



**KAISER FOUNDATION HEALTH PLAN, INC. AND
SUBSIDIARIES AND KAISER FOUNDATION
HOSPITALS AND SUBSIDIARIES**

Combined Financial Statements

December 31, 2019 and 2018

(With Independent Auditors' Report Thereon)

**KAISER FOUNDATION HEALTH PLAN, INC. AND
SUBSIDIARIES AND KAISER FOUNDATION
HOSPITALS AND SUBSIDIARIES**

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KPMG LLP
Suite 1400
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report

The Boards of Directors
Kaiser Foundation Health Plan, Inc.
and Kaiser Foundation Hospitals:

We have audited the accompanying combined financial statements of Kaiser Foundation Health Plan, Inc. and Subsidiaries and Kaiser Foundation Hospitals and Subsidiaries (Health Plans and Hospitals), which comprise the combined balance sheets as of December 31, 2019 and 2018, and the related combined statements of operations and changes in net worth, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Health Plans and Hospitals as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



Emphasis of Matter

As discussed in Note 2(x) to the combined financial statements, in 2019, Health Plans and Hospitals adopted Accounting Standard Update (ASU) No. 2016-02 *Leases*. Our opinion is not modified with respect to this matter.

As discussed in Note 2(x) to the combined financial statements, in 2019, Health Plans and Hospitals adopted ASU No. 2016-01 *Financial Instruments-Overall*. Our opinion is not modified with respect to this matter.

KPMG LLP

San Francisco, California
February 14, 2020

**KAISER FOUNDATION HEALTH PLAN, INC. AND
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Combined Balance Sheets

December 31, 2019 and 2018

(In millions)

Assets	2019	2018
Current assets:		
Cash and cash equivalents	\$ 904	\$ 636
Current investments	9,039	8,035
Securities lending collateral	1,039	996
Broker receivables	355	308
Due from associated medical groups	47	19
Accounts receivable – net	2,532	2,175
Inventories and other current assets	1,733	1,747
Total current assets	15,649	13,916
Noncurrent investments	33,245	32,800
Land, buildings, equipment, and software – net	27,606	26,716
Operating lease right-of-use assets	1,437	—
Other long-term assets	1,230	1,322
Total assets	\$ 79,167	\$ 74,754
Liabilities and Net Worth		
Current liabilities:		
Accounts payable and accrued expenses	\$ 4,556	\$ 4,539
Medical claims payable	2,341	2,417
Due to associated medical groups	1,536	1,249
Payroll and related charges	2,469	2,231
Securities lending payable	1,039	996
Broker payables	554	538
Long-term debt subject to short-term remarketing arrangements – net	—	475
Other current debt	385	999
Other current liabilities	3,036	2,665
Total current liabilities	15,916	16,109
Long-term debt	9,903	8,670
Physicians' retirement plan liability	9,927	7,521
Pension and other retirement liabilities	4,482	7,588
Operating lease liabilities	1,263	—
Other long-term liabilities	2,622	2,630
Total liabilities	44,113	42,518
Net worth	35,054	32,236
Total liabilities and net worth	\$ 79,167	\$ 74,754

See accompanying notes to combined financial statements.

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Combined Statements of Operations and Changes in Net Worth

Years ended December 31, 2019 and 2018

(In millions)

	2019		2018
Revenues:			
Members' dues	\$ 56,812	\$	54,369
Medicare	20,262		18,267
Copays, deductibles, fees, and other	7,464		7,067
Total operating revenues	84,538		79,703
Expenses:			
Medical services	41,597		38,661
Hospital services	21,199		20,221
Outpatient pharmacy and optical services	9,251		9,063
Other benefit costs	5,628		5,315
Total medical and hospital services	77,675		73,260
Health Plan administration	4,131		4,552
Total operating expenses	81,806		77,812
Operating income	2,732		1,891
Other income and expense:			
Investment income – net	4,471		662
Interest expense and other income (expense) – net	233		(50)
Total other income and expense	4,704		612
Net income	7,436		2,503
Change in pension and other retirement liability charges	(5,464)		2,675
Change in net unrealized gains (losses) on investments	835		(1,898)
Other	11		3
Change in net worth	2,818		3,283
Net worth at beginning of year	32,236		28,953
Net worth at end of year	\$ 35,054	\$	32,236

See accompanying notes to combined financial statements.

**KAISER FOUNDATION HEALTH PLAN, INC. AND
SUBSIDIARIES AND KAISER FOUNDATION
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Combined Statements of Cash Flows

Years ended December 31, 2019 and 2018

(In millions)

	2019	2018
Cash flows from operating activities:		
Net income	\$ 7,436	\$ 2,503
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and software amortization	2,633	2,566
Other amortization	214	(69)
Loss (gain) recognized on investments – net	(3,288)	306
Loss on land, buildings, equipment, and software – net	35	27
Releases of restricted donations	(29)	(32)
Changes in assets and liabilities:		
Accounts receivable – net	(334)	(122)
Due from associated medical groups	(28)	(8)
Other assets	(273)	(383)
Accounts payable and accrued expenses	27	423
Medical claims payable	(76)	114
Due to associated medical groups	332	80
Payroll and related charges	238	97
Pension and other retirement liabilities	(6,731)	(212)
Other liabilities	146	(42)
Net cash provided by operating activities	302	5,248
Cash flows from investing activities:		
Additions to land, buildings, equipment, and software	(3,451)	(3,357)
Proceeds from investments	41,810	31,165
Investment purchases	(39,005)	(33,505)
Decrease (increase) in securities lending collateral	(43)	253
Broker receivables / payables	(31)	98
Issuance of notes receivable	(118)	(156)
Prepayment and repayment of notes receivable	132	171
Physicians' retirement plan liability	567	653
Other investing	22	(95)
Net cash used in investing activities	(117)	(4,773)
Cash flows from financing activities:		
Issuance of debt	3,341	1,601
Prepayment and repayment of debt	(3,318)	(1,733)
Increase (decrease) in securities lending payable	43	(253)
Other financing	17	(6)
Net cash provided by (used in) financing activities	83	(391)
Net change in cash and cash equivalents	268	84
Cash and cash equivalents at beginning of year	636	552
Cash and cash equivalents at end of year	\$ 904	\$ 636
Supplemental cash flows disclosure:		
Cash paid for interest – net of capitalized amounts	\$ 329	\$ 354

See accompanying notes to combined financial statements.

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Notes to Combined Financial Statements

December 31, 2019 and 2018

(1) Description of Business

The accompanying combined financial statements include Kaiser Foundation Health Plan, Inc. and Subsidiaries (Health Plans) and Kaiser Foundation Hospitals and Subsidiaries (Hospitals) (collectively referred to herein as Health Plans and Hospitals). Health Plans and Hospitals is primarily comprised of not-for-profit corporations whose capital is available for charitable, educational, research, and related purposes. Health Plans is primarily comprised of health maintenance organizations that are generally exempt from federal and state income taxes. Membership at both December 31, 2019 and 2018 was 12.2 million. At both December 31, 2019 and 2018, the percentage of enrolled membership in California was approximately 73%. The principal operating subsidiary of Kaiser Foundation Hospitals is Kaiser Hospital Asset Management, Inc. The principal operating subsidiaries of Kaiser Foundation Health Plan, Inc. (Health Plan, Inc.) are:

Kaiser Foundation Health Plan of Colorado

Kaiser Foundation Health Plan of Georgia, Inc.

Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc.

Kaiser Foundation Health Plan of the Northwest

Kaiser Foundation Health Plan of Washington

Kaiser Health Plan Asset Management, Inc.

Independent Medical Groups (Medical Groups) cooperate with Health Plans and Hospitals in conducting the Kaiser Permanente Medical Care Program. Health Plans contracts with Hospitals and the Medical Groups to provide or arrange hospital and medical services for members. Hospitals also contracts with the Medical Groups for certain professional services. Contract payments to the Medical Groups represent a substantial portion of the expenses for medical services reported in these combined financial statements. Payments from Health Plans and Hospitals constitute substantially all of the revenues for the Medical Groups. Because the Medical Groups are independent and not controlled by Health Plans and Hospitals, their financial statements are not combined or consolidated with Health Plans and Hospitals.

At December 31, 2019 and 2018, the percentage of Health Plans and Hospitals' total labor force covered under collective bargaining agreements was approximately 72% and 71%, respectively. At December 31, 2019, approximately 1% of the workforce was covered under collective bargaining agreements that were scheduled to expire within one year. At December 31, 2019, less than 1% of the workforce was working under an expired agreement, and less than 1% of the workforce was in a new bargaining unit that was negotiating an agreement.

Health Plans and Hospitals strives to improve the health and welfare of the communities it serves through its Community Benefit investment programs. Community Benefit expenditures provide funding for programs that serve communities through research, community-based health partnerships, the provision of charity care to low-income patients, direct health coverage for low-income families, and collaboration with community clinics, health departments, and public hospitals.

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Cost-based methods are used to account for losses incurred under the care and coverage by members and patient types qualifying for treatment as Community Benefit. Assigned members and patients must first prove eligibility based upon family income relative to the Federal Poverty Guidelines. Certain Community Benefit costs are determined using the out-of-pocket costs directly billed to patients or a cost-to-charge ratio applied to uncompensated charges associated with care provided to these patients.

For the year ended December 31, 2019, Community Benefit expenditures (at cost, net of approximately \$3.8 billion of related revenues) were \$3.4 billion, representing 4.1% of operating revenues. In comparison, for the year ended December 31, 2018, Community Benefit expenditures (at cost, net of approximately \$3.3 billion of related revenues) were \$2.8 billion, representing 3.5% of operating revenues.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The financial statements of Health Plans and Hospitals are presented on a combined basis due to the operational interdependence of these organizations and because their governing boards and management are substantially the same. These combined financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All material intercompany balances and transactions have been eliminated. Management has evaluated subsequent events through February 14, 2020, which is the date that these combined financial statements were issued.

(b) Cash and Cash Equivalents

Cash and cash equivalents include interest-bearing deposits purchased with an original or remaining maturity of three months or less. Cash and cash equivalents held by outside investment managers are classified as investments. Cash, cash equivalents, and investments that are restricted per contractual or regulatory requirements are classified as noncurrent investments.

(c) Investments

Investments including equity, U.S. Treasury, government agencies, money market funds, and other marketable debt securities are reported at fair value. Investments are categorized as current assets if they are designated to be available to satisfy current liabilities. Alternative investments are reported under the equity method. Certain investments are illiquid and are valued based on the most current information available. Other-than-temporary impairment and recognized gains and losses, which are recorded on the specific identification basis, and interest, dividend income, and income from equity method alternative investments are included in investment income – net. Health Plans and Hospitals has designated a portion of its investments for the physicians' retirement plan liability related to defined retirement benefits provided for physicians associated with certain Medical Groups. These investments are unrestricted assets of Health Plans and Hospitals. A portion of investment income that represents the expected return on the investments designated for the physicians' retirement plan has been recorded as a reduction in the provision for physicians' retirement plan benefits and is excluded from investment income – net, as described in the *Physicians' Retirement Plan* note.

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Investments are regularly reviewed for impairment and a charge is recognized when the fair value is below cost basis and is judged to be other-than-temporary. In its review of assets for impairment that is deemed other-than-temporary, management generally follows these guidelines:

- Substantially all investments are managed by outside investment managers who do not need Health Plans and Hospitals' management preapproval for sales; therefore, substantially all declines in value below cost are recognized as impairment that is other-than-temporary. Changes in estimated fair value for equity method alternative investments and equity investments that do not result in consolidation, are recognized in investment income – net. Therefore, these investments do not typically require impairment.
- For other securities, losses are recognized for known matters, such as bankruptcies, regardless of ownership period, and investments that have been continuously below book value for an extended period of time are evaluated for impairment that is other-than-temporary.

All other unrealized losses and all unrealized gains on fixed income securities are included as other changes in net worth.

Interest income is calculated under the effective interest method and included in investment income – net. Dividends are included in investment income – net on the ex-dividend date, which immediately follows the record date.

Health Plans and Hospitals' investment transactions are recorded on a trade date basis.

