of Columbia, Puerto Rico and Guam signed the RSA (other than the states of Massachusetts and Delaware), which became effective on August 15, 2008. The Insurance Companies filed the last of the semi-annual reports required by the RSA on February 15, 2010 and have taken actions to meet all the standards of the RSA on or before the due date. In 2010, the Insurance Companies furnished information responsive to requests by the Monitoring Regulators and responded to comments by the Monitoring Regulators. In the first quarter of 2011, the Monitoring Regulators initiated a re-examination to assess the Insurance Companies' performance with respect to RSA standards. Field work for the re-examination was completed in July 2011. The Washington Office of the Insurance Commissioner, as the lead regulator, issued an Order dated April 16, 2012 adopting the Final Report of Examination in this matter. The Insurance Companies' response to the Report was attached to the Order. The Report concluded that the Insurance Companies met 95 % of the standards set forth in the RSA Standards for Performance Measurement. On May 10, 2012, the Monitoring Regulators and the Insurance Companies reached a preliminary understanding in principle to resolve the re-examination and close the multi-state market conduct examination for an amount that, after consideration of applicable reserves, will not have a material adverse effect on the Company's consolidated financial condition and results of operations.

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.

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



**Table of Contents**

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, 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 March 31, 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 \$10.33.

**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.

**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:

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>	
<b><i>Revenue from continuing operations:</i></b>		
Commercial Health Division:	\$ 124,890	\$ 162,523
Insphere:	20,848	16,387
Corporate:	3,531	9,529
Intersegment Eliminations:	(5,928)	(3,819)
Total revenues excluding disposed operations	143,341	184,620
Disposed Operations:	39	404
Total revenue from continuing operations	\$ 143,380	\$ 185,024

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>	
<b><i>Income (loss) from continuing operations before federal income taxes:</i></b>		
Commercial Health Division:	\$ 17,176	\$ 24,530
Insphere:	(11,204)	(12,826)
Corporate:	(9,721)	(6,000)
Total operating income (loss) excluding disposed operations	(3,749)	5,704
Disposed Operations	106	661
Total income (loss) from continuing operations before federal income taxes	\$ (3,643)	\$ 6,365

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

	<b>March 31, 2012</b>	<b>December 31, 2011</b>
	<b>(In thousands)</b>	
<b><i>Assets:</i></b>		
Commercial Health Division:	\$ 393,772	\$ 400,908
Insphere:	59,466	62,194
Corporate:	464,799	830,253
Total assets excluding assets of Disposed Operations	918,037	1,293,355
Disposed Operations	375,775	380,238
Total assets	\$ 1,293,812	\$ 1,673,593

Disposed Operations assets at March 31, 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 three months ended March 31, 2012, approximately 87% of the Company's life and health benefit plan sales marketed by Insphere were underwritten by these four third-party carriers.

Additionally, during the three months ended March 31, 2012, the Company's insurance subsidiaries generated approximately 56% of their premium revenue from new and existing business from the following 10 states:

	<b>Percentage</b>
California	14%
Maine	8%
Texas	8%
Florida	6%
Washington	5%
Illinois	5%
North Carolina	3%
Massachusetts	3%
Pennsylvania	2%
Georgia	2%
	<b>56%</b>

**Table of Contents***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 March 31, 2012 the Company had accrued \$27.0 million for the 2011 medical loss ratio rebate of which \$26.9 million was accrued as of December 31, 2011. The 2011 rebate payments are to be paid by August 1, 2012 or other date specified by state regulations. Additionally, as of March 31, 2012, the Company has accrued \$7.9 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.

**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 result 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 \$1.8 million and \$1.1 million of expense for the three months ended March 31, 2012 and 2011, respectively, in connection with the ISOP. The Company's liability for nonemployee participation in the ISOP decreased \$1.6 million for the three months ended March 31, 2012. Approximately, \$3.1 million of the liability decrease is the result of vesting of awards which was offset by additional expense recognized during the quarter. Paid in capital for employee awards under the ISOP decreased \$1.2 million for the three months ended March 31, 2012 due to the issuance of treasury stock as a result of vesting.

