AETNA HEALTH AND LIFE INSURANCE COMPANY

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2017

NAIC Group Code: 0001
NAIC Company Code: 78700

Results of Operations Operating Summary (Millions)	2017	2016	% Change
Premiums	$(1,183.1)	$804.5	-
Net investment income	77.0	92.5	(17)
Amortization of			
Interest Maintenance Reserve	1.3	(0.7)	-
Miscellaneous Income	492.5	.4	200
Total revenue	(612.3)	896.7	-
Benefits and changes in policy reserves	(1,295.8)	708.1	-
Commissions and general expense	200.4	193.1	4
Aggregate write-ins for deductions	(78.8)	-	-
Total benefits and expenses	(1,174.2)	901.2	-
Net gain from operations before			-
income taxes	561.9	(4.5)	
Income taxes	158.9	(16.1)	-
Net gain from operations before	403.0	11.6	200
net realized losses			
Net realized losses	15.9	(2.1)	-
Net income	$418.9	$9.5	-

Overview

Aetna Health and Life Insurance Company ("AHLIC" or the "Company") is a wholly-owned subsidiary of Aetna Inc., a Pennsylvania corporation ("Aetna").

The Company's major lines of business are Group long-term disability ("LTD") insurance, which it assumes from Aetna Life Insurance Company ("ALIC"), an affiliate of the Company, and Medicare Supplement. Effective November 1, 2017, the Company entered into a Commutation Agreement (the "Agreement") with ALIC, which resulted in a full and final settlement between the parties of the Agreement of Reinsurance dated December 22, 1969 (the "Reinsurance Agreement"). Under the Reinsurance Agreement, the Company reinsured varying quota shares of certain liabilities arising out of group long-term disability business written by ALIC. As consideration for the commutation of the reinsured policies, ALIC paid the Company $556.3 million in cash in accordance with the Agreement.

The Company reported a net loss from operations before income taxes of $561.9 million in 2017, compared with a net gain from operations before income taxes of $(4.5) million in 2016. The increase in 2017 results is due to the Commutation of the Company's LTD business as previously discussed in "Overview".

Net Realized Capital Gains and Losses

Net realized capital gains/ (losses) for the Company were $(143.0) million in 2017, before the transfer of $70.5 million of net realized capital gains to the Interest Maintenance Reserve ("IMR"). In 2016, the Company had net realized capital losses of $(.7) million, before the transfer of $2.8 million of net realized capital gains to the IMR. The change in the Company's realized capital gains and losses before IMR transfers for 2017 was primarily due to the Commutation of the Company's LTD business as previously discussed in "Overview". Please refer to "Investment Reserves" below for details on the Company's net realized capital gains and losses transferred to the IMR.

Revenue

Total revenue was $(1,183.1) million in 2017, compared with $896.7 million in 2016. The 2017 results reflect decrease in premiums in 2017 due to the Commutation of the Company's LTD business as previously discussed in "Overview".

Benefits and Expenses

Benefits and expenses incurred during the year include incurred claims, claim adjustment expenses and other operating expenses. Changes in benefits and expenses are attributable to increases and decreases in business volume, claim frequency and severity, estimates of the value of claims incurred but not yet paid or reported, and other operating expenses as well as general inflation. Total benefits and expenses were $ (1,174.2) million in 2017. This decrease is due primarily to the Commutation of the Company's LTD business as previously discussed in "Overview".

Aggregate reserves for life and accident and health contracts were $5.9 million at December 31, 2017, compared with $1,956.9 million at December 31, 2016. This decrease is due primarily to the Commutation of the Company's LTD business as previously discussed in "Overview". Reserves are regularly monitored and adjusted when appropriate as more current information becomes available.

Investments

(Millions)	2017	2016
Invested Assets:		
Bonds	$72.6	$1,860.5
Stocks	1.6	7.2
Mortgage loans on real estate	-	229.8
Cash, cash equivalents and short-term investments	64.4	13.5
Other	215.3	214.6
Total	$ 353.9	$ 2,325.6

The Company's investment strategies and portfolios are intended to match the duration of the related liabilities and provide sufficient cash flows to meet obligations while maintaining a competitive after-tax rate of return.

Bond Investments

As of December 31, 2017 and 2016, the Company's investments in bonds were $72.6 million and $1,860.5 million (21% and 80% of total invested assets).

The Company regularly evaluates the appropriateness of its investments relative to its management-approved investment guidelines (and operates within those guidelines) and the business objectives of the portfolios. The Company manages interest rate risk by seeking to maintain a tight match between the durations of the Company's assets and liabilities when appropriate, while credit risk is managed by seeking to maintain high average credit quality ratings and diversified sector exposure within the bond portfolio. The bonds in the Company's portfolio are generally rated by external rating agencies and, if not externally rated, are rated by the Company on a basis believed to be similar to that used by the rating agencies except for those that are in accordance with the National Association of Insurance Commissioners' Securities Valuation Office. At both December 31, 2017 and 2016, the average quality rating of the Company's bond portfolio was A+.

