KPMG LLP
American International Plaza
Suite 1100
250 Munoz Rivera Avenue
San Juan, PR 00918-1819

Independent Auditors' Report

The Board of Directors
Medical Card System, Inc.:

We have audited the accompanying consolidated balance sheets of Medical Card System, Inc. and Subsidiaries (the Company), as of December 31, 2018 and 2017, and the related notes to the consolidated financial statements (the consolidated financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Medical Card System, Inc. and Subsidiaries as of December 31, 2018 and 2017 in accordance with U.S. generally accepted accounting principles.

Other Matters

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating schedule of balance sheet information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

San Juan, Puerto Rico
August 30, 2019

License No. 21
Expires December 1, 2019

By: _____

MEDICAL CARD SYSTEM, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2018 and 2017

Assets	2018	2017
Cash and cash equivalents	$ 84,549,291	170,610,451
Certificates of deposit	2,936,817	2,328,167
Investment in securities available for sale	286,370,968	226,807,466
Total cash, cash equivalents, and investments	373,857,076	399,746,084
Receivables:		
Premiums, trade, and other, net	37,698,297	27,167,574
Amounts due from the Centers for Medicaid and Medicare Services	37,271,732	—
Accrued interest receivable	1,487,340	1,086,812
Total receivables	76,457,369	28,254,386
Prepaid expenses and other assets	15,072,774	8,800,196
Prepaid income taxes	2,983,621	972,286
Deferred tax assets, net	—	7,977,004
Total current assets	468,370,840	445,749,956
Equipment and leasehold improvements, net	9,205,131	8,878,485
Deferred tax assets, net	2,490,453	7,694,665
Total assets	$ 480,066,424	462,323,106
Liabilities and Stockholders' Equity		
Liabilities:		
Medical claim liabilities	$ 162,221,308	163,252,518
Accounts payable and accrued expenses	65,233,426	57,041,777
Amounts due to the Centers for Medicaid and Medicare Services	—	7,146,876
Income taxes payable	5,617,466	32,853,752
Current installments of long-term debt	59,111,050	8,750,000
Total current liabilities	292,183,250	269,044,923
Long-term debt, excluding current installments	96,666,667	156,632,596
Total liabilities	388,849,917	425,677,519
Stockholders' equity:		
Common stock	6,225	6,225
Additional paid-in capital	11,928,868	11,928,868
Treasury stock	(3,632,774)	(3,632,774)
Retained earnings	85,301,644	29,964,944
Accumulated other comprehensive (loss), net of tax	(2,387,456)	(1,621,676)
Total stockholders' equity	91,216,507	36,645,587
Total liabilities and stockholders' equity	$ 480,066,424	462,323,106

See accompanying notes to consolidated financial statements.

(1) Reporting Entity and Summary of Significant Accounting Policies and Practices

The consolidated financial statements of Medical Card System, Inc., and Subsidiaries (the Company or MCS) include the accounts of its wholly owned subsidiaries MCS Healthcare Holdings, LLC. (MCSHH), MCS Life Insurance Company (MCS Life), MCS Advantage, Inc. (MCS Advantage), and MCS Health Management Options, Inc. (MCS-HMO), the last three collectively referred to as insurance subsidiaries. Also include are the accounts of its wholly owned subsidiary MCS General Insurance Agency (MCS-GIA).

The Company's subsidiaries are engaged in the following business operations:

MCSHH – Engaged in providing administrative and support services to its subsidiaries.

MCS Life – Engaged in offering group life and health insurance products for groups and individuals.

MCS-HMO – Provided comprehensive healthcare services under the MiSalud Program (MiSalud) (effective October 1, 2010 through June 30, 2011) and the Puerto Rico Health Reform Program (the Reform) (through September 30, 2010) through contracts with the Puerto Rico Health Insurance Administration (the Administration or ASES, for its Spanish acronym) to qualified subscribers on a prepaid basis. MCS-HMO contracts with independent professional associations (IPAs) and a network of providers to render medical services to its subscribers. MCS-HMO pays capitation to IPAs and negotiated fees for services rendered by providers.