**11. TRANSACTIONS WITH RELATED PARTIES**

As of March 31, 2012, affiliates of The Blackstone Group, Goldman Sachs Capital Partners and DLJ Merchant Banking Partners (the Private Equity Investors ) held 53.3%, 21.9% and 10.9%, 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.



**Table of Contents**

*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 \$3.1 million through March 31, 2012.

*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. During the three months ended March 31, 2012, the Company received a capital distribution of \$152,000. As of March 31, 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 March 31, 2012, the Company received a capital distribution credit of \$51,000. As of March 31, 2012, the Company had a remaining commitment to The Blackstone Strategic Alliance Fund L.P. of \$407,000.

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

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

**Introduction**

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

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

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

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

**Table of Contents**

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 March 31, 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 36 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 Company for individual health insurance products.

**Results of Operations**

The table below sets forth certain summary information about the Company's operating results for the three months ended March 31, 2012 and 2011:

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(Dollars in thousands)</b>	
<b>REVENUE</b>		
Health premiums	\$ 115,544	\$ 151,201
Life premiums and other considerations	471	466
	116,015	151,667
Investment income	6,461	8,965
Other income	20,928	20,534
Realized gains (losses), net	(24)	3,858
	143,380	185,024
<b>BENEFITS AND EXPENSES</b>		
Benefits, claims, and settlement expenses	81,848	103,966
Underwriting, acquisition, and insurance expenses	19,444	29,047
Other expenses	41,184	38,535
Interest expense	4,547	7,111
	147,023	178,659
Income (loss) from continuing operations before income taxes	(3,643)	6,365
Federal income tax expense (benefit)	(1,126)	2,431
	(2,517)	3,934
Income (loss) from continuing operations	(2,517)	3,934
Income from discontinued operations, net	281	14
	\$ (2,236)	\$ 3,948
Net income (loss)	\$ (2,236)	\$ 3,948

**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 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.

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

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. Subject to the outcome of final rulemaking, a minimum medical loss ratio at or near the 80% level could, at an appropriate time in the future, compel us to issue rebates to customers, 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, income (loss) from continuing operations before income taxes, and assets by operating segment are set forth in the tables below:

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>	
<b><i>Revenue from continuing operations:</i></b>		
Commercial Health Division:	\$ 124,890	\$ 162,523
Insphere:	20,848	16,387
Corporate:	3,531	9,529
Intersegment Eliminations:	(5,928)	(3,819)
Total revenues excluding disposed operations	143,341	184,620
Disposed Operations:	39	404
Total revenue from continuing operations	\$ 143,380	\$ 185,024

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>	
<b><i>Income (loss) from continuing operations before federal income taxes:</i></b>		
Commercial Health Division:	\$ 17,176	\$ 24,530
Insphere:	(11,204)	(12,826)
Corporate:	(9,721)	(6,000)
Total operating income (loss) excluding disposed operations	(3,749)	5,704
Disposed Operations	106	661
Total income (loss) from continuing operations before federal income taxes	\$ (3,643)	\$ 6,365

***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 March 31, 2012 and 2011:

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(Dollars in thousands)</b>	
<b>Revenue</b>		
Earned premium revenue	\$ 116,015	\$ 151,667
Investment income	3,301	3,578
Other income	5,574	7,278
Total revenue	124,890	162,523
<b>Benefits and Expenses</b>		
Benefit expenses	81,983	104,612
Underwriting, acquisition and insurance expenses	24,270	31,257

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

Other expenses	1,461	2,124
Total expenses	107,714	137,993
Operating income	\$ 17,176	\$ 24,530
<i>Other operating data:</i>		
Loss ratio	70.7%	69.0%
Expense ratio	20.9%	20.6%
Combined ratio	91.6%	89.6%

**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.

*Three Months Ended March 31, 2012 versus 2011*

The Commercial Health Division reported earned premium revenue of \$116.0 million during the three months ended March 31, 2012 compared to \$151.7 million in the corresponding period of 2011, a decrease of \$35.7 million or 23.5%, which is due to a decrease in policies in force. The decrease in policies in force reflects the continuing trend of an attrition rate that currently exceeds the pace of new sales of our supplemental and health insurance products. Beginning in 2010, the Company's emphasis has been primarily on the distribution of health insurance products underwritten by non-affiliated carriers and the discontinuation in marketing health benefit plans underwritten by the Company's insurance subsidiaries in all but a limited number of states. The Company continues to offer supplemental insurance products underwritten by the Company's insurance subsidiaries.