(d) *Securities Lending Collateral and Payable*

Health Plans and Hospitals enters into securities lending agreements whereby certain securities from its portfolios are loaned to other institutions. Securities lent under such agreements remain in the portfolios of Health Plans and Hospitals. Health Plans and Hospitals receives a fee from the borrower under these agreements, which is recognized ratably over the period that the securities are lent. Collateral, primarily cash, is required at a rate of 102% of the fair value of securities lent and is carried as securities lending collateral. The obligation of Health Plans and Hospitals to return the cash collateral is carried as securities lending payable. The fair value of securities lending collateral is determined using level 1 or 2 inputs as appropriate, as defined in the *Summary of Significant Accounting Policies – Fair Value Estimates* note. The fair value of the loaned securities is monitored on a daily basis, with additional collateral obtained or refunded as the fair value of the loaned securities fluctuates.

(e) *Broker Receivables and Payables*

Broker receivables and payables represent current amounts for unsettled securities sales or purchases.

(f) *Accounts Receivable – Net*

Accounts receivable – net are comprised of members' dues, Medicare receivables, patient receivables, and other receivables.

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(g) Inventory

Inventories, consisting primarily of pharmaceuticals and supplies, are carried at the lower of cost (generally first-in, first-out, or average price) or net realizable value.

(h) Land, Buildings, Equipment, and Software

Land, buildings, equipment, and software are stated at cost less accumulated depreciation and amortization. Software, which includes internal and external costs incurred in developing or obtaining computer software for internal use, is capitalized. Qualifying costs incurred during the application development stage are capitalized. Interest is capitalized on facilities construction and internally developed software work in progress and is added to the cost of the underlying asset.

Depreciation and amortization begin when the project is substantially complete and ready for its intended use. Software is amortized on a straight-line basis over the estimated useful lives, generally ranging from three to seven years. Buildings and equipment are depreciated on a straight-line basis over the estimated useful lives of the various classes of assets, generally ranging from 3 to 40 years.

Management evaluates alternatives for delivering services that may affect the current and future utilization of existing and planned assets and could result in an adjustment to the carrying values or remaining lives of such land, buildings, equipment, and software in the future. Management evaluates and records impairment losses or adjusts remaining lives, where applicable, based on expected utilization, projected cash flows, and recoverable values.

Maintenance and repairs are expensed as incurred. Major improvements that increase the estimated useful life of an asset are capitalized. Upon the sale or retirement of assets, recorded cost and related accumulated depreciation are removed from the accounts, and any gain or loss on disposal is reflected in operations.

Management estimates the fair value of asset retirement obligations that are conditional on a future event if the amount can be reasonably estimated. Estimates are developed through the identification of applicable legal requirements, identification of specific conditions requiring incremental cost at time of asset disposal, estimation of costs to remediate conditions, and estimation of remaining useful lives or date of asset disposal.

(i) Goodwill and Other Acquired Intangible Assets

Goodwill and other acquired intangible assets generally arise from acquisition related activity. Goodwill represents the excess of the purchase price over the fair value of net assets acquired when accounted for using the acquisition method of accounting. Goodwill is tested for impairment at least annually, or sooner, whenever events or circumstances indicate that the asset may be impaired. Other acquired intangible assets are recognized at fair value on the date of purchase and are amortized on a straight-line basis or accelerated basis over periods from 2 to 16 years. These intangible assets are subject to impairment tests whenever events or circumstances indicate that these assets may be impaired. For the years ended December 31, 2019 and 2018, goodwill and other acquired intangible assets – net totaled \$543 million and \$588 million, respectively, and were recorded in other long-term assets.

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(j) Medical Claims Payable

The cost of health care services is recognized in the period in which services are incurred. Medical claims payable consists of unpaid health care expenses to third party providers, which include an estimate of the cost of services provided to Health Plans' members by the third party providers that have been incurred but not reported. The estimate for incurred but not reported claims is based on actuarial projections of costs using historical paid claims and other relevant data. Estimates are monitored and reviewed and, as claim payments are received, adjudicated, and paid, estimates are revised and are reflected in current operations. Such estimates are subject to actual utilization of medical services, changes in membership and product mix, claim submission and processing patterns, medical inflation, and other relevant factors. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided.

(k) Due to Associated Medical Groups

Due to associated medical groups consists primarily of unpaid medical expenses owed to the Medical Groups for medical services provided to members under medical services agreements with Health Plans. The cost of medical services is recognized by Health Plans in the period in which services are provided and is reflected as a component of medical and hospital services expenses.

(l) Self-Insured Risks

Costs associated with self-insured risks, primarily for professional, general, and workers' compensation liabilities, are charged to operations based upon actual and estimated claims. The portion estimated to be paid during the next year is included in current liabilities. The estimate for incurred but not reported self-insured claims is based on actuarial projections of costs using historical claims and other relevant data. Estimates are monitored and reviewed and, as settlements are made or estimates are revised, adjustments are reflected in current operations. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. While the ultimate payments for self-insured claims are dependent on future developments, management is of the opinion that the reserve for self-insured risks is adequate. Insurance coverage, in excess of the per occurrence self-insured retention, has been secured with insurers or reinsurers for specified amounts for professional, general, and workers' compensation liabilities. The limit and scope of the self-insured layer and the amounts of excess insurance purchased are reviewed each year, subject to management's analysis of actuarial loss projections and the price and availability of acceptable commercial insurance.

(m) Premium Deficiency Reserves

Premium deficiency reserves and the related expense are recognized when it is probable that expected future health care and maintenance costs under a group of existing contracts will exceed anticipated future premiums over the contract period. If applicable, premium deficiency reserves extending beyond one year are shown as a long-term liability. Expected investment income and interest expense are included in the calculation of premium deficiency reserves, as appropriate. The level at which contracts are grouped for evaluation purposes is generally by geographic region. The methods for making such estimates and for establishing the resulting reserves are reviewed and estimates are periodically updated, and any resulting adjustments are reflected in current operations. At December 31, 2019 and

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2018, premium deficiency reserves were \$111 million and \$103 million, respectively. Given the inherent variability of such estimates, the actual liability could differ significantly from the calculated amount.

(n) Derivative Financial Instruments

Derivative financial instruments are utilized primarily to manage the interest costs and the risk associated with changing interest rates. Health Plans and Hospitals enters into interest rate swaps with investment or commercial banks with significant experience with such instruments. In addition, certain investments include derivative products. The changes in the fair value of these derivative instruments are included in investment income – net and settlement costs are recorded as interest expense or investment income – net.

Derivative financial instruments are also utilized to manage the risk of holding equity investments, primarily to hedge downside volatility risk. Health Plans and Hospitals enters into derivatives such as put-spread collars with similar investment or commercial banks noted above. The changes in fair value for these derivatives are included in investment income – net.

Derivative financial instruments are utilized by Health Plans and Hospitals' investment portfolio managers. These instruments include futures, forwards, options, and swaps. The changes in fair value for these derivative financial instruments are included in investment income – net.

(o) Revenue Recognition

Revenues from contracts with customers include revenues from the following categories: members' dues, Medicare, copays, deductibles, fees, and other revenues. Health Plans and Hospitals recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which Health Plans and Hospitals expects to be entitled in exchange for those goods or services. At contract inception, Health Plans and Hospitals assesses the promised goods or services in the contract and identifies the performance obligation for each promise to transfer a good or service (or bundle of goods or services) that is distinct. Revenue is recognized when performance obligations are satisfied by transferring control of the good or service provided. For the majority of Health Plans and Hospitals' operations, the primary performance obligation is to provide access to integrated health care services.

The consideration received for goods and services may include variable components. Variable consideration is included in the transaction price to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

Health Plans satisfies its performance obligation and recognizes revenue ratably over the period in which members are eligible to access integrated health care services.

Members' Dues

Members' dues generally includes amounts received from employer groups, individuals, and government entities. The service promised is access to integrated health care services for a typical

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term of one year. Members' dues are generally based on a prepaid fee and billed on a monthly, fixed, per member per month basis.

Significant variable consideration items related to members' dues include the following:

- *Copays and Deductibles:* These are member cost share amounts due to Health Plans and Hospitals. Amounts due are based on contractual agreements and evidence of coverage documentation and are typically calculated and collected at the point of service. Amounts may be fixed per unit/service or vary based on venue of care, coverage, and/or whether certain maximum out of pocket or deductible thresholds have been met. Member cost share amounts qualify as variable consideration within the members' dues revenue stream as they would not occur without the existence of a members' dues contract and are not separated from the primary obligation of providing access to integrated health care services.
- *Commercial Risk Adjustment:* Health Plans participates in certain contracts with commercial large group plan sponsors that include provision for risk adjustment of members' dues based on comparative data provided by Health Plans as well as other health plan vendors participating in these same arrangements. Settlements are typically calculated and paid according to the contract provisions and final settlements are made after the contract terms expire. For the years ended December 31, 2019 and 2018, dues subject to these risk adjustment arrangements comprise 1.8% and 8.1%, respectively, of total members' dues. For the years ended December 31, 2019 and 2018, \$31 million and \$99 million, respectively, have been recorded as reductions to revenue for these risk adjustment arrangements.

Medicare

Health Plans provides various Medicare products, including the Medicare Advantage Program (Part C) and Medicare cost plans with and without prescription drug coverage and Medicare supplemental products that supplement traditional fee-for-service Medicare coverage. The majority of Health Plans and Hospitals' Medicare revenue is received from Part C. Medicare revenues are based on contracts to provide access to integrated health care services to enrolled Medicare recipients.

Revenues for Part C plans include monthly capitated payments made from the Centers for Medicare & Medicaid Services (CMS), which vary based on health status, demographic status, and other factors.

Certain Medicare revenues are paid under cost reimbursement plans based on pre-established rates and the final settlement is made after the end of the year. Estimates of final settlements of the cost reports are recorded by Health Plans in current operations.

Revenues for Medicare also include a voluntary prescription drug benefit (Part D). Revenues for Part D include monthly capitated payments made from CMS, which are adjusted for health risk factor scores. Revenues for Part D also include amounts to reflect a portion of the health care costs for low-income Medicare beneficiaries and a risk-sharing arrangement to limit the exposure to unexpected expenses.

Medicare Part C and D revenue is subject to governmental audits and potential payment adjustments. CMS performs audits to validate the supporting documentation maintained by Health Plans and its care providers.

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Significant variable consideration items related to Medicare include the following:

- *Medicare Part C and D*: adjustments related to annual settlements from CMS, changes in members risk scores, member demographics, and data reconciliations.

In connection with Medicare, members may have to pay copays and/or deductibles.

Third Party Medicaid

Third party Medicaid represents coverage to certain Medicaid enrollees through contracts with third parties known as plan partners and is recorded in copays, deductibles, fees, and other revenues. Health Plans generally receives capitation payments on a monthly, fixed, per member per month basis. Health Plans satisfies its performance obligation and recognizes revenue ratably over the period in which enrollees are eligible to access integrated health care services, which is generally over a one year period.

Significant variable consideration items related to third party Medicaid include the following:

- *Rate Retroactivity*: periodic settlements from plan partners based on rate retroactivity.

For the years ended December 31, 2019 and 2018, revenues related to third party Medicaid contracts were \$1.8 billion and \$1.7 billion, respectively.

Collectibility Assessment

At contract inception, Health Plans and Hospitals generally collects payments for contracts with customers in advance of the services provided or in the month due, thus a collectibility assessment is typically not required. Health Plans and Hospitals includes an estimate of collectibility as an implicit price concession in the transaction price at contract inception and bases the amount of contractual adjustments on a monthly evaluation of historical collection experience, aged accounts receivable, and current market conditions using a portfolio approach. If actual amounts of consideration ultimately received differ from the estimates, Health Plans and Hospitals adjusts these estimates, which would affect revenues in the period such variances become known.

Disaggregation of Revenue

Health Plans and Hospitals earns substantially all of its revenues from contracts with customers. Revenue and adjustments not related to contracts with customers primarily include amounts for the Affordable Care Act (ACA) Risk Adjustment Program. These amounts are included in other revenue in the table below and in the *Summary of Significant Accounting Policies – The ACA Health Insurance Providers Fee and Risk Adjustment Program* note.

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For the years ended December 31, contracts with customers revenue disaggregated by geographical market were as follows (in millions):

<u>Primary Geographical Markets:</u>	<u>2019</u>	<u>2018</u>
Northern California	\$ 33,246	\$ 31,081
Southern California	29,550	27,733
Colorado	4,319	4,218
Georgia	1,959	2,219
Hawaii	1,747	1,679
Mid-Atlantic	4,822	4,574
Northwest	4,628	4,337
Washington	4,684	4,510
Other	548	524
	<hr/>	<hr/>
Total contracts with customers revenue	85,503	80,875
Other revenue	(965)	(1,172)
	<hr/>	<hr/>
Total operating revenue	<u>\$ 84,538</u>	<u>\$ 79,703</u>

Contract Asset / Liability Balances

Health Plans and Hospitals generally satisfies its performance obligation when it provides access to integrated health care services in exchange for consideration from its customers. The timing of Health Plans and Hospitals' performance may differ from the timing of the customer's payment, which may result in the recognition of a contract asset or a contract liability. At both December 31, 2019 and 2018, there were no material contract assets with customers.