In June 2011, MCS-HMO elected not to renew its MiSalud contract with the Administration and allowed it to expire as of June 30, 2011. MCS-HMO entered in a transition agreement with the Administration (effective July 1, 2011 through October 31, 2011) to serve the regions for a negotiated rate while allowing the Administration to contract with a new insurance company. As of December 31, 2018 and 2017, MCS-HMO is in a run-out period, as defined in the transition agreement, where it continues to pay claims incurred prior to November 1, 2011. MCS-HMO expects to complete the run-out period during 2019. Once completed, MCS-HMO will cease operations and remain inactive but maintain its certificate of authority in good standing.

MCS Advantage – Engaged in offering Medicare Advantage Plan (MA) insurance coverage pursuant to a contract with the U.S. Centers for Medicare and Medicaid Services (CMS), a Federal agency within the U.S. Department of Health and Human Services. Under the terms of this contract, CMS pays this subsidiary a fixed premium for each healthcare member of its coordinated care plan and this subsidiary provides the coverage to that member for the health services provided. The contract is for Medicare Advantage and Prescription Drugs (MAPD) plan. The contract is for a period of one year commencing January 1 and ending on December 31, and can be renewed for periods of one year, as defined in the contract. This contract was renewed effective January 1, 2019 for another one-year period.

MCS GIA – Operates as a general insurance agency in Puerto Rico. Engaged in selling accident and health insurance policies.

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MCS Life, MCS Advantage, and MCS-HMO operate under the provisions of the Insurance Code and Insurance Regulations of the Commonwealth of Puerto Rico. The Company and its subsidiaries are incorporated under the laws of the Commonwealth of Puerto Rico.

All of the Company's business activity is with clients within the Commonwealth of Puerto Rico, which exposes the Company to geographical risk.

The following summarizes the significant accounting policies followed in the preparation of the accompanying consolidated financial statements:

(a) Basis of Presentation and Consolidation

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) and include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The Company has no involvement with variable interest entities.

(b) Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make a number of estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include medical claim liabilities, the carrying amount of equipment and leasehold improvements, amounts due from/to CMS, valuation allowances for receivables and deferred income tax assets, Part-D related risk-sharing, and reinsurance estimates.

(c) Revenue Recognition

Individual and Group Health/Life:

Individual and group health and group life insurance premiums are recognized as revenue when earned. Premiums receivable are recorded at the invoiced amount and do not bear interest.

MCS charges self-insured groups administrative fees that are recorded as management service revenue when due. Service fees charged are based on contracted rates.

The Company adjusts revenues for estimated rebates to policyholders under the minimum benefit ratios required under the U.S. Health Insurance Reform Legislation. The Company estimates these policyholder rebates by projecting calendar year minimum benefit ratios for the individual, small group, and large group markets, as defined by the U.S. Health Insurance Reform Legislation using a methodology prescribed by the U.S. Department of Health and Human Services. No accrual was recorded at 2018 and 2017 since the Company met the minimum benefit ratios defined by the Health Insurance Reform Legislation.

Medicare Advantage Plan:

Substantially, all of the MCS Advantage revenue is received from CMS and ASES. Revenue is recorded ratably over the period of coverage based on anticipated CMS and ASES reimbursement rates and the

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number of eligible enrollees. Actual amounts received from CMS are subject to adjustment based on subsequent review of members' eligibility characteristics, reported terminations, or retroactive adjustments of reimbursement rates. Management periodically estimates such retroactive adjustments, including, premiums, number of members, eligibility characteristics, terminations, and other information. Retroactive membership adjustments result from enrollment changes not yet processed, or not yet reported by CMS.