The Commercial Health Division reported operating income of \$17.2 million in 2012 compared to operating income of \$24.5 million in 2011, a decrease of \$7.3 million or 30.0%. Operating income as a percentage of earned premium revenue (i.e., operating margin) for 2012 was 14.8% compared to the operating margin of 16.2% in 2011, which is generally attributable to a 170 basis point increase in the loss ratio, primarily as a result of the minimum loss ratio requirements.

**Table of Contents**

Underwriting, acquisition and insurance expense decreased by \$7.0 million, or 22.4%, to \$24.3 million in 2012 from \$31.3 million in 2011. This decrease reflects the variable nature of commission expenses and premium taxes included in these amounts which generally vary in proportion to earned premium revenue.

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 decrease also.

**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 months ended March 31, 2012 and 2011:

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(Dollars in thousands)</b>	
<b>Revenue</b>		
Commission revenue from non-affiliates	\$ 12,165	\$ 10,418
Commission revenue from affiliates	5,088	2,738
Commission revenue from association memberships	3,100	2,757
Investment income	277	240
Other income	218	234
<b>Total revenue</b>	<b>20,848</b>	<b>16,387</b>
<b>Expenses</b>		
Commission expenses	10,928	8,558
Agent incentives	6,327	5,867
Other expenses	14,797	14,788
<b>Total expenses</b>	<b>32,052</b>	<b>29,213</b>
<b>Operating loss</b>	<b>\$ (11,204)</b>	<b>\$ (12,826)</b>

*Three Months Ended March 31, 2012 versus 2011*

For the three months ended March 31, 2012 and 2011, Insphere recorded commission revenue of approximately \$20.4 million and \$15.9 million, respectively. Commission revenue consisted of \$5.1 million generated from the sale of the insurance products underwritten by the Company's insurance subsidiaries as of March 31, 2012, and approximately \$2.7 million generated in the corresponding period of 2011, for an increase of \$2.4. The increase is due primarily to an increase in the sale of supplemental products. The remaining commission was generated from third party carriers, of which approximately 87% and 88% was generated from four carriers for March 31, 2012 and 2011, respectively.

For the three months ended March 31, 2012 and 2011, Insphere reported commission expense of \$10.9 million and \$8.6 million, respectively. 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. The increase in commission expense over the prior year primarily trends with commission revenue.

For the three months ended March 31, 2012 and 2011, Insphere reported agent incentives of \$6.3 million and \$5.9 million, respectively. 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.

For the three months ended March 31, 2012 and 2011, Insphere reported other expenses of \$14.8 million in each period. Other expenses associated with Insphere are related to employee compensation, costs associated with our field offices, depreciation and amortization, and other administrative expenses.

**Table of Contents*****Corporate***

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.

Set forth below is a summary of the components of operating loss at Corporate for the three months ended March 31, 2012 and 2011:

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>	
<i>Operating loss:</i>		
Investment income on equity	\$ 2,148	\$ 4,169
Realized gains, net		3,858
Interest expense on corporate debt	(4,546)	(7,110)
Student loan operations	(116)	8
General corporate expenses and other	(7,207)	(6,925)
<b>Operating loss</b>	<b>\$ (9,721)</b>	<b>\$ (6,000)</b>

***Three Months Ended March 31, 2012 versus 2011***

Corporate reported an operating loss in 2012 of \$9.7 million compared to \$6.0 million in 2011 for an overall increase in the operating loss of \$3.7 million. The change in operating loss is primarily due to the following items:

The Company recognized realized gains of \$3.9 million during the three months ended March 31, 2011. These realized gains resulted from the sales of various fixed maturities in 2011 as a result of cash needed for the then pending maturity of our term loan.

Interest expense on corporate debt decreased for the three months ended March 31, 2012 compared to the same period in 2011 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 for the three months ended March 31, 2012 compared to the same period in 2011 by \$282,000.