At December 31, Health Plans and Hospitals' contract liabilities, recorded in other current liabilities were as follows (in millions):

	<u>2019</u>	<u>2018</u>
Opening (January 1)	\$ 1,191	\$ 954
Closing (December 31)	935	1,191
	<hr/>	<hr/>
Increase/(decrease)	<u>\$ (256)</u>	<u>\$ 237</u>

For the years ended December 31, 2019 and 2018, the majority of the contract liability balances at January 1, 2019 and 2018 of \$1.2 billion and \$1.0 billion, respectively, were recognized.

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Significant Judgments

Below is a summary of significant judgments related to the recognition of revenue that significantly affect the determination of the amount and timing of revenue for Health Plans and Hospitals.

For the performance obligation related to access to integrated health care services, Health Plans and Hospitals transfers promised services by providing access to integrated health care services over time. A time-elapsing output method is used for revenue recognition to measure progress because Health Plans and Hospitals transfers promised services by providing access to integrated health care services over the period that the member is entitled to the services.

Determining a measure of progress requires management to make judgments that affect the timing of revenue recognized. Health Plans and Hospitals has determined that the above method provides a faithful depiction of the transfer of goods or services to the customer. Health Plans and Hospitals stands ready to provide coverage for integrated health care services as needed and efforts are expended evenly throughout the period.

Practical Expedients

Health Plans and Hospitals has elected the following significant practical expedient:

- *Incremental costs of obtaining a contract:* Health Plans and Hospitals has elected to recognize the incremental costs of obtaining a contract (primarily brokerage commissions) as an expense when incurred as the time period of most contracts with customers is one year or less and renewal commission rates are commensurate with new commission rates.

Remaining Performance Obligations

The remaining performance obligations greater than one year relate to contracts with customers in which the transaction price is not yet determinable for future years as the Members' Dues rate has not yet been negotiated and is also dependent on membership volume. For the years ended December 31, 2019 and 2018, the amount of revenues from contracts with customers with performance obligations greater than one year was \$3.6 billion and \$0, respectively.

(p) Pension and Other Postretirement Benefits

Health Plans and Hospitals' defined benefit pension and other postretirement benefit plans are actuarially evaluated and involve various assumptions. Critical assumptions include the discount rate and the expected rate of return on plan assets, and the rate of increase for health care costs (for postretirement benefit plans other than pension), which are important elements of expense and/or liability measurement. Other assumptions involve demographic factors such as retirement age, mortality, turnover, and the rate of compensation increases. Health Plans and Hospitals evaluates assumptions annually, or when significant plan amendments occur, and modifies them as appropriate. Pension and other postretirement costs are allocated over the service period of the employees in the plans. The non-service cost components of net benefit expense for pension, other postretirement

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benefits, and the physicians' retirement plan are included in interest expense and other income (expense) – net.

Health Plans and Hospitals uses a discount rate to determine the present value of the future benefit obligations. The discount rate is established based on the development of a sample bond portfolio consisting of high quality corporate bonds. From this portfolio, a spot rate curve is interpolated and used to derive a single discount rate.

Differences between actual and expected plan experience and changes in actuarial assumptions, in excess of a 10% corridor around the larger of plan assets or plan liabilities, are recognized into benefits expense over the expected average future service of active participants. Prior service costs and credits arise from plan amendments and are amortized into postretirement benefits expense over the expected average future service to full eligibility of active participants.

(q) *Donations and Grants Made or Received*

Donations and grants made or received, that are contributions, are recognized at fair value in the period in which a commitment is made unconditionally, or in the period that conditions placed on the donations or grants are met. A condition is present if there is a barrier that the recipient must overcome to be entitled to the assets, and either a right of return of assets transferred or a right of release of a promisor's obligation to transfer assets exists.

(r) *Income Taxes*

Health Plans and Hospitals are not-for-profit corporations exempt from income taxes under Internal Revenue Code Section 501(a) as organizations described in section 501(c)(3) and the laws of the states in which they operate. Accordingly, Health Plans and Hospitals are generally not subject to federal or state income taxes. Health Plans and Hospitals are subject to income taxes on unrelated business income. A limited number of Health Plans and Hospitals' subsidiaries are for profit entities and are subject to income taxes. For the years ended December 31, 2019 and 2018, no significant income tax provision has been recorded.

(s) *Use of Estimates*

The preparation of these combined financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts. Estimated fair value of investments; fair value of assets acquired and liabilities assumed via acquisition; recoverability of goodwill and other acquired intangible assets – net; Medicare revenue accruals; Medicare reserves; incurred but not reported medical claims payable; physicians' retirement plan liabilities; pension and other retirement liabilities; premium deficiency reserves; self-insured professional liabilities; self-insured general and workers' compensation liabilities; land, buildings, equipment, and software impairment and useful lives; investment impairment; and certain amounts accrued related to the ACA Risk Adjustment Program represent significant estimates. Actual results could differ materially from those estimates. As occurs from time to time, negotiations with labor partners may result in changes to compensation and benefits. These changes are reflected in the combined financial statements as appropriate when agreements are finalized.

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(t) Fair Value Estimates

The carrying amounts reported in the combined balance sheets for cash and cash equivalents, securities lending collateral, broker receivables, accounts receivable – net, accounts payable and accrued expenses, medical claims payable, due to associated medical groups, payroll and related charges, securities lending payable, and broker payables approximate fair value.

Investments, other than alternative investments, as discussed in the *Investments* note, are reported at fair value. The fair values of investments are based on quoted market prices, if available, or estimated using quoted market prices for similar investments. If listed prices or quotes are not available, fair value is based upon other observable inputs or models that primarily use market-based or independently sourced market parameters as inputs. In addition to market information, models incorporate transaction details such as timing of cash flows, including maturity. Fair value adjustments, including credit, liquidity, and other factors, are included, as appropriate, to arrive at a fair value measurement.

The carrying value of alternative investments, which include absolute return, risk parity, and private equity, is reported under the equity method, which management believes to approximate fair value. The fair values of alternative investments have been estimated by management based on all available data, including information provided by fund managers or the general partners. The underlying securities within absolute return investments are typically valued using quoted prices for identical or similar instruments within active and inactive markets. The underlying holdings within private equity investments are valued based on recent transactions, operating results, and industry and other general market conditions. Certain investments are illiquid and are valued based on the most current information available, which may be less current than the date of these combined financial statements.

Health Plans and Hospitals utilizes a three-level valuation hierarchy for fair value measurements. An instrument's categorization within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. For instruments classified in level 1 of the hierarchy, valuation inputs are quoted prices for identical instruments in active markets at the measurement date. For instruments classified in level 2 of the hierarchy, valuation inputs are directly observable but do not qualify as level 1 inputs. Examples of level 2 inputs include: quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in inactive markets; other observable inputs such as interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates; and market-correlated inputs that are derived principally from or corroborated by observable market data. For instruments classified in level 3 of the hierarchy, valuation inputs are unobservable inputs for the instrument. Level 3 inputs incorporate assumptions about the factors that market participants would use in pricing the instrument.

At December 31, 2019 and 2018, Health Plans and Hospitals held derivative financial instruments including interest rate swaps, as well as futures, swaps, options, and forwards within investment portfolios. The estimated fair values of derivative instruments were determined using level 2 inputs, including available market information and valuation methodologies, primarily discounted cash flows. Additional description and the fair value of derivative instruments are contained in the *Derivative Instruments* note.

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(u) The ACA Health Insurance Providers Fee and Risk Adjustment Program

The ACA requires Health Plans to pay a Health Insurance Providers (HIP) fee that is assessed based on Health Plans' prior year net premiums as a percentage of total premiums for all U.S. health plans. The Internal Revenue Service (IRS) assessed a HIP fee of \$676 million for 2018 and the amount was paid and expensed in 2018. The HIP fee was suspended for 2019.

The ACA Risk Adjustment Program provides for retrospective adjustment of revenue for non-grandfathered individual and small group market plans, whether inside or outside ACA exchanges. The ACA Risk Adjustment Program is designed such that payments to plans with higher relative risk are funded by transfers from plans with lower relative risk. For the years ended December 31, 2019 and 2018, Health Plans recorded \$1.1 billion and \$1.4 billion, respectively, in net revenue reductions related to the ACA Risk Adjustment Program. At December 31, 2019 and 2018, net payables for Risk Adjustment settlements were \$1.2 billion and \$1.3 billion, respectively.

(v) Natural Classification of Expenses

Operating expenses classified by function in the combined statements of operations and changes in net worth are presented by their natural classifications for the years ended December 31, as follows (in millions):

	2019					
	Salaries, wages, and benefits	Outside medical costs	Depreciation and software amortization	Pharmacy and supplies costs	Other operating expenses	Total operating expenses
Medical services	\$ 4,981	\$ 29,619	\$ 1,033	\$ 3,540	\$ 2,424	\$ 41,597
Hospital services	9,181	5,796	1,362	1,938	2,922	21,199
Outpatient pharmacy and optical services	1,929	204	88	6,722	308	9,251
Other benefit costs	775	4,443	19	193	198	5,628
Health Plan administration	1,796	-	131	73	2,131	4,131
Total operating expenses	<u>\$ 18,662</u>	<u>\$ 40,062</u>	<u>\$ 2,633</u>	<u>\$ 12,466</u>	<u>\$ 7,983</u>	<u>\$ 81,806</u>

	2018					
	Salaries, wages, and benefits	Outside medical costs	Depreciation and software amortization	Pharmacy and supplies costs	Other operating expenses	Total operating expenses
Medical services	\$ 4,769	\$ 27,597	\$ 998	\$ 3,116	\$ 2,181	\$ 38,661
Hospital services	8,897	6,025	1,327	1,750	2,222	20,221
Outpatient pharmacy and optical services	1,933	196	90	6,581	263	9,063
Other benefit costs	742	4,088	20	185	280	5,315
Health Plan administration	1,670	-	131	59	2,692	4,552
Total operating expenses	<u>\$ 18,011</u>	<u>\$ 37,906</u>	<u>\$ 2,566</u>	<u>\$ 11,691</u>	<u>\$ 7,638</u>	<u>\$ 77,812</u>

Some categories of natural class expenses are attributable to more than one function and require allocation, applied on a consistent basis. Outside medical costs include Medical Group costs and other

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outside medical costs. Property costs including depreciation are allocated on the basis of square footage. Indirect salaries and benefits are allocated on the basis of budgeted full time equivalent employees. Other expenses are assigned directly to specific functions as expenditures are made.

(w) Liquidity and Availability of Resources

Cash and cash equivalents, current investments, and accounts receivable – net, as reported on the combined balance sheets at December 31, 2019 and 2018, are the primary liquid resources used by Health Plans and Hospitals to meet general expenditure needs within the next year. As part of liquidity management, Health Plans and Hospitals' policy is to structure and manage its financial assets to be available to meet its general expenditure needs. Health Plans and Hospitals invests cash in excess of daily requirements in current investments. To help manage unanticipated liquidity needs, Hospitals has both a credit facility and commercial paper program, as described in the *Debt* note. Additionally, although intended to satisfy long-term obligations, 79% of noncurrent investments at December 31, 2019, could be utilized within the next year if necessary.

(x) Recently Issued Accounting Standards

In January 2016, the FASB issued ASU No. 2016-01 *Financial Instruments – Overall (Subtopic 825-10)*. The standard requires entities to measure equity investments that are not accounted for under the equity method or do not result in consolidation to be recorded at fair value and recognize any changes in fair value to net income. The new standard was adopted by Health Plans and Hospitals on January 1, 2019. The standard requires the use of the cumulative effect transition method, except for equity securities without readily determinable fair values, for which the standard requires the application of the prospective transition method. Management recorded a cumulative effect adjustment of \$1.3 billion within net worth as of January 1, 2019. There was no net impact to net worth.

In February 2016, the FASB issued ASU No. 2016-02 *Leases (Topic 842)*. The standard introduces new requirements to increase transparency and comparability among organizations for leasing transactions for both lessees and lessors. Topic 842 requires a lessee to record a right-of-use asset and a lease liability for almost all leases. These leases will be classified as either operating or finance, with classification affecting the pattern of expense recognition. The new standard was adopted by Health Plans and Hospitals on January 1, 2019. In July 2018, the FASB issued an update to its guidance providing companies with the option to adopt the provisions of the standard prospectively without adjusting comparative periods; Health Plans and Hospitals elected this option.