Every year, CMS adjusts the premium base paid to Medicare Advantage Part D (MAPD) plans for risk factor considerations. These adjustments are related to the severity of the clinical condition of each member and are calculated by CMS using, for the most part, claims data from the prior year. Final risk factor adjustments for the year are paid on a lump-sum basis to account for the proper risk factor retroactively to the beginning of the year. Changes in revenues from CMS resulting from the periodic changes in risk adjustment scores for the Company's membership are recognized when the amounts become determinable and the collectibility is reasonably assured. Such estimates are regularly reviewed and updated and any resulting adjustments are included in the current period results.

The Company recognizes premium revenue for the Part D payments received from CMS for which it assumes risk. The Company does not record revenue related to Part D payments from CMS that represent payments for medical claims for which it assumes no risk (note 3).

In March 2010, the President of the United States of America signed into law The Patient Protection and Affordable Care Act and The Health Care and Education Reconciliation Act of 2010 (collectively referred to as the Health Insurance Reform Legislation), which enacted significant reforms to various aspects of the U.S. health insurance industry.

Certain significant provisions of the Health Insurance Reform Legislation include, among others, mandated coverage requirements and rebates to policyholders based on minimum benefit ratios. Implementation dates of the Health Insurance Reform Legislation began in September 2010 and continue through 2018.

(d) Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. Cash consisted primarily of cash deposited in financial institutions and money market funds. Cash equivalents in money market accounts amounted to approximately $7.1 million and $1.5 million at December 31, 2018 and 2017, respectively.

(e) Certificates of Deposit

The Company also has certain certificates of deposit with an original maturity of one year or less, which amounted to approximately $2.9 million and $2.3 million as of December 31, 2018 and 2017, respectively. Such amounts are carried at cost which approximates fair value.

(f) Investments

Investments in securities consist of U.S. Treasury securities and obligations of U.S. government instrumentalities, obligations of the Commonwealth of Puerto Rico and its instrumentalities, corporate debt securities, mortgaged-backed securities, corporate debt securities and equity securities. The Company classifies its debt securities in one of three categories: held-to-maturity, trading, or

available-for-sale and its equity securities that have readily determinable fair value into trading or available for sale. Held-to-maturity securities are those securities in which the Company has the ability and intent to hold the security until maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. All other securities not included in held to maturity and trading are classified as available-for-sale.

As of December 31, 2018 and 2017, all investment securities were classified as available-for-sale and recorded at fair value.

Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield, using the effective-interest method. Interest and dividend income are recognized when earned. Realized gains and losses from the sale of available-for-sale securities are included in operations and are determined on a specific-identification basis.

Investments classified as available-for-sale by the Company resulted in a net unrealized loss of $2,984,320 and $2,027,066 at December 31, 2018 and 2017, respectively, which are excluded from earnings and are reported as a separate component of accumulated other comprehensive income within stockholders' equity. Deferred income tax asset, net, of $596,865 and $405,420 were recognized at December 31, 2018 and 2017, respectively, related to such net unrealized losses.

The Company conducts periodic reviews to identify and evaluate each investment in an unrealized loss position for other-than-temporary impairments. The Company follows Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320-10-65-1, *Investment – Debt and Equity Securities*, which rules the accounting requirements for other-than-temporary impairments for debt securities, and in certain circumstances, separates the amount of total impairment into credit and noncredit-related amounts and expands the financial statement disclosures for other-than-temporary impairment on debt and equity securities. The review takes into consideration current market conditions, issuer rating changes and trends, the creditworthiness of the obligor of the security, current analysts' evaluations, failure of the issuer to make scheduled interest or principal payments, the Company's intent to not sell the security or whether it is more likely than not that the Company will be required to sell the debt security before its anticipated recovery, as well as other qualitative factors. The term "other-than-temporary impairment" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Any portion of a decline in value associated with credit loss is recognized in income with the remaining noncredit-related component being recognized in other comprehensive income (loss). A credit loss is determined by assessing whether the amortized-cost basis of the security will be recovered, by comparing the present value of cash flows expected to be collected from the security, computed using original yield as the discount rate, to the amortized-cost basis of the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized-cost basis is considered to be the "credit loss."