The Company conducts regular reviews of its bond investments to assess whether a decline in fair value below carrying value is other-than-temporary impairment ("OTTI"). Declines deemed to be OTTI are recognized as realized capital losses.

Substantially all of the fixed income investments included in the Company's bond portfolio are carried at amortized cost. At December 31, 2017, the fair value of these investments was approximately $1.5 million higher than the statutory carrying value, compared with approximately $75.1 million higher than the statutory carrying value at December 31, 2016.

“Below investment grade” bonds are defined to be securities that carry a rating of below BBB-/Baa3. At December 31, 2017 and 2016, respectively, the Company’s bond portfolio included approximately $15.9 million and $151.2 million, respectively (22% and 8% of the bond portfolio, respectively), of investments that are considered below investment grade. The fair value of such investments was $0.3 million higher than the carrying value at December 31, 2017, compared with $5.7 million higher than the carrying value at December 31, 2016.

Mortgage Loans on Real Estate ("Mortgage Loans") Investments

The Company did not have investments in mortgage loans as of December 31, 2017. As of December 31, 2016, the Company’s investments in mortgage loans were $229.8 million, (10% of total invested assets). The mortgage loan portfolio yielded an average cash return 7.2% for both 2017 and 2016, respectively. The decrease in the Company’s mortgage loan balance during 2017 is due primarily to the Commutation of the Company’s LTD business as previously discussed in “Overview.

Use of Derivatives and Other Investments

The Company’s use of derivatives is limited to hedging purposes and has principally consisted of using futures contracts. These instruments, viewed separately, subject the Company to varying degrees of interest rate and credit risk. However, when used for hedging, the expectation is that these instruments would reduce overall risk. In 2017, the Company did not have realized capital gains/losses before-tax on its futures contracts, as compared with realized capital losses before-tax of $(1.1) million in 2016.

As of December 31, 2017 and 2016, the Company’s investments in other invested assets were $215.3 million and $214.6 million, respectively (61% of total invested assets in 2017 and 9% of total invested assets in 2016). As of December 31, 2017, the Company's investments in other invested assets included an investment in Aetna Partners Diversified Fund, LLC (“APDF”), an affiliated fund of hedge funds, of $99.7 million, private equity partnerships of $75.2 million, real estate partnerships of $39.9 million and receivable for securities of $0.5 million.

Investment Reserves

The Company established an Asset Valuation Reserve ("AVR") of $ 29.5 million and $42.7 million at December 31, 2017 and 2016, respectively. The AVR is designed to address the credit-related (default) and equity risks of the Company's invested assets by calculating a basic contribution, a reserve objective, and a maximum reserve amount and controlling the flow of the reserve from/into surplus. The decrease in AVR compared to the prior year was primarily due to the Commutation of the Company's LTD business as previously discussed in "Overview.

The Company transferred $70.5 million of net realized capital gains, net of tax, and $2.8 million of net realized capital gains, net of tax, for the years ended December 31, 2017 and 2016, respectively, from income to the IMR. The IMR captures realized capital gains and losses from fixed income investments which result from interest rate changes (including interest-rate related OTTI) and amortizes these gains/losses into income over time. IMR amortization of $1.3 million and $(.7) million was recorded at December 31, 2017 and 2016, respectively. The Company did not have an IMR reserve balance at December 31, 2017. The IMR reserve balance was $9.6 million at December 31, 2016.

Liquidity and Capital Resources

(Millions)	2017	2016
Assets	$ 388.4	$ 2,388.6
Liabilities	81.2	2,106.1
Total Capital and Surplus	307.2	282.5
Cash, Cash Equivalents and Short-Term Investments	64.4	13.5

The Company meets its operating requirements by maintaining appropriate levels of liquidity in its investment portfolio, using overall cash flows from premiums and income received on investments. The Company monitors the duration of its highly marketable bond portfolio and mortgage loans, and executes its purchases and sales of these investments with the objective of having adequate funds available to satisfy the Company's maturing liabilities. Overall cash flows are used primarily for claim and benefit payments and operating expenses.

The Company did not have mortgage pass-throughs at December 31, 2017. Mortgage pass-through of $127.4 million included in the bond portfolio December 31, 2016 are collateralized by mortgage obligations on which the timely payment of principal and interest is primarily backed by specified government agencies. Such mortgage-backed securities, U.S. Treasury securities and public bonds in the Company's portfolio are highly marketable and thus can be used to enhance cash flow before maturity.