Health Plans and Hospitals elected the package of transition practical expedients as a relief option offered in Topic 842. Health Plans and Hospitals did not elect the hindsight practical expedient, which allows entities to use hindsight when determining lease term and impairment of right-of-use assets.

Management recorded \$1.4 billion and \$1.6 billion for right-of-use assets and lease liabilities, respectively, on its combined balance sheet from a lessee perspective as of January 1, 2019. The adoption of Topic 842 did not have a significant impact on the results of operations or cash flows. Health Plans and Hospitals does not have significant lessor activity. Disclosures in the *Summary of Significant Accounting Policies – Leases* note and the *Leases* note have been added as required by the standard.

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In June 2018, the FASB issued ASU No. 2018-08 *Not-For-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The amendments in this update clarify and improve current guidance about whether a transfer of assets is a contribution or an exchange transaction. Additional guidance about when a contribution should be recognized is also included in the amendments. These amendments apply to both resources received by a recipient and given by a resource provider. The new standard was adopted by Health Plans and Hospitals on January 1, 2019. The adoption of ASU No. 2018-08 did not have a significant impact on the combined financial statements and related disclosures.

In August 2018, the FASB issued ASU No. 2018-14 *Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20): Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans*. The amendments in this update remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant including an explanation of the reasons for significant gains and losses related to changes in the benefit obligation. The new standard was adopted by Health Plans and Hospitals for the year ended December 31, 2019. The standard requires the amendments to be applied on a retrospective basis. Disclosures in the *Pension Plans – Defined Benefit Plan* note and the *Postretirement Benefits Other than Pensions – Defined Benefit Plan* note have been updated as required by the standard.

(y) Leases

Transactions give rise to leases when Health Plans and Hospitals receives substantially all the economic benefits from and has the ability to direct the use of specified property, plant, and equipment. Health Plans and Hospitals primarily has lessee activity that is classified as operating leases. Operating leases are included in operating lease right-of-use assets, other current liabilities, and operating lease liabilities in the combined balance sheets. Finance leases are included in land, buildings, equipment, and software – net, other current debt, and long-term debt in the combined balance sheets.

Right-of-use assets represent the right to use underlying assets for the lease term and lease liabilities represent obligations to make lease payments arising from the lease. Operating lease right-of-use assets and liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. When discount rates implicit in leases cannot be readily determined, Health Plans and Hospitals uses the applicable incremental borrowing rate at lease commencement to perform lease classification tests and to measure lease liabilities and right-of-use assets. Lease expense for operating lease payments is recognized on a straight-line basis over the lease term.

Health Plans and Hospitals has agreements with lease and non-lease components (such as common area maintenance), and generally has elected to account for the lease and non-lease components as a single lease component. For certain leases, such as service contracts with real estate and supply contracts with equipment leases, the lease and non-lease components are accounted for separately. Health Plans and Hospitals elects not to recognize right-of-use assets and lease liabilities that arise from short-term leases (i.e. leases with terms of 12 months or less).

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(z) Reclassifications

Certain reclassifications have been made in these combined financial statements to conform 2018 information to the 2019 presentation.

(3) Investments

Management's methods for estimating fair value of financial instruments are discussed in the *Summary of Significant Accounting Policies – Fair Value Estimates* note.

At December 31, 2019, the estimated fair value of current investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	\$ 49	\$ —	\$ —	\$ 49
Foreign equity securities	4	—	—	4
Debt securities issued by the U.S. government	—	2,619	—	2,619
Debt securities issued by U.S. government agencies and corporations	—	17	—	17
Debt securities issued by U.S. states and political subdivisions of states	—	76	—	76
Foreign government debt securities	—	39	—	39
U.S. corporate debt securities	—	2,762	—	2,762
Foreign corporate debt securities	—	1,123	—	1,123
U.S. agency mortgage-backed securities	—	667	—	667
Non-U.S. agency mortgage-backed securities	—	269	—	269
Other asset-backed securities	—	1,302	—	1,302
Short-term investment funds	—	112	—	112
Total	\$ <u>53</u>	\$ <u>8,986</u>	\$ <u>—</u>	\$ <u>9,039</u>

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At December 31, 2019, the estimated fair value of noncurrent investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	\$ 5,324	\$ 1,071	\$ —	\$ 6,395
Foreign equity securities	3,314	1,088	—	4,402
Debt securities issued by the U.S. government	—	2,175	—	2,175
Debt securities issued by U.S. government agencies and corporations	—	62	—	62
Debt securities issued by U.S. states and political subdivisions of states	—	186	—	186
Foreign government debt securities	—	1,524	—	1,524
U.S. corporate debt securities	—	4,690	—	4,690
Foreign corporate debt securities	—	1,418	—	1,418
U.S. agency mortgage-backed securities	—	888	—	888
Non-U.S. agency mortgage-backed securities	—	147	2	149
Other asset-backed securities	—	287	—	287
Short-term investment funds	—	941	—	941
Other	—	295	—	295
	<u>\$ 8,638</u>	<u>\$ 14,772</u>	<u>\$ 2</u>	<u>23,412</u>
Alternative investments:				
Absolute return				2,272
Private equity				6,624
Risk parity				937
Total			\$	<u>33,245</u>

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At December 31, 2018, the estimated fair value of current investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	\$ 21	\$ —	\$ —	\$ 21
Foreign equity securities	3	—	—	3
Debt securities issued by the U.S. government	—	2,486	—	2,486
Debt securities issued by U.S. government agencies and corporations	—	17	—	17
Debt securities issued by U.S. states and political subdivisions of states	—	53	—	53
Foreign government debt securities	—	83	—	83
U.S. corporate debt securities	—	2,579	—	2,579
Foreign corporate debt securities	—	984	—	984
U.S. agency mortgage-backed securities	—	407	—	407
Non-U.S. agency mortgage-backed securities	—	256	—	256
Other asset-backed securities	—	993	—	993
Short-term investment funds	—	151	—	151
Other	—	2	—	2
Total	<u>\$ 24</u>	<u>\$ 8,011</u>	<u>\$ —</u>	<u>\$ 8,035</u>

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At December 31, 2018, the estimated fair value of noncurrent investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	\$ 5,280	\$ 776	\$ —	\$ 6,056
Foreign equity securities	2,624	1,130	—	3,754
Global equity funds	—	521	—	521
Debt securities issued by the U.S. government	—	1,970	—	1,970
Debt securities issued by U.S. government agencies and corporations	—	56	—	56
Debt securities issued by U.S. states and political subdivisions of states	—	196	—	196
Foreign government debt securities	—	1,493	—	1,493
U.S. corporate debt securities	—	5,164	—	5,164
Foreign corporate debt securities	—	1,922	—	1,922
U.S. agency mortgage-backed securities	—	865	—	865
Non-U.S. agency mortgage-backed securities	—	212	2	214
Other asset-backed securities	—	342	—	342
Short-term investment funds	—	792	—	792
Other	21	685	1	707
	<u>\$ 7,925</u>	<u>\$ 16,124</u>	<u>\$ 3</u>	<u>24,052</u>
Alternative investments:				
Absolute return				2,092
Private equity				5,825
Risk parity				831
Total			\$	<u>32,800</u>

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At December 31, 2019, debt and other securities available-for-sale were as follows (in millions):

	<u>Amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Fair value</u>
Debt securities issued by the U.S. government	\$ 4,672	\$ 122	\$ —	\$ 4,794
Debt securities issued by U.S. government agencies and corporations	74	5	—	79
Debt securities issued by U.S. states and political subdivisions of states	223	39	—	262
Foreign government debt securities	1,413	150	—	1,563
U.S. corporate debt securities	6,909	543	—	7,452
Foreign corporate debt securities	2,377	164	—	2,541
U.S. agency mortgage-backed securities	1,516	39	—	1,555
Non-U.S. agency mortgage-backed securities	405	13	—	418
Other asset-backed securities	1,570	19	—	1,589
Short-term investment funds	1,053	—	—	1,053
Other	295	—	—	295
Total	<u>\$ 20,507</u>	<u>\$ 1,094</u>	<u>\$ —</u>	<u>\$ 21,601</u>

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At December 31, 2018, debt and equity securities available-for-sale were as follows (in millions):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. equity securities	\$ 5,232	\$ 845	\$ —	\$ 6,077
Foreign equity securities	3,376	381	—	3,757
Global equity funds	452	69	—	521
Debt securities issued by the U.S. government	4,394	62	—	4,456
Debt securities issued by U.S. government agencies and corporations	70	3	—	73
Debt securities issued by U.S. states and political subdivisions of states	226	23	—	249
Foreign government debt securities	1,545	31	—	1,576
U.S. corporate debt securities	7,660	83	—	7,743
Foreign corporate debt securities	2,882	24	—	2,906
U.S. agency mortgage-backed securities	1,255	17	—	1,272
Non-U.S. agency mortgage-backed securities	462	8	—	470
Other asset-backed securities	1,324	11	—	1,335
Short-term investment funds	943	—	—	943
Other	706	3	—	709
Total	<u>\$ 30,527</u>	<u>\$ 1,560</u>	<u>\$ —</u>	<u>\$ 32,087</u>

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At December 31, available-for-sale debt and other securities by contractual maturity and mortgage-backed and other asset-backed debt securities were as follows (in millions):

	2019		2018	
	Amortized cost	Fair value	Amortized cost	Fair value
Due in one year or less	\$ 1,815	\$ 1,821	\$ 1,889	\$ 1,890
Due after one year through five years	7,216	7,402	7,612	7,675
Due after five years through ten years	3,311	3,508	4,336	4,376
Due after ten years	4,674	5,308	4,589	4,714
U.S. agency mortgage-backed securities	1,516	1,555	1,255	1,272
Non-U.S. agency mortgage-backed securities	405	418	462	470
Other asset-backed securities	1,570	1,589	1,324	1,335
Total	\$ <u>20,507</u>	\$ <u>21,601</u>	\$ <u>21,467</u>	\$ <u>21,732</u>

For the year ended December 31, 2019, the reconciliation of investments with fair value measurements using significant unobservable inputs (level 3) was as follows (in millions):

	Debt securities
Beginning balance	\$ 3
Transfers into level 3	—
Total net losses:	
Realized	—
Unrealized	—
Purchases	—
Sales	—
Settlements	(1)
Ending balance	\$ <u>2</u>
Total realized and unrealized year-to-date net gains (losses) related to assets held at December 31, 2019	\$ —

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For the year ended December 31, 2018, the reconciliation of investments with fair value measurements using significant unobservable inputs (level 3) was as follows (in millions):

		<u>Debt securities</u>
Beginning balance	\$	3
Transfers into level 3		—
Total net losses:		
Realized		—
Unrealized		—
Purchases		—
Sales		—
Settlements		—
Ending balance	\$	<u>3</u>
Total realized and unrealized year-to-date net gains (losses) related to assets held at December 31, 2018	\$	—

Transfers between fair value input levels, if any, are recorded at the end of the reporting period. Transfers between fair value input levels occur when valuation inputs used to record or disclose assets or liabilities change from one level of the valuation hierarchy to another. During the years ended December 31, 2019 and 2018, there were no transfers between assets with inputs with quoted prices in active markets for identical assets (level 1) and assets with inputs with significant other observable inputs (level 2).

Investments include specific funds held in trust accounts related to collateral requirements for certain reinsurance agreements. At December 31, 2019 and 2018, the values of these funds were \$30 million and \$39 million, respectively.

Absolute return investments use advanced investment strategies, including derivatives, to generate positive long-term risk adjusted returns. Private equity investments consist of funds that make direct investments in private companies. Risk parity funds use risk as the primary factor to allocate investments among asset classes. Management meets with alternative investment fund managers periodically to assess portfolio performance and reporting and exercises oversight over fund managers. At December 31, 2019, Hospitals had original commitments related to alternative investments of \$14.0 billion, of which \$7.6 billion was invested, leaving \$6.4 billion of remaining commitments. At December 31, 2018, Hospitals had original commitments related to alternative investments of \$11.2 billion, of which \$6.7 billion was invested, leaving \$4.5 billion of remaining commitments.