A decline in the fair value of any available-for-sale or held-to-maturity security below cost that is deemed to be other than temporary results in an impairment to reduce the carrying amount to fair value. To determine whether impairment is other than temporary, the Company considers all available information relevant to the collectibility of the security, including past events, current conditions, and

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reasonable and supportable forecasts when developing the estimate of cash flows expected to be collected. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end, forecasted performance of the investee, and the general market condition in the geographic area or industry the investee operates in.

(g) Contractual Health Services

Health services are provided by independent care providers such as hospitals, physicians, clinics, and others under contractual arrangements, including capitation arrangements. Services rendered to subscribers are billed to the Company and are paid on a fee-for-service or capitation basis up to established limits based on eligible members. These costs are accrued as services are rendered.

(h) Equipment and Leasehold Improvements, Net

Equipment and leasehold improvements are stated at cost, net of accumulated depreciation. Equipment under capital leases is stated at the present value of minimum lease payments. Maintenance and repairs are expensed as incurred.

Depreciation on equipment is calculated using the straight-line method over the estimated useful lives of the assets. Equipment held under capital leases and leasehold improvements are amortized on a straight-line basis over the shorter of the lease term or the estimated useful life of the asset.

(i) Long-Lived Assets

Long-lived assets, such as equipment and leasehold improvements, and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or asset group be tested for possible impairment, the Company first compares undiscounted cash flows expected to be generated by that asset or asset group to its carrying amount. If the carrying amount of the long-lived asset or asset group is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying amount exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values, and third-party independent appraisals, as considered necessary. No impairments of long-lived assets have been recognized in any of the periods presented.

(j) Medical Claim Liabilities and Medical Costs and Claims

Medical claim liabilities consist of the liability for reported medical claims and an estimate for medical claims incurred but not reported based on experience and accumulated statistical data. Loss-adjustment expenses related to such medical claims are accrued currently based on estimated future expenses necessary to process such medical claims. In addition, the Company contracts with various service providers, which are compensated based on a capitation basis.

The medical claim liabilities are necessarily based on estimates and, while management believes that the amounts are adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed, including periodic review by consulting actuaries, and any adjustments are reflected in the consolidated statements of operations of the current year.

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Medical costs and claims consist of claim payments, capitation payments, risk-sharing payments, and pharmacy costs, net of rebates as well as estimates of future payments of claims provided for services rendered prior to the end of the reporting period. Capitation payments represent monthly contractual fees disbursed to physicians and other providers who are responsible for providing medical care to members. Risk-sharing payments represent amounts paid under risk-sharing arrangements with providers, including independent physician associations. Pharmacy costs represent payments for members' prescription drug benefits, net of rebates from drug manufacturers. Rebates are recognized when the rebates are earned according to the contractual arrangements with the respective vendors. Premiums the Company pays to reinsurers are reported as an offset to premiums, and related reinsurance recoveries are reported as reductions from medical expenses.

During 2018, the Company adopted new accounting pronouncements, FASB ASC 944, *Disclosure about Short-Duration* Contracts. The same required the financial statements to disclose more information for GAAP purposes about the Company's claims liabilities.

(k) Income Taxes

Income taxes are accounted for under the asset-and-liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the consolidated statements of operations in the period that includes the enactment date. The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest related to unrecognized tax benefits in interest expense and penalties in general and administrative expenses.

During 2018, the Company adopted the Accounting Standards Update No. 2015-17, *Balance Sheet Classification of Deferred Taxes*. The amendments in this Update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. The amendments in this Update are effective for financial statements issued for annual period beginning after December 15, 2017. The Company adopted this Update prospectively, causing a reclassification of current deferred tax assets, net, to noncurrent assets. Prior period (2017) was not retrospectively adjusted.

(l) Allowance for Doubtful Receivables

Receivables, which are recorded net of an estimate of retroactive adjustments of reimbursable rates, are stated net of an allowance for doubtful accounts. The allowance for doubtful receivables is based on management's evaluation of the aging of accounts and such other factors that deserve current recognition. At December 31, 2018 and 2017, the allowance for doubtful receivables amounted to approximately $2.1 million and $2.0 million, respectively.