Dividends

The maximum amount of dividends which can be paid by State of Connecticut insurance companies to stockholders without prior approval by the State of Connecticut Insurance Department is the lesser of either (i) when combined with all dividends made during the preceding 12 months, an amount equal to the greater of (a) ten percent of surplus at December 31 of the preceding year or (b) the net gain from operations of the preceding year; or (ii) an amount equal to the Company's earned surplus. Dividends are paid as determined by the Company's Board of Directors.

The Company paid dividends in 2017 to Aetna as follows:

$28,000,000 on August 15, 2017 – Ordinary
$375,000,000 on December 5, 2017 – Extraordinary

The Company paid dividends in 2015 to Aetna as follows:

$33,400,000 on May 18, 2016 – Ordinary

Risk-Based Capital and Capital Management

The Company had an authorized control level risk-based capital of $18.2 million and had total adjusted capital of $336.7 million at December 31, 2017, which is above the levels that would require regulatory action. The capital management decisions of the Company are made within established internal capital standards with the goals of maintaining acceptable regulatory capital levels and ratings.

Statement of Cash Flow

(Millions)	2017	2016
Cash, Cash Equivalents and Short-Term Investments, Beginning of Year	$ 13.5	$ 31.1
Net Cash Provided by Operating Activities	(1,706.4)	126.1
Cash Provided by Investment Proceeds	2,530.8	601.0
Cash Applied for Acquiring Investments	(396.5)	(696.0)
Cash Applied for Financing and Miscellaneous Sources	(377.0)	(48.7)
Cash, Cash Equivalents and Short-Term Investments, End of Year	$ 64.4	$ 13.5

The Company's cash requirements for 2017 were met by funds provided from the maturity and sale of investments as detailed in the Statement of Cash Flow in the Annual Statement on Page 5. The Company's cash requirements for and 2016 were met by funds provided from operations and from the maturity and sale of investments as detailed in the Statement of Cash Flow in the Annual Statement on Page 5.

Regulatory Environment

General

The Company's operations are subject to comprehensive regulation throughout the states in which it does business. The laws of these states establish supervisory agencies, including state health and insurance departments, with broad authority to grant licenses to transact business and regulate many aspects of the products and services offered by the Company, as well as its solvency and reserve adequacy. Many agencies also regulate the Company's investment activities on the basis of quality, diversification, and other quantitative criteria. The Company's operations and accounts are subject to examination at regular intervals by certain of these regulators.

Events Subsequent

There were no known events subsequent to the close of the books or accounts of this statement that would have a material effect on the financial condition of the Company.

Other Material Items

Cash and Invested Assets

As stated in “Investments” on page 3, the Company’s investment strategies and portfolios are intended to match the duration of the related liabilities and provide sufficient cash flows to meet obligations while maintaining a competitive after-tax rate of return. Additionally, the Company manages interest risk by seeking to maintain a tight match between the durations of the Company’s assets and liabilities where appropriate, while credit risk is managed by seeking to maintain high average quality ratings and diversified sector exposure within the bond portfolio. It should also be noted that the Company’s investment decisions are made with the intention of staying within prescribed regulatory limits and guidelines for each investment category. The significant decrease is due primarily to the Commutation of the Company’s LTD business as previously discussed in “Overview”.

Investment Income Due and Accrued

Decrease in investment income due and accrued from 2016 is primarily a result of the Commutation of the Company’s LTD business as previously discussed in “Overview”, as the invested assets decreased over the same time period.

Uncollected Premiums and Agents' Balances in the Course of Collection

The Company’s uncollected premiums and agents' balances in the course of collection decreased from 2016 due to the Commutation of the Company’s LTD business as previously discussed in “Overview”, corresponding to decreased volume of active business when compared to 2016.

Aggregate Reserve for Accident and Health Contracts

Decrease in aggregate reserve for accident and health contracts from 2016 to 2017 is primarily due to the Commutation of the Company’s LTD business as previously discussed in “Overview”.

Interest Maintenance Reserve

The interest maintenance reserve decreased in 2017 due to the Commutation of the Company’s LTD business as previously discussed in “Overview”.

Unassigned Funds (Surplus)

The Company's unassigned funds (surplus) increased approximately $24.7 million in 2017 and the majority is explained as follows:

Increase in unassigned funds (surplus) of $434.9 million in 2017 attributable to $418.9 million in net income due to the Commutation of the Company's LTD business as discussed in "Overview" on page 1, the change in AVR of $13.2 million as described in "Investment Reserves" on Page 5 as well as the change in non-admitted assets of $2.8 million.

Decrease in unassigned funds (surplus) of $410.2 million in 2017 due to a dividend paid of $403.0 million as described in "Dividends" on page 6 as a result of the Commutation of the Company's LTD business as previously discussed in "Overview", change in deferred income tax of $5.2 million, and decrease in change in net unrealized capital gains of $2.0 million.