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For the years ended December 31, investment income – net was comprised of the following (in millions):

	2019	2018
Other-than-temporary impairment	\$ (234)	\$ (1,599)
Recognized gains	2,490	1,184
Recognized losses	(435)	(244)
Income from equity method alternative investments	929	796
Change in fair value from equity investment	853	—
Interest, dividends, and other income – net	1,239	1,061
Derivative income	147	34
Total investment income – net	4,989	1,232
Less investment income included in interest expense and other income (expense) – net	(518)	(570)
Investment income – net	\$ 4,471	\$ 662

For the years ended December 31, 2019 and 2018, Health Plans and Hospitals recorded impairment of certain investments in accordance with the policy described in the *Summary of Significant Accounting Policies – Investments* note. During the years ended December 31, 2019 and 2018, there was \$4 million and \$18 million, respectively, of impairment of alternative investments.

Absolute return, risk parity, and private equity investments include redemption restrictions. Absolute return and risk parity investments require 10 to 90 day written notice of intent to withdraw and are often subject to the approval and capital requirements of the fund manager. At December 31, 2019, absolute return and risk parity investments of \$671 million were subject to lock-up periods of up to two years. Private equity agreements do not include provisions for redemption. Distributions will be received as the underlying investments of the funds are liquidated, which is expected over the next 11 years.

The majority of debt and equity securities or funds can be redeemed within 10 days. At December 31, 2019, equity investment funds of \$484 million were redeemable between 10 and 30 days. At December 31, 2019, equity investment funds of \$707 million had a redemption period of between 30 days and one year. No debt or equity investments require a redemption period of greater than one year.

(4) Derivative Instruments

(a) Interest Rate Swaps

At both December 31, 2019 and 2018, Health Plans and Hospitals had 11 agreements to manage interest rate fluctuations (Interest Rate Swaps) with a total notional amount of \$1.1 billion. At December 31, 2019 and 2018, the fair values of these agreements were \$(257) million and \$(192) million, respectively, and were recorded in other long-term liabilities. For the years ended December 31, 2019 and 2018, Health Plans and Hospitals recorded \$20 million and \$21 million, respectively, in interest expense relating to the Interest Rate Swaps. For the years ended December 31, 2019 and 2018, net changes in fair values totaled \$(65) million and \$37 million, respectively, and were recorded in investment income – net.

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These derivatives contain reciprocal provisions whereby if Health Plans and Hospitals' or the counterparties' credit rating was to decline to certain levels, provisions would be triggered requiring Health Plans and Hospitals or the counterparties to provide certain collateral. At December 31, 2019 and 2018, no collateral was required to be posted by either Health Plans and Hospitals or the counterparties.

(b) Derivatives Held in Investment Portfolios

At December 31, 2019 and 2018, Health Plans and Hospitals' portfolio managers held \$(21) million and \$(19) million, respectively, of futures, forwards, options, and swaps to attempt to protect certain investments against volatility. For the years ended December 31, 2019 and 2018, net changes in fair values totaled \$(74) million and \$30 million, respectively, and were recorded in investment income – net. For the years ended December 31, 2019 and 2018, gains (losses) resulting from derivative settlements totaled \$286 million and \$(33) million, respectively, and were recorded in investment income – net.

(c) Information on Derivative Gain (Loss) and Fair Value

Management's methods for estimating fair value of financial instruments are discussed in the *Summary of Significant Accounting Policies – Fair Value Estimates* note.

**Information on Derivative Gain (Loss) Mark-to-Market Valuation
Recognized in Income**

(In millions)

Derivatives not designated as hedging instruments	Statement of operations category	Gain (loss) recognized in income on derivatives for the years ended December 31,	
		2019	2018
Interest rate swaps – related to debt	Investment income – net	\$ (65)	\$ 37
Interest rate swaps – other	Investment income – net	12	(6)
Futures and forwards	Investment income – net	(97)	40
Options, rights, and warrants	Investment income – net	11	(4)
		<u>\$ (139)</u>	<u>\$ 67</u>

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**Information on Derivative Settlement Costs
Recognized in Income**

(In millions)

Derivatives not designated as hedging instruments	Statement of operations category	Gain (loss) recognized in income on derivatives for the years ended December 31,	
		2019	2018
Interest rate swaps – related to debt	Interest expense	\$ (20)	\$ (21)
Interest rate swaps – other	Investment income – net	25	18
Futures and forwards	Investment income – net	257	(58)
Options, rights, and warrants	Investment income – net	4	7
		<u>\$ 266</u>	<u>\$ (54)</u>

Information on Fair Value of Derivative Instruments – Assets

(In millions)

Derivatives not designated as hedging instruments	Balance sheet category	Fair value at December 31,	
		2019	2018
Interest rate swaps – other	Noncurrent investments	\$ 51	\$ 56
Futures and forwards	Noncurrent investments	39	25
Options, rights, and warrants	Noncurrent investments	7	11
		<u>\$ 97</u>	<u>\$ 92</u>

Information on Fair Value of Derivative Instruments – Liabilities

(In millions)

Derivatives not designated as hedging instruments	Balance sheet category	Fair value at December 31,	
		2019	2018
Interest rate swaps – related to debt	Other long-term liabilities	\$ 257	\$ 192
Interest rate swaps – other	Other long-term liabilities	45	62
Futures and forwards	Other long-term liabilities	62	35
Options, rights, and warrants	Other long-term liabilities	11	14
		<u>\$ 375</u>	<u>\$ 303</u>

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(5) Accounts Receivable – Net

At December 31, accounts receivable – net were as follows (in millions):

	<u>2019</u>	<u>2018</u>
Members' dues	\$ 933	\$ 836
Patient services	470	457
Medicare	227	296
Other	<u>902</u>	<u>586</u>
Total	<u>\$ 2,532</u>	<u>\$ 2,175</u>

At both December 31, 2019 and 2018, the allowances for bad debt were not material.

(6) Inventories and Other Current Assets

At December 31, inventories and other current assets were as follows (in millions):

	<u>2019</u>	<u>2018</u>
Inventories – net	\$ 851	\$ 854
Prepaid expenses	763	803
Other	<u>119</u>	<u>90</u>
Total	<u>\$ 1,733</u>	<u>\$ 1,747</u>

(7) Land, Buildings, Equipment, and Software – Net

At December 31, land, buildings, equipment, and software – net were as follows (in millions):

	<u>2019</u>	<u>2018</u>
Land	\$ 2,298	\$ 2,195
Buildings and improvements	38,139	35,989
Furniture, equipment, and software	13,379	12,855
Construction and software development in progress	<u>2,517</u>	<u>2,336</u>
	56,333	53,375
Accumulated depreciation and amortization	<u>(28,727)</u>	<u>(26,659)</u>
Total	<u>\$ 27,606</u>	<u>\$ 26,716</u>

Health Plans and Hospitals capitalizes interest costs on borrowings incurred during the construction, upgrade, or development of qualifying assets. Capitalized interest is added to the cost of the underlying assets and is depreciated or amortized over the useful lives of the assets. During the years ended December 31, 2019 and 2018, Health Plans and Hospitals capitalized \$50 million and \$38 million, respectively, of interest in connection with various capital projects.

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Asset retirement obligations relate primarily to the following: leased building restoration, building demolition, building materials containing asbestos, leaded wall shielding, storage tanks (above ground and below ground), chillers or cooling tower chemicals, mercury in large fixed-components, polychlorinated biphenyl window caulk, and hard drives requiring data wiping prior to disposal. At December 31, 2019 and 2018, the liability for asset retirement obligations was \$109 million and \$103 million, respectively. At December 31, 2019 and 2018, the unamortized asset related to these retirement obligations was \$40 million and \$35 million, respectively.

(8) Medical Claims Payable

For the years ended December 31, activity in the liability for medical claims payable was as follows (in millions):

	2019	2018
Balances at January 1	\$ 2,417	\$ 2,303
Incurred related to:		
Current year	14,024	13,326
Prior years	(340)	(114)
Total incurred	13,684	13,212
Paid related to:		
Current year	12,016	11,180
Prior years	1,744	1,918
Total paid	13,760	13,098
Balances at December 31	\$ 2,341	\$ 2,417

Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately adjudicated and paid. Liabilities are reviewed and revised as information regarding actual claims payments becomes known. Negative amounts reported for incurred related to prior years result from claims being adjudicated and paid for amounts less than originally estimated.

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(9) Other Liabilities

At December 31, other current liabilities were as follows (in millions):

	<u>2019</u>	<u>2018</u>
Self-insured risks	\$ 453	\$ 403
Dues collected in advance	917	904
Physicians' retirement plan liability	232	219
Other	<u>1,434</u>	<u>1,139</u>
Total	<u>\$ 3,036</u>	<u>\$ 2,665</u>

At December 31, other long-term liabilities were as follows (in millions):

	<u>2019</u>	<u>2018</u>
Self-insured risks	\$ 1,698	\$ 1,629
Derivatives liability	375	303
Due to associated medical groups	288	243
Other	<u>261</u>	<u>455</u>
Total	<u>\$ 2,622</u>	<u>\$ 2,630</u>

(10) Debt

At December 31, debt was as follows (in millions):

	<u>2019</u>	<u>2018</u>
Tax-exempt revenue bonds and taxable bonds and notes:		
1.00% to 1.92% variable rate due through 2049	\$ 1,871	\$ 3,643
3.15% to 5.00% fixed rate due through 2051	8,195	6,461
Others at various rates due through 2047	<u>222</u>	<u>40</u>
Total	<u>\$ 10,288</u>	<u>\$ 10,144</u>
Other current debt:		
Commercial paper	\$ 369	\$ 750
Current portion of long-term debt	16	249
Long-term debt subject to short-term remarketing arrangements – net	—	475
Long-term debt classified as a long-term liability	<u>9,903</u>	<u>8,670</u>
Total	<u>\$ 10,288</u>	<u>\$ 10,144</u>

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On October 31, 2019, Hospitals received proceeds in connection with the issuance of \$1.0 billion par value taxable fixed rate debt, as well as proceeds from the issuance of \$0.8 billion of par value remarketed tax-exempt fixed rate debt, all of which were used to redeem or remarket existing debt. Total proceeds from issuance, which includes \$223 million of bond premium, were \$2.0 billion.

The fair value of long-term debt is based on level 2 inputs for debt with similar risk, terms, and remaining maturities. At December 31, 2019 and 2018, the carrying amount of long-term debt totaled \$9.9 billion and \$9.4 billion, respectively. At December 31, 2019 and 2018, the estimated fair value of long-term debt was approximately \$10.7 billion and \$9.6 billion, respectively.

At December 31, 2019 and 2018, repurchase of variable rate bonds totaling \$1.5 billion and \$2.9 billion, respectively, may be required at earlier than stated maturity. These bonds may be remarketed rather than repurchased. Health Plans and Hospitals has provided self liquidity for the variable rate demand bonds with put options. Additionally, at both December 31, 2019 and 2018, management had the ability to finance the acquisition of up to \$2.4 billion of any unremarketed bonds that are put, using available long-term credit facilities. At December 31, 2019 and 2018, \$0 million and \$475 million, respectively, of these variable rate demand bonds were classified in current liabilities.

At December 31, 2019 and 2018, \$405 million and \$200 million, respectively, of the above tax-exempt fixed-rate revenue bonds and taxable fixed-rate bonds represented a net unamortized premium balance. At December 31, 2019 and 2018, \$(41) million and \$(39) million, respectively, of unamortized debt issuance cost was presented within long-term debt.

Scheduled principal payments for each of the next five years and thereafter considering obligations subject to short-term remarketing as due according to their long-term amortization schedule, except as described below, were as follows (in millions):

2020	\$	385
2021		127
2022		794
2023		15
2024		6
Thereafter		8,597
Total	\$	9,924

Credit Facility

Hospitals' credit facility of \$2.4 billion terminates in September 2022. Various interest rate options are available under this facility. Any revolving borrowings mature on the termination date. Hospitals pays facility fees, which range from 0.05% to 0.15% per annum, depending upon Hospitals' long-term senior unsecured debt rating. At December 31, 2019, the facility fee was at an annual rate of 0.05%. At December 31, 2019 and 2018, no amounts were outstanding under this credit facility.

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Hospitals' revolving credit facility contains a financial covenant. Under the terms of this facility, Hospitals is required to maintain a ratio of total debt to capital, as defined.