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(m) Fair Value Measurements

The Company determines the fair value of its financial instruments based on the Fair Value Measurement framework, which establishes a fair value hierarchy that prioritizes the inputs of valuation techniques used to measure fair value as provided by ASC Topic 820, *Fair Value Measurement*. ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820 also establishes a framework for measuring fair value and expands disclosures about fair value measurements. See note 5.

(n) Amounts Due from/to CMS

Amounts due from/to CMS represent the net amounts due from/to CMS for premiums receivables, risk-sharing, reinsurance, and coverage gap subsidies.

(o) Reinsurance

In accordance with general industry practices, MCS Life annually purchases reinsurance to protect itself from the impact of large unforeseen losses and prevent sudden and unpredictable fluctuations in net income and capitalization of their insurance operations. Reinsurance contracts do not relieve MCS Life from its obligations to policyholders. In the event that all or any of the reinsuring companies might be unable to meet obligations under existing reinsurance agreements, MCS Life would be liable for such defaulted amounts. MCS Life evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

(p) Stock-Based Compensation

The Company follows the provisions of FASB ASC Topic 718, *Compensation – Stock Compensation*, which establishes the accounting for employee stock-based awards. Under the provisions of ASC Topic 718, stock-based compensation is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the requisite employee service period (generally the vesting period of the grant). The Company adopted ASC Topic 718 using the modified-prospective method.

Under the modified-prospective method, ASC Topic 718 applies to new awards and to awards outstanding on the effective date that are subsequently modified or canceled. Compensation expense for outstanding awards for which the requisite service had not been rendered as of December 31, 2005 is being recognized over the remaining service period using the compensation cost calculated under ASC Topic 718. The Company amortizes the fair values of all awards on a straight-line basis over the total requisite service period. Cumulative compensation expense recognized at any date will at least equal the grant-date fair value of the vested portion of the award at that time.

Under ASC Topic 718, share-based compensation expense is based on the fair value of the portion of share-based payment awards that is ultimately expected to vest, reduced for estimated forfeitures at the time of grant, with subsequent revisions for differences between actual and the estimated forfeiture rates. The Company does not consider estimated forfeitures on its share-based compensation expense and accounts for forfeitures as they occur. It was determined that the effect of estimating future

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forfeitures would not be significant under the existing Stock Option Plans. ASC Topic 718 also requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows instead of operating cash inflows.

(q) Insurance-Related Assessments

MCS Life records liabilities for insurance-related assessments when the following three conditions are met: (1) the assessment has been imposed or the information available prior to the issuance of the consolidated financial statements indicates it is probable that an assessment will be imposed, (2) the event obligating an entity to pay (underlying cause of) an imposed or probable assessment has occurred on or before the date of the consolidated financial statements, and (3) the amount of the assessment can be reasonably estimated. MCS Life also considers the recognition of an asset when the paid or accrued assessment is recoverable through policy surcharges. There were no assessments during 2018 and 2017.

(r) Operating Leases

The Company recognizes rent expense from operating leases with periods of free and scheduled rent increases on a straight-line basis over the applicable lease term. The Company considers lease renewals in the useful life of its leasehold improvements when such renewals are reasonably assured.

(s) Commitments and Contingencies

Liabilities for loss contingencies arising from claims, assessments, litigation, fines and penalties, and other sources are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred.

(t) Advertising Cost

Advertising costs are expensed as incurred. Total amount charged to advertising expense for the period is approximately $7.6 million and $4.8 million in 2018 and 2017, respectively, and is included in general and administrative expenses.

(2) Medicare Payment System

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) made numerous changes to the Medicare payment system. Under the Medicare risk adjustment formula, MA plans are paid by CMS based on a member's health condition.