**Table of Contents****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 March 31, 2012	March 31, 2012	December 31, 2011
			(In thousands)	
Term loan	2012		\$	\$ 362,500
Grapevine Note	2021	6.712%	72,350	72,350
<i>Trust preferred securities:</i>				
UICI Capital Trust I	2034	4.003%	15,470	15,470
HealthMarkets Capital Trust I	2036	3.524%	51,550	51,550
HealthMarkets Capital Trust II	2036	3.524%	51,550	51,550
Total			\$ 190,920	\$ 553,420
Student Loan Credit Facility	(a)	0.000%(b)	57,700	60,050
Total			\$ 248,620	\$ 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. See Note 5 of Notes to Consolidated Condensed Financial Statements.

(b) The interest rate on each series of notes resets monthly in a Dutch auction process. See Note 5 of Notes to Consolidated Condensed Financial Statements for additional information on the Student Loan Credit Facility.

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.

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.

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

HealthMarkets, LLC provides working capital to its wholly-owned subsidiary, Insphere, pursuant to a \$100 million Loan Agreement. As of March 31, 2012 and December 31, 2011, Insphere had an outstanding balance owed to HealthMarkets, LLC of \$12.3 million and \$6.9 million, respectively.

At March 31, 2012, HealthMarkets, Inc. and HealthMarkets, LLC, in the aggregate, held cash and short-term investments in the amount of \$89.5 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.

## **Table of Contents**

### **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 March 31, 2011 by the following amounts: (i) a decrease to Underwriting acquisition and insurance expenses in the amount of \$1.2 million, (ii) an increase to Federal income tax expense in the amount of \$414,000, (iii) an increase in Income from continuing operations and Net income in the amount of \$770,000, and (iv) an increase in diluted earnings per share in the amount of \$0.03.

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 March 31, 2012 the Company had accrued \$27.0 million for the 2011 medical loss ratio rebate of which \$26.9 million was accrued as of December 31, 2011. The 2011 rebate payments are to be paid by August 1, 2012. Additionally, as of March 31, 2012, the Company has accrued \$7.9 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 March 31, 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*.



---

**Table of Contents****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 in Note 7 of the Notes to Consolidated Condensed Financial Statements included herein, during the three month period covered by this Quarterly Report on Form 10-Q, the Company has not been named in any new material legal proceeding, and there have been no material developments in the previously reported legal proceedings.

**ITEM 1A. RISK FACTORS**

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

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

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

During the quarter ended March 31, 2012, the Company issued an aggregate of 28,998 unregistered shares of its Class A-1 common stock. In particular, an executive officer of the Company purchased 10,433 shares of the Company's Class A-1 common stock for aggregate consideration of \$108,503 (or \$10.40 per share) and employee participants in the HealthMarkets, Inc. InVest Stock Ownership Plan purchased 18,565 shares of the Company's Class A-1 common stock for aggregate consideration of \$193,076 (or \$10.40 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.





**Table of Contents****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 March 31, 2012:

<b>Period</b>	<b>Total Number of Shares Purchased<sup>(1)</sup></b>	<b>Average Price Paid per Share (\$)</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares That May Yet Be Purchased Under The Plan or Program</b>
1/1/12 to 1/31/12		\$		
2/1/12 to 2/28/12				
3/1/12 to 3/31/12	73,516	10.40		
<b>Totals</b>	<b>73,516</b>	<b>\$ 10.40</b>		

(1) The number of shares purchased other than through a publicly announced plan or program includes 73,516 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 March 31, 2012:

<b>Period</b>	<b>Total Number of Shares Purchased<sup>(1)</sup></b>	<b>Average Price Paid per Share (\$)</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares That May Yet Be Purchased Under The Plan or Program</b>
1/1/12 to 1/31/12	1,949	\$ 9.58		
2/1/12 to 2/28/12				
3/1/12 to 3/31/12	197,619	10.40		
<b>Totals</b>	<b>199,568</b>	<b>\$ 10.39</b>		

(1) The number of shares purchased other than through a publicly announced plan or program includes 199,568 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.

<b>Exhibit No.</b>	<b>Description</b>
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 March 31, 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, tagged as blocks of text.

**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: May 14, 2012

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

Date: May 14, 2012

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