Taxable Commercial Paper Program

Hospitals maintains a commercial paper program providing for the issuance of up to \$2.4 billion in aggregate maturity value of short-term indebtedness. The commercial paper is issued in denominations of \$100,000 and will bear such interest rates, if interest-bearing, or will be sold at such discount from their face amounts, as agreed upon by Hospitals and the dealer acting in connection with the commercial paper program. The commercial paper may be issued with varying maturities up to a maximum of 270 days from the date of issuance. At December 31, 2019 and 2018, commercial paper of \$369 million and \$750 million, respectively, was outstanding under this program and is included within other current debt.

(11) Pension Plans

(a) Defined Benefit Plan

Health Plans and Hospitals has a defined benefit pension plan (Plan) covering substantially all their employees. Benefits are based on age at retirement, years of credited service, and average compensation for a specified period prior to retirement. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future.

For financial reporting purposes, the projected unit credit method is used. At December 31, 2019 and 2018, pension fund assets were held in a group trust. At December 31, 2019 and 2018, trust assets were invested primarily in fixed-income and equity securities, with approximately 19% and 25%, respectively, of trust assets, net of liabilities, invested in alternative investments.

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At December 31, the funded status of the Plan was as follows (in millions):

	<u>2019</u>	<u>2018</u>
Change in projected benefit obligation (PBO):		
Benefit obligation at beginning of year	\$ 22,345	\$ 23,632
Service cost	1,326	1,484
Interest cost	913	809
Plan amendments	2	—
Net actuarial loss (gain)	5,989	(2,830)
Benefits paid	<u>(862)</u>	<u>(750)</u>
Benefit obligation at end of year	\$ <u>29,713</u>	\$ <u>22,345</u>
Accumulated benefit obligation at end of year	\$ 22,219	\$ 17,069
Change in Health Plans and Hospitals' share of trust assets:		
Fair value of plan assets at beginning of year	\$ 15,783	\$ 15,693
Actual return on plan assets	3,508	(753)
Contributions	7,632	1,593
Benefits paid	<u>(862)</u>	<u>(750)</u>
Fair value of plan assets at end of year	\$ <u>26,061</u>	\$ <u>15,783</u>
Funded status	\$ (3,652)	\$ (6,562)
Amounts recognized in the combined balance sheets consist of:		
Noncurrent assets	\$ —	\$ —
Other current liabilities	—	—
Pension and other retirement liabilities	<u>(3,652)</u>	<u>(6,562)</u>
	\$ <u>(3,652)</u>	\$ <u>(6,562)</u>
Amounts recognized in net worth:		
Net actuarial loss	\$ 9,694	\$ 6,341
Prior service cost	<u>70</u>	<u>76</u>
	\$ <u>9,764</u>	\$ <u>6,417</u>

The measurement date used to determine pension valuations was December 31.

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For the years ended December 31, pension expense was as follows (in millions):

	2019	2018
Service cost	\$ 1,326	\$ 1,484
Interest cost	913	809
Expected return on plan assets	(1,163)	(1,079)
Amortization of net actuarial loss	291	542
Amortization of prior service cost	8	11
Net pension expense	1,375	1,767
Other changes in plan assets and PBO recognized in net worth:		
Net actuarial loss (gain)	3,644	(999)
Prior service cost	2	—
Amortization of net actuarial loss	(291)	(542)
Amortization of prior service cost	(8)	(11)
Total recognized in net worth	3,347	(1,552)
Total recognized in net periodic benefit cost and net worth	\$ 4,722	\$ 215

At December 31, 2019, the benefit obligation included a net actuarial loss of \$6.0 billion, primarily due to the decrease in the discount rate used to determine the benefit obligation from 4.50% in 2018 to 3.40% in 2019. At December 31, 2018, the benefit obligation included a net actuarial gain of \$2.8 billion, primarily due to the increase in the discount rate used to determine the benefit obligation from 3.80% in 2017 to 4.50% in 2018.

Actuarial assumptions used were as follows:

	2019	2018
Discount rate at January 1 for calculating service cost	4.64%	3.92%
Discount rate at January 1 for calculating interest cost	4.16%	3.48%
Discount rate for calculating December 31 PBO	3.40%	4.50%
Salary scale for calculating pension expense	4.20%	4.20%
Salary scale for calculating December 31 PBO	4.20%	4.20%
Expected long-term rate of return on plan assets for calculating pension expense	6.75%	7.00%

During 2020, management expects to contribute approximately \$1.4 billion to the Plan.

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The following benefit payments, which reflect expected future service, are expected to be paid (in millions):

2020	\$	1,053
2021		1,140
2022		1,226
2023		1,311
2024		1,402
2025–2029		8,264

Explanation of Investment Strategies and Policies

A total return investment approach is employed for the Plan whereby the Plan invests in a mix of equity, fixed-income, and alternative asset classes to maximize the long-term return of plan assets for a prudent level of risk. The intent of this strategy is to minimize plan expenses by outperforming plan liabilities over the long run. Risk tolerance is established through consideration of plan liabilities, plan funded status, and corporate financial condition. The investment portfolio will consist over time of a varying but diversified blend of equity, fixed-income, and alternative investments. Diversification includes such factors as geographic location, equity capitalization size and style, placement in the capital structure, and security type. Investment risk is measured and monitored on an ongoing basis through annual liability measurements, periodic asset/liability studies, and quarterly investment portfolio reviews. The Plan's investment policy has restrictions relating to credit quality, industry/sector concentration, duration, concentration of ownership, and use of derivatives.

Capital Market Assumption Methodology

To determine the long-term rate of return assumption for plan assets, management incorporates historical relationships among the various asset classes and subclasses to be accessed over the investment horizon. Management's intent is to maximize portfolio efficiency. This will be accomplished by seeking the highest returns prudently available among the available asset classes. Overall portfolio volatility is managed through diversification among asset classes. Current market factors such as inflation and interest rates are evaluated before long-term capital market assumptions are determined. From time to time, management reviews its long-term investment strategy and reconciles that strategy with the long-term liabilities of the Plan. This asset-liability study produces a range of expected returns over medium and long-term time periods. Those intermediate and long-term investment projections form the basis for the expected long-term rate of return on assets.

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At December 31, 2019, the estimated fair value of total pension trust assets – net by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Total
Assets:			
Cash and cash equivalents	\$ 212	\$ 1,789	\$ 2,001
Broker receivables	—	317	317
Securities lending collateral	—	954	954
U.S. equity securities	13,176	1,265	14,441
Foreign equity securities	9,726	1,471	11,197
Global equity funds	—	432	432
Debt securities issued by the U.S. government	—	2,838	2,838
Debt securities issued by U.S. government agencies and corporations	—	51	51
Debt securities issued by U.S. states and political subdivisions of states	—	262	262
Foreign government debt securities	—	716	716
U.S. corporate debt securities	—	6,151	6,151
Non-U.S. corporate debt securities	—	1,131	1,131
U.S. agency mortgage-backed securities	—	295	295
Non-U.S. agency mortgage-backed securities	—	58	58
Other	—	215	215
Total assets	<u>23,114</u>	<u>17,945</u>	<u>41,059</u>
Liabilities:			
Broker payables	—	769	769
Securities lending payable	—	954	954
Other liabilities	43	647	690
Total liabilities	<u>43</u>	<u>2,370</u>	<u>2,413</u>
Fair value of pension trust assets – net	<u>\$ 23,071</u>	<u>\$ 15,575</u>	<u>\$ 38,646</u>
Investments measured at net asset value (NAV):			
Alternative investments:			
Absolute return			1,745
Private equity			6,192
Risk parity			1,408
Total pension trust assets – net			<u>\$ 47,991</u>

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At December 31, 2019, Health Plans and Hospitals' share of pension trust assets was 54.3%, or \$26.1 billion. The remaining share of pension trust assets is for Medical Groups and a related party associated with Medical Groups.

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At December 31, 2018, the estimated fair value of total pension trust assets – net by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Total
Assets:			
Cash and cash equivalents	\$ 148	\$ 992	\$ 1,140
Broker receivables	—	320	320
Securities lending collateral	—	949	949
U.S. equity securities	6,311	603	6,914
Foreign equity securities	5,347	2,152	7,499
Global equity funds	—	340	340
Debt securities issued by the U.S. government	—	1,770	1,770
Debt securities issued by U.S. government agencies and corporations	—	46	46
Debt securities issued by U.S. states and political subdivisions of states	—	220	220
Foreign government debt securities	—	600	600
U.S. corporate debt securities	—	4,646	4,646
Non-U.S. corporate debt securities	—	1,259	1,259
U.S. agency mortgage-backed securities	—	156	156
Non-U.S. agency mortgage-backed securities	—	51	51
Other	—	943	943
Total assets	<u>11,806</u>	<u>15,047</u>	<u>26,853</u>
Liabilities:			
Broker payables	—	639	639
Securities lending payable	—	949	949
Other liabilities	14	294	308
Total liabilities	<u>14</u>	<u>1,882</u>	<u>1,896</u>
Fair value of pension trust assets – net	<u>\$ 11,792</u>	<u>\$ 13,165</u>	<u>\$ 24,957</u>
Investments measured at NAV:			
Alternative investments:			
Absolute return			1,712
Private equity			5,272
Risk parity			1,248
Total pension trust assets – net			<u>\$ 33,189</u>

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At December 31, 2018, Health Plans and Hospitals' share of pension trust assets was 47.6%, or \$15.8 billion. The remaining share of pension trust assets is for Medical Groups and a related party associated with Medical Groups.

During the years ended December 31, 2019 and 2018, there were no significant transfers of assets with inputs with quoted prices in active markets for identical assets (level 1) and assets with inputs with significant other observable inputs (level 2).

The target asset allocations for calculating pension expense were as follows:

	2019 and 2018 target
Equity securities	45%
Debt securities	30%
Alternative investments	25%
Total	<u>100%</u>

Alternative investments, which include absolute return, risk parity, and private equity, held in the pension trust are reported at NAV as a practical expedient for fair value. Absolute return investments use advanced investment strategies, including derivatives, to generate positive long-term risk adjusted returns. Private equity investments consist of funds that make direct investments in private companies. Risk parity funds use risk as the primary factor to allocate investments among asset classes. At December 31, 2019, the trust had original commitments related to alternative investments of \$12.3 billion, of which \$6.4 billion was invested, leaving \$5.9 billion of remaining commitments. At December 31, 2018, the trust had original commitments related to alternative investments of \$10.1 billion, of which \$5.6 billion was invested, leaving \$4.5 billion of remaining commitments.

Absolute return, risk parity, and private equity investments include redemption restrictions. Absolute return and risk parity investments require 10 to 90 day written notice of intent to withdraw and are often subject to the approval and capital requirements of the fund manager. At December 31, 2019, absolute return and risk parity investments of \$561 million were subject to lock-up periods of up to two years. Private equity agreements do not include provisions for redemption. Distributions will be received as the underlying investments of the funds are liquidated, which is expected over the next 11 years.

The majority of debt and equity securities can be redeemed within 10 days. At December 31, 2019, equity investment funds of \$912 million were redeemable between 10 and 30 days. No debt or equity investments require a redemption period of greater than 120 days.

(b) Defined Contribution Plans

Health Plans and Hospitals has defined contribution plans for eligible employees. Employer contributions and costs are typically based on a percentage of covered employees' eligible compensation. During the years ended December 31, 2019 and 2018, there were no required

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employee contributions. For the years ended December 31, 2019 and 2018, plan expense, primarily employer contributions, was \$380 million and \$341 million, respectively.

(c) Multi-Employer Plans

Health Plans and Hospitals participates in a number of multi-employer defined benefit pension plans under the terms of collective bargaining agreements that cover some union-represented employees. Some risks of participating in these multi-employer plans that differ from single-employer plans include:

- Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers.
- If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
- Employers that choose to stop participating in a multi-employer plan may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

Health Plans and Hospitals' participation in these plans for the year ended December 31, 2019 is outlined in the table below. The "EIN/PN" column provides the Employer Identification Number (EIN) and the three-digit plan number (PN), if applicable. Unless otherwise noted, the most recent Pension Protection Act (PPA) zone status available in 2019 and 2018 is for the plan's year-end in 2018 and 2017, respectively. The zone status is based on information that Health Plans and Hospitals obtained from publicly available information provided by the United States Department of Labor. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow zone are between 65% and 80% funded, and plans in the green zone are at least 80% funded. The "FIP/RP status pending/implemented" column indicates plans for which a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented. The "Health Plans and Hospitals' contributions to plan exceeded more than 5% of total contributions" columns represent those plans where Health Plans and Hospitals was listed in the plans' Forms 5500 as providing more than 5% of the total contributions for the plan years listed. The last column lists the expiration dates of the collective bargaining agreements to which the plans are subject. There have been no significant changes that affect the comparability of 2019 and 2018 employer expense.