CMS uses a risk adjustment process to modify Medicare Advantage plan payments to better reflect the relative risk of each enrollee. Payments to each MA plan are modified based on risk scores that reflect the enrollee's health status and demographic characteristics derived from member claims data. MA plans are currently transitioning from the traditional Risk Adjustment Processing System (RAPS) – where risk adjustment filter rules are applied by health plan to the new Encounter Data System (EDS) where Medicare Advantage Organizations (MAOs) submit their members' claims and CMS applies the filtering logic.

At December 31, 2018 and 2017, the Company has estimated Medicare risk adjustment revenue due from CMS of approximately $58.7 million and $30.4 million, respectively, and is reflected as a component of amounts due from the Centers for Medicaid and Medicare Services in 2018 and amounts due to the

Centers for Medicaid and Medicare Services in 2017 in the accompanying consolidated balance sheets based on an analysis of the health status of its members.

The amount of Medicare risk adjustment revenue recorded is subject to future adjustment based on the final determination by CMS of the amounts actually due to the Company. Management believes that the estimated Medicare risk adjustment revenue due from CMS is reasonable and that the actual settlement would not result in a significant deviation in relation to the financial position and results of operations of the Company.

During 2018, the Company collected approximately $30.4 million associated with the 2017 Medicare risk adjustment. During 2017, the Company collected approximately $36.5 million associated with the 2016 Medicare risk adjustment.

(3) Accounting for Prescription Drugs Benefit under Medicare Part D

The Company provides Medicare prescription drug coverage to eligible members. In general, pharmacy benefits under Part D plans (collectively referred to as Part D plans) may vary in terms of coverage levels and out-of-pocket costs for beneficiary premiums, deductibles, and coinsurance. However, all Part D plans must offer either "standard coverage" or its actuarial equivalent (with the Company's out-of-pocket threshold and deductible amounts that do not exceed those of standard coverage). These "defined standard" benefits represent the minimum level of benefits mandated by the U.S. Congress.

The payment the Company receives monthly from CMS generally represents the Company's bid amount for providing insurance coverage. The Company recognizes premium revenue for providing this insurance coverage ratably over the term of the annual contract. However, the payment is subject to 1) risk sharing through the risk corridor provisions, 2) reinsurance subsidy in order for the Company and CMS to share the risk associated with financing the ultimate costs of the Part D benefit, and 3) CMS coverage gap discount program (CGDP) subsidy.

The amount of revenue payable to a plan by CMS is subject to adjustment, positive or negative, based upon the application of risk corridors that compare a plan's revenues targeted in their bids (target amount) to actual prescription drug costs. Variances exceeding certain thresholds may result in CMS making additional payments to the Company (risk-sharing receivable) or require the Company to refund to CMS (risk-sharing payable) a portion of the payments the Company received. Actual prescription drug costs subject to risk sharing with CMS are limited to the costs that are, or would have been, incurred under the CMS "defined standard" benefit plan (allowable risk corridor costs). The Company recognizes any changes in the risk-sharing receivable from or payable to CMS as an adjustment to premium revenue.

Reinsurance subsidies represent reimbursements from CMS for claims the Company paid for which the Company assumed no risk, including reinsurance payments. Claims paid above the out-of-pocket or catastrophic threshold for which the Company is not at risk are all reimbursed by CMS through the reinsurance subsidy for Part D plans offering the standard coverage. The Company accounts for these subsidies as a reinsurance receivable or liability recorded within the amount due from CMS or amount due to CMS in the accompanying consolidated balance sheets, and as a financing activity in the Company's consolidated statements of cash flows. The Company does not recognize premium revenue or claims expense for these CMS subsidies.

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Part D sponsors must provide the discounts for applicable drugs in the Medicare Part D coverage gap (difference between the initial coverage limit and the catastrophic coverage threshold) at point of sale under the CGDP. Part D sponsors receive monthly prospective payments from CMS under the CGDP. These prospective payments provide cash flows to Part D sponsors for advancing the gap discounts at the point of sale. The Company accounts for these prospective payments or subsidies as a liability in the accompanying consolidated balance sheets and as a financing activity in the consolidated statements of cash flows. For the years ended December 31, 2018 and 2017, CGDP payments made monthly by CMS to MCS were lower than the actual gap discounts incurred and paid by MCS on behalf of CMS, resulting in a receivable from CMS (approximately $3.3 million and $1.8 million at December 31, 2018 and 2017, respectively) reported as part of amounts due from/to CMS in the accompanying consolidated balance sheets.

On a quarterly basis, CMS invoices manufacturers for discounts provided by Part D sponsors that are recorded as an account receivable from manufacturers as part of premiums, trade, and other receivables, net in the accompanying consolidated balance sheets. The manufacturers remit payments for invoiced amounts directly to Part D sponsors. The prospective payments made to Part D sponsors are reduced by the discount amounts invoiced to manufacturers. For the years ended December 31, 2018 and 2017, the discount amounts invoiced to manufacturers exceeded the reductions applied by CMS to the prospective payments received, causing the Company to have an outstanding payable to CMS (approximately $10.4 million and $7.2 million at December 31, 2018 and 2017, respectively) reported within amounts due from (to) CMS in the accompanying consolidated balance sheets. The Company does not recognize premium revenue or claims expense for these CMS prospective payments or invoiced amounts to manufacturers.

These estimates of amounts due to or from CMS are primarily determined on the prescription drug benefit claim data submitted by plans to CMS in the form of Prescription Drug Event (PDE) data records. The Company used PDE submission reports and data, claims paid data, and actuarial assumptions pursuant to CMS risk-sharing and reinsurance guidelines in order to estimate the final settlement of amounts due to or from CMS.

At December 31, 2018 and 2017, the Company recorded a Part D risk-sharing payable of approximately $5.0 million and $6.8 million, respectively, as a component of the amounts due from (to) CMS in the accompanying consolidated balance sheets. At December 31, 2018 and 2017, the Company recorded a payable of approximately $8.0 million and $20.2 million, respectively, for Part D reinsurance subsidies reported as part of amounts due from/to CMS in the accompanying consolidated balance sheets.

The final net amount paid by the Company in 2018 for risk-sharing and reinsurance subsidy related to 2017 was approximately $25.8 million. The Company is still pending to pay a portion of the subsidy related to prior periods.

The Part D related accounting estimates for risk sharing and reinsurance due to or from CMS are necessarily based on estimates and, while management believes that amounts are adequate, the ultimate asset or liability may be in excess of or less than the amount provided. The methodology for making such estimates and for establishing the resulting assets or liabilities are continually reviewed, and adjustments, if any, are reflected in the current year. The final Part D related estimates due to or from CMS are determined within one year after the contract year-end.

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The Company also receives premiums to enhance the drug benefit coverage to Medicaid-eligible members under the Medicare Platino Program sponsored by ASES.

Pharmacy benefit costs are recognized as incurred. The Company has subcontracted the pharmacy claims administration to a third-party pharmacy benefit manager.

(4) Investment in Securities

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of investment in securities, all of which are classified as available-for-sale, at December 31, 2018 and 2017 were as follows:

	2018			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. Treasury securities and obligations of U.S. government instrumentalities and States	$ 273,851,411	40,664	(3,039,745)	270,852,330
Obligations of the Commonwealth of PR and its instrumentalities	644,732	—	—	644,732
Corporate debt securities	12,815,356	74,312	(177,595)	12,712,073
Mortgage-backed securities	1,792,325	9,291	(17,719)	1,783,897
Subtotal	289,103,824	124,267	(3,235,059)	285,993,032
Common and preferred stocks	251,464	126,472	—	377,936
Total	$ 289,355,288	250,739	(3,235,059)	286,370,968