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Pension fund	EIN-PN	Pension Protection Act zone status		FIP/RP status pending / implemented	(in millions) Health Plans and Hospitals' contributions December 31,		Surcharge imposed	Health Plans and Hospitals' contributions to plan exceeded more than 5% of total contributions ⁽¹⁾		Expiration date of collective bargaining agreement
		2019	2018		2019	2018		2018	2017	
IUOE Stationary Engineers Local 39 Pension Fund	946118939-001	Green	Green	N/A	\$ 13	\$ 12	N/A	Yes	Yes	9/17/2021
Southern California United Food and Commercial Workers Unions and Drug Employers Pension Fund	516029925-001	Red	Red	Implemented	6	6	No	Yes	Yes	11/1/2021
Oregon Retail Employees Pension Trust ⁽²⁾	936074377-001	Green	Red	N/A	3	3	N/A	Yes	Yes	9/30/2021 - 10/31/2021
Solano - Napa County Electrical Workers Pensions Trust (IBEW Local 180) ⁽³⁾	946220673-001	Green	Green	N/A	—	—	N/A	Yes	Yes	5/31/2020
International Painters and Allied Trades Industry Pension Fund (IUPAT Industry Pension Fund)	526073909-001	Red	Red	Implemented	1	3	No	No	No	6/30/2023
Other	Various	Green	Green	N/A	19	17	N/A	No	No	5/31/2020 - 6/30/2023
Other	Various	Yellow	Yellow	Implemented	12	10	No	No	No	6/30/2020
Total expense					\$ 54	\$ 51				

(1) Forms 5500 information was available for all plan years ended in 2018. The majority of plans have a plan year end of December 31.

(2) Includes UFCW Local 555 Pharmacy Techs and Radiologists expiring September 30, 2021 and October 31, 2021, respectively.

(3) 2017 was the first year that KP reached the 5% contribution threshold for this union. Total 2018 pension contributions for the year were \$71K. For 2019, total pension contributions were \$93K.

(12) Postretirement Benefits Other than Pensions

(a) Defined Benefit Plan

Certain employees may become eligible for postretirement health care and life insurance benefits while working for Health Plans and Hospitals. Benefits available to retirees, through both affiliated and unaffiliated provider networks, vary by employee group. Postretirement health care benefits available to retirees include subsidized Medicare premiums, medical and prescription drug benefits, dental benefits, vision benefits, and contributions to health care savings accounts.

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At December 31, the accrued liability for postretirement benefits was as follows (in millions):

	<u>2019</u>	<u>2018</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 5,356	\$ 5,926
Service cost	164	195
Interest cost	219	209
Plan amendments	—	16
Benefits paid or provided	(165)	(162)
Net actuarial loss (gain)	<u>459</u>	<u>(828)</u>
Benefit obligation at end of year	<u>\$ 6,033</u>	<u>\$ 5,356</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	4,326	4,483
Actual return on plan assets	872	(157)
Contributions	170	162
Benefits paid or provided	<u>(165)</u>	<u>(162)</u>
Fair value of plan assets at end of year	<u>\$ 5,203</u>	<u>\$ 4,326</u>
Funded status	\$ (830)	\$ (1,030)
Amounts recognized in the combined balance sheets consist of:		
Noncurrent assets	\$ —	\$ —
Other current liabilities	—	(4)
Pension and other retirement liabilities	<u>(830)</u>	<u>(1,026)</u>
	<u>\$ (830)</u>	<u>\$ (1,030)</u>
Amounts recognized in net worth:		
Net actuarial loss	\$ 1,560	\$ 1,710
Prior service credit	<u>(1,014)</u>	<u>(1,440)</u>
	<u>\$ 546</u>	<u>\$ 270</u>

The measurement date used to determine postretirement benefits valuations was December 31.

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For the years ended December 31, postretirement benefits expense was as follows (in millions):

	2019	2018
Service cost	\$ 164	\$ 195
Interest cost	219	209
Expected return on plan assets	(315)	(303)
Amortization of net actuarial loss	52	105
Amortization of prior service credit	(426)	(433)
Postretirement benefits expense	(306)	(227)
Other changes in plan assets and benefit obligations recognized in net worth:		
Net actuarial gain	(98)	(369)
Prior service credit	—	16
Amortization of net actuarial loss	(52)	(105)
Amortization of prior service credit	426	433
Total recognized in net worth	276	(25)
Total recognized in net periodic benefit cost and net worth	\$ (30)	\$ (252)

During the year ended December 31, 2019, employer contributions and benefits paid or provided were \$170 million and \$165 million, respectively. During the year ended December 31, 2018, both the employer contributions and benefits paid or provided were \$162 million. During 2019 and 2018, there were no participant contributions from active employees.

At December 31, 2019, the benefit obligation included a net actuarial loss of \$459 million, primarily due to the decrease in discount rates used to determine the benefit obligation ranging from 4.00% – 4.50% in 2018 to 3.40% in 2019. The actuarial loss was partially offset by lower health care premium cost assumptions. At December 31, 2018, the benefit obligation included a net actuarial gain of \$828 million, primarily due to the increase in discount rates used to determine the benefit obligation ranging from 3.35% – 3.80% in 2017 to 4.00% – 4.50 % in 2018.

Actuarial assumptions used were as follows:

	2019	2018
Discount rates at January 1 for calculating service cost	4.35% – 4.71%	3.35% – 3.99%
Discount rates at January 1 for calculating interest cost	3.73% – 4.23%	3.35% – 3.55%
Discount rates for calculating December 31 accumulated postretirement benefit obligation	3.40%	4.00% – 4.50%
Expected long-term rate of return on plan assets for calculating benefits expense	6.75%	7.00%

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The following were the assumed health care cost trend rates used to determine the December 31, 2019 and 2018 benefit obligation and postretirement benefits expense for the years ended December 31, 2019 and 2018:

	Basic medical pre-65/post-65	Prescription drug pre-65/post-65	Medicare Part D	Dental	Medicare Part A&B	Medicare Part C	Supplemental medical pre-65/post-65
Initial trend rate – 2018	5.25% / 5.00%	6.25% / 6.25%	4.00%	4.50%	5.00%	4.50%	5.25% / 5.00%
Initial trend rate – 2019	5.25% / 5.00%	6.00% / 6.00%	4.00%	4.50%	5.00%	4.50%	5.25% / 5.00%
Ultimate trend rate	4.50% / 4.50%	4.50% / 4.50%	4.50%	4.50%	4.50%	4.50%	4.50% / 4.50%
First year at ultimate trend rate	2026 / 2022	2025 / 2025	2026	n/a	2022	n/a	2026 / 2022

The following benefit payments, which reflect expected future service, are expected to be paid or provided (in millions):

2020	\$	174
2021		188
2022		203
2023		218
2024		234
2025-2029		1,390

Explanation of Investment Strategies and Policies

A total return investment approach is employed for the retirement benefit trust whereby the assets are invested in various asset classes to maximize the long-term return of plan assets for a prudent level of risk. The intent of this strategy is to minimize plan expenses by outperforming plan liabilities over the long run. Risk tolerance is established through consideration of plan liabilities, plan funded status, and corporate financial condition. The investment portfolio will consist over time of a varying but diversified blend of equity, fixed-income, and alternative investments. Diversification includes such factors as geographic location, equity capitalization size and style, placement in the capital structure, and security type. Investment risk is measured and monitored on an ongoing basis through annual liability measurements, periodic asset/liability studies, and quarterly investment portfolio reviews. The retirement benefit trust investment policy has restrictions relating to credit quality, industry/sector concentration, duration, concentration of ownership, and use of derivatives.

Capital Market Assumption Methodology

To determine the long-term rate of return assumption for plan assets, management incorporates historical relationships among the various asset classes and subclasses to be accessed over the investment horizon. Management's intent is to maximize portfolio efficiency. This will be accomplished by seeking the highest returns prudently available among the available asset classes. Overall portfolio volatility is managed through diversification among asset classes. Current market factors such as inflation and interest rates are evaluated before long-term capital market assumptions are determined. From time to time, management reviews its long-term investment strategy and reconciles that strategy with the long-term liabilities of the Plan. This asset-liability study produces a range of expected returns

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over medium and long-term time periods. Those intermediate and long-term investment projections form the basis for the expected long-term rate of return on assets.

At December 31, 2019, the estimated fair value of retirement benefit trust assets by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Total
	<u>level 1</u>	<u>level 2</u>	<u>Total</u>
Assets:			
Cash and cash equivalents	\$ —	\$ 151	\$ 151
Broker receivables	—	62	62
U.S. equity securities	1,814	—	1,814
Foreign equity securities	826	—	826
Debt securities issued by the U.S. government	—	1,186	1,186
Debt securities issued by U.S. states	—	14	14
Foreign government debt securities	—	2	2
U.S. corporate debt securities	—	176	176
Non-U.S. corporate debt securities	—	23	23
U.S. agency mortgage-backed securities	—	109	109
Non-U.S. agency mortgage-backed securities	—	19	19
Other	—	15	15
Total assets	<u>2,640</u>	<u>1,757</u>	<u>4,397</u>
Liabilities:			
Broker payables	—	139	139
Other liabilities	—	3	3
Total liabilities	<u>—</u>	<u>142</u>	<u>142</u>
Total fair value of retirement benefit trust assets	<u>\$ 2,640</u>	<u>\$ 1,615</u>	<u>\$ 4,255</u>
Investments measured at NAV:			
Alternative investments:			
Absolute return			398
Risk parity			550
Total retirement benefit trust assets			<u>\$ 5,203</u>

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At December 31, 2018, the estimated fair value of retirement benefit trust assets by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Total
	<u>level 1</u>	<u>level 2</u>	<u>Total</u>
Assets:			
Cash and cash equivalents	\$ 1	\$ 159	\$ 160
Broker receivables	—	14	14
U.S. equity securities	1,408	—	1,408
Foreign equity securities	570	—	570
Debt securities issued by the U.S. government	—	1,024	1,024
Debt securities issued by U.S. states	—	11	11
Foreign government debt securities	—	3	3
U.S. corporate debt securities	—	185	185
Non-U.S. corporate debt securities	—	24	24
U.S. agency mortgage-backed securities	—	70	70
Non-U.S. agency mortgage-backed securities	—	20	20
Other	—	15	15
Total assets	<u>1,979</u>	<u>1,525</u>	<u>3,504</u>
Liabilities:			
Broker payables	—	65	65
Other liabilities	—	28	28
Total liabilities	<u>—</u>	<u>93</u>	<u>93</u>
Total fair value of retirement benefit trust assets	<u>\$ 1,979</u>	<u>\$ 1,432</u>	<u>3,411</u>
Investments measured at NAV:			
Alternative investments:			
Absolute return			425
Risk parity			490
Total retirement benefit trust assets			<u>\$ 4,326</u>

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The target asset allocations for calculating postretirement benefits expense were as follows:

	2019 and 2018 target
Equity securities	45%
Debt securities	30%
Alternative investments	25%
Total	100%

Absolute return and risk parity investments include redemption restrictions. Absolute return and risk parity investments require 10 to 90 day written notice of intent to withdraw and are often subject to the approval and capital requirements of the fund manager. At December 31, 2019, absolute return and risk parity investments of \$165 million were subject to lock-up periods of up to two years.

(b) Multi-Employer Plans

Health Plans and Hospitals participates in multi-employer union-administered retiree medical health and welfare plans that provide benefits to some union employees. Benefits for retirees under these plans are negotiated as part of the collective bargaining process. For the years ended December 31, 2019 and 2018, Health Plans and Hospitals' employer expense for both current and retiree benefits was \$104 million and \$90 million, respectively.

(13) Physicians' Retirement Plan

Kaiser Foundation Health Plan, Inc. provides defined retirement benefits for physicians associated with certain Medical Groups. Benefits are determined based on the length of service and level of compensation of each participant. The plan is unfunded and is not subject to the Employee Retirement Income Security Act.

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At December 31, the accrued liability for physicians' retirement plan was as follows (in millions):

	2019	2018
Change in projected benefit obligation:		
Physicians' retirement plan liability at January 1	\$ 7,740	\$ 8,165
Service cost	405	454
Interest cost	326	291
Net actuarial loss (gain)	1,890	(981)
Benefits paid	(202)	(189)
Physicians' retirement plan liability at December 31	\$ 10,159	\$ 7,740
Accumulated benefit obligation at end of year	\$ 7,711	\$ 5,996
Change in plan assets:		
Fair value of plan assets at the beginning of year	\$ —	\$ —
Company contributions	202	189
Benefits paid	(202)	(189)
Fair value of plan assets at end of year	\$ —	\$ —
Funded status	\$ (10,159)	\$ (7,740)
Amounts recognized in the combined balance sheets consist of:		
Noncurrent assets	\$ —	\$ —
Other current liabilities	(232)	(219)
Physicians' retirement plan liability	(9,927)	(7,521)
	\$ (10,159)	\$ (7,740)
Amounts recognized in net worth:		
Net actuarial loss	\$ 3,391	\$ 1,552

The measurement date used to determine physicians' retirement valuation was December 31.

A portion of the investments of Health Plans has been designated by management for the liabilities of the physicians' retirement plan. These investments are not held in trust or otherwise legally segregated and are not restricted even though it has been intended that these assets be used to pay the obligations of the physicians' retirement plan.

For purposes of the physicians' retirement plan expense, the expected return on assets is the portion of investment income that represents the expected return on the investments designated for the physicians' retirement plan. This amount is recorded as a reduction in the expense for the physicians' retirement plan and is excluded from investment income – net, as described below and in the *Summary of Significant Accounting Policies – Investments* note.

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For the years ended December 31, physicians' retirement plan provision was as follows (in millions):

	<u>2019</u>	<u>2018</u>
Service cost	\$ 405	\$ 454
Interest cost	326	291
Amortization of net actuarial loss	<u>51</u>	<u>117</u>
Total benefit expense	782	862
Expected return on assets – investment income included in interest expense and other income (expense) – net	<u>(518)</u>	<u>(570)</u>
Net benefit expense	<u>264</u>	<u>292</u>
Other changes in projected benefit obligations recognized in net worth:		
Net actuarial loss (gain)	1,890	(981)
Amortization of net actuarial loss	<u>(51)</u>	<u>(117)</u>
Total recognized in net worth	<u>1,839</u>	<u>(1,098)</u>
Total recognized in net periodic benefit cost and net worth	<u>\$ 2,103</u>	<u>\$ (806)</u>

At December 31, 2019, the benefit obligation included in net actuarial loss of \$1.9 billion, primarily due to the decrease in the discount rate used to determine the benefit obligation from 4.60% in 2018 to 3.50% in 2019. At December 31, 2018, the benefit obligation included a net actuarial gain of \$981 million, primarily due to the increase in the discount rate used to determine the benefit obligation from 3.85% in 2017 to 4.60% in 2018.

Actuarial assumptions used were as follows:

	<u>2019</u>	<u>2018</u>
Discount rate at January 1 for calculating service cost	4.79%	3.99%
Discount rate at January 1 for calculating interest cost	4.19%	3.52%
Discount rate for calculating December 31 PBO	3.50%	4.60%
Salary scale for calculating pension expense	4.40%	4.40%
Salary scale for calculating December 31 PBO	4.40%	4.40%
Expected long-term rate of return on designated investments for calculating benefit expense	6.75%	7.00%

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The following benefit payments, which reflect expected future service, are expected to be paid (in millions):

2020	\$	232
2021		258
2022		283
2023		309
2024		336
2025–2029		2,031

(14) Leases

Health Plans and Hospitals leases land, medical office buildings, office space, data centers, and equipment. The remaining lease term for leases primarily ranges from 1-17 years. Many leases contain renewal options. For those contracts where options are reasonably certain to be exercised, Health Plans and Hospitals recognizes renewal options as part of the right-of-use assets and lease liabilities.

Quantitative disclosures

At December 31, 2019, lease assets and lease liabilities were as follows (in millions):

Assets	Classification		
Operating	Operating lease right-of-use assets	\$	1,437
Finance	Land, buildings, equipment, and software — net		210
	Total	\$	<u>1,647</u>
Liabilities	Classification		
Current			
Operating	Other current liabilities	\$	315
Finance	Other current debt		5
Noncurrent			
Operating	Operating lease liabilities		1,263
Finance	Long-term debt		216
	Total	\$	<u>1,799</u>

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For the year ended December 31, 2019, total lease costs incurred by lease type and type of payment were as follows (in millions):

Operating lease cost	\$	449
Finance lease cost:		
Amortization of lease assets		7
Interest on lease liabilities		6
Short-term lease cost		54
Variable lease cost		80
Total	\$	596

For the year ended December 31, 2018, total lease costs for all leases was \$515 million.

For the year ended December 31, 2019, other supplemental quantitative disclosures were as follows (in millions):

Cash paid for amounts included in the measurement of lease liabilities:

Operating cash flows used for operating leases	\$	(460)
Financing cash flows used for finance leases	\$	(4)

Additions to right-of-use assets obtained in the period from operating leases	\$	194
Additions to right-of-use assets obtained in the period from finance leases	\$	198

Weighted-average remaining lease term (years):

Operating leases		6.39
Finance leases		9.16

Weighted-average discount rate:

Operating leases		3.46%
Finance leases		3.18%

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At December 31, 2019, the undiscounted future lease payments under non-cancelable operating leases and finance leases, along with a reconciliation of the undiscounted cash flows to operating and finance lease liabilities were as follows (in millions):

Lease Maturity	Operating leases	Finance leases	Total
2020	\$ 361	\$ 12	\$ 373
2021	327	123	450
2022	279	8	287
2023	237	9	246
2024	171	9	180
Thereafter	401	105	506
Total lease payments	1,776	266	2,042
Less amount representing interest	(198)	(45)	(243)
Present value of undiscounted future cash flows	<u>\$ 1,578</u>	<u>\$ 221</u>	<u>\$ 1,799</u>

(15) Commitments and Contingencies

(a) Purchase Commitments

At December 31, 2019, minimum purchase commitments extending beyond one year were as follows (in millions):

2020	\$ 408
2021	376
2022	337
2023	246
2024	79
Thereafter	304
Total	<u>\$ 1,750</u>

During the years ended December 31, 2019 and 2018, Health Plans and Hospitals' total purchases under contracts with minimum purchase commitments were \$639 million and \$660 million, respectively.

(b) Capital and Other Improvements

On February 1, 2017, KFHPW Holdings, a subsidiary of Health Plan, Inc., acquired and became the sole corporate member of Group Health Cooperative (GHC), a Washington nonprofit corporation (the "Acquisition"). Following the Acquisition, GHC was renamed "Kaiser Foundation Health Plan of Washington". The Acquisition Agreement requires \$1.0 billion to be spent over the 10 year period following closing (subject to standard capital and budget approval processes) for capital improvements and key investments in infrastructure and other improvements at Kaiser Foundation Health Plan of Washington and its subsidiaries. During the years ended December 31, 2019 and 2018, \$153 million

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and \$145 million, respectively, in capital and other investments were made. At December 31, 2019, \$487 million of remaining capital and other investment commitments are required to be made relating to the Acquisition.

(c) Surety Instruments and Standby Letters of Credit

In the normal course of business, Health Plans and Hospitals contracts to perform certain financial obligations that require a guarantee from a third party. This guarantee creates a contingent liability to the entity that provides that guarantee. At December 31, 2019 and 2018, Health Plans and Hospitals had entered into surety instruments and standby letters of credit that totaled \$110 million and \$126 million, respectively.

Health Plan, Inc. and Kaiser Foundation Hospitals also guarantee payment of workers' compensation liabilities of certain Medical Groups under self-insurance programs. The majority of such liabilities are recorded as other long-term liabilities of Health Plan, Inc., as payment is provided for under the applicable medical service agreements. At December 31, 2019 and 2018, in addition to amounts accrued, pursuant to such guarantees, Health Plan, Inc. and Hospitals were contingently liable for approximately \$125 million and \$130 million, respectively, of certain Medical Groups' self-insured workers' compensation liabilities.

(d) Regulatory

Health Plans is required to periodically file financial statements with regulatory agencies in accordance with statutory accounting and reporting practices. Health Plans must comply with the various states' minimum regulatory net worth requirements generally under the regulation of the California Department of Managed Health Care and various state departments of insurance. Such requirements are generally based on tangible net equity or risk-based capital, and for California are calculated on the basis of combined net worth of Health Plans and Hospitals. At December 31, 2019 and 2018, the regulatory net worth, so defined, exceeded the aggregate regulatory minimum requirements by approximately \$32.2 billion and \$29.5 billion, respectively.

Health Plans' regulated subsidiaries maintain investments in various states where they are licensed. At December 31, 2019 and 2018, \$7 million and \$6 million, respectively, in securities were held to satisfy various state regulatory requirements.

Health Plans and Hospitals is subject to numerous and complex laws and regulations of federal, state, and local governments, and accreditation requirements. Compliance with such laws, regulations, and accreditation requirements can be subject to retrospective review and interpretation, as well as regulatory actions. These laws and regulations include, but are not necessarily limited to, requirements of tax exemption, government reimbursement, government program participation, privacy and security, false claims, anti-kickback, accreditation, healthcare reform, controlled substances, facilities, and professional licensure. In recent years, government activity has increased with respect to compliance and enforcement actions.

In the ordinary course of business operations, Health Plans and Hospitals is subject to periodic reviews, investigations, and audits by various federal, state, and local regulatory agencies and accreditation

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agencies, including, without limitation, CMS, Department of Managed Health Care, U.S. Office of Personnel Management, Occupational Safety and Health Administration, Drug Enforcement Administration (DEA), State Boards of Pharmacy, Food and Drug Administration, IRS, National Committee for Quality Assurance, and state departments of insurance.

Health Plans and Hospitals' compliance with the wide variety of rules and regulations and accreditation requirements applicable to their business may result in certain remediation activities and regulatory fines and penalties, which could be substantial. Where appropriate, reserves have been established for such sanctions. While management believes these reserves are adequate, the outcome of legal and regulatory matters is inherently uncertain, and it is possible that one or more of the legal or regulatory matters currently pending or threatened could have a material adverse effect on the combined financial position or results of operations.

(e) *Litigation*

Health Plans and Hospitals is involved in lawsuits and various governmental investigations, audits, reviews, and administrative proceedings arising, for the most part, in the ordinary course of business operations. Lawsuits have been brought under a wide range of laws and include, but are not limited to, business disputes, employment and retaliation claims, claims alleging professional liability, improper disclosure of personal information, labor disputes, administrative regulations, the False Claims Act, information privacy and Health Insurance Portability and Accountability Act laws, mental health parity laws, and consumer protection laws. In addition, Health Plans indemnifies the Medical Groups against various claims, including professional liability claims.

Health Plans and Hospitals records reserves for legal proceedings and regulatory matters where available information indicates that at the date of the combined financial statements a loss is probable and the amount can be reasonably estimated. While such reserves reflect management's best estimate of the probable loss for such matters, Health Plans and Hospitals' recorded amounts may differ materially from the actual amount of any such losses.

In the opinion of management, based upon current facts and circumstances, and except as stated below with respect to particular matters, the resolution of these matters is not expected to have a material adverse effect on the combined financial position or combined results of operations of Health Plans and Hospitals. The outcome of litigation and other legal and regulatory matters is inherently uncertain, however, and it is possible that one or more of the legal or regulatory matters currently pending or threatened could have a material adverse effect.

In September 2015, a lawsuit was filed seeking to have the State of California impose the gross premiums tax on Health Plan, Inc. In the opinion of management, strong defenses exist regarding this claim. However, an unfavorable outcome could have a material adverse effect. No reserves have been provided related to this lawsuit.

Pursuant to civil subpoenas, Health Plans and Hospitals has provided documents and information to the U.S. Department of Justice (DOJ) and Department of Health and Human Services – Office of Inspector General relating to Medicare Part C risk adjustment practices, policies, and programs.

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These matters could result in False Claims Act litigation, in which an unfavorable outcome could have a material adverse effect. No significant reserves have been provided related to these matters.

On September 17, 2019, the DEA served administrative inspection warrants at eight Health Plans and Hospitals pharmacies in six states, as part of a broader investigation by the DOJ into Health Plans' and Hospitals' controlled substance prescribing practices, policies, and controls. Health Plans and Hospitals have been providing documents and information to the DEA and DOJ related to this matter. Although management is unaware at this time of any material undisclosed compliance risks relating to the investigation, the outcomes of this matter are inherently uncertain and could result in False Claims Act litigation, citations, fines, criminal penalties, termination of the Medicare provider status of a Hospitals' facility and other sanctions upon Health Plans and Hospitals. No reserves have been provided related to this matter.