	2017			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. Treasury securities and obligations of U.S. government instrumentalities and States	$ 216,171,494	36,510	(2,275,174)	213,932,830
Corporate debt securities	10,479,780	120,559	(36,551)	10,563,788
Mortgage-backed securities	1,931,794	34,808	(14,904)	1,951,698
Subtotal	228,583,068	191,877	(2,326,629)	226,448,316
Common and preferred stocks	251,464	107,686	—	359,150
Total	$ 228,834,532	299,563	(2,326,629)	226,807,466

(Continued)

The amortized cost and estimated fair value of the investment in debt securities at December 31, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties:

	Amortized cost	Fair value
Due less than one year	$ 69,929,714	69,709,099
Due after one year through five years	216,413,531	213,461,630
Due after five years through ten years	121,157	145,697
Due after ten years	847,097	892,709
Mortgage-backed securities	1,792,325	1,783,897
Subtotal	$ 289,103,824	285,993,032

Amortized cost exceeds the estimated fair value of certain investments at December 31, 2018 and 2017. Write-downs for impairment of securities of the Commonwealth of Puerto Rico and its instrumentalities, which are deemed to be other than temporary impaired primarily due to the continued deterioration in the credit of this issuer, amounted to $1,711,193 during the year ended December 31, 2017, and is recorded in investment income, net in the accompanying consolidated statements of operations. There were no impairment of securities in 2018.

The following tables show the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2018 and 2017:

	2018					
	Less than 12 months		12 months or more		Total	
	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
U.S. Treasury securities and obligations of U.S. government instrumentalities and States	$ 42,549,826	(34,245)	213,467,789	(3,005,500)	256,017,615	(3,039,745)
Corporate debt securities	399,356	(274)	9,933,090	(177,321)	10,332,446	(177,595)
Mortgage-backed securities	835,515	(3,811)	552,786	(13,908)	1,388,301	(17,719)
Total	$ 43,784,697	(38,330)	223,953,665	(3,196,729)	267,738,362	(3,235,059)

	2017					
	Less than 12 months		12 months or more		Total	
	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
U.S. Treasury securities and obligations of U.S. government instrumentalities and States	$ 160,991,990	(1,458,870)	45,910,116	(816,304)	206,902,106	(2,275,174)
Corporate debt securities	9,127,680	(36,551)	—	—	9,127,680	(36,551)
Mortgage-backed securities	102,773	(2,438)	524,281	(12,466)	627,054	(14,904)
Total	$ 170,222,443	(1,497,859)	46,434,397	(828,770)	216,656,840	(2,326,629)

For those debt securities for which the fair value of the security is less than its amortized cost, the Company does not intend to sell such security, and it is more likely than not that it will not be required to sell such security prior to the recovery of its amortized-cost basis less any current period credit losses.

The unrealized losses on investments in fixed income securities were caused mainly by changes in interest rates during 2018 and 2017. This had negative implications for fixed income securities prices. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Because the Company does not intend to sell and it is more likely than not that it will not be required to sell such securities prior to the recovery of its amortized cost or maturity, these investments are not considered other-than-temporarily impaired.

Factors considered in determining whether a loss is temporary include the following:

- The length of time and the extent to which fair value has been below cost
- The severity of the impairment
- The cause of the impairment and the financial condition and near-term prospects of the issuer
- Activity in the market of the issuer, which may indicate adverse credit conditions
- The Company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery

The Company's review for impairment generally entails the following:

- Identification and evaluation of investments that have indications of possible impairment
- Analysis of individual investments that have fair values less than amortized cost, including consideration of the length of time the investment has been in an unrealized loss position and the expected recovery period
- Discussion of evidential matter, including an evaluation of factors or triggers that could cause individual investments to qualify as having other-than-temporary impairment and those that would not support other-than-temporary impairment
- Documentation of the results of these analyses, as required under business policies

(Continued)

Proceeds from the sale and redemption of investment securities classified as available-for-sale during 2018 and 2017 amounted to $48,173,028 and $7,550,730, respectively, which resulted in gross realized gains of $116,081 in 2017 and gross realized losses of $693,220 in 2017, reported as investment income, net in the accompanying consolidated statements of operations. There were no gross realized gains nor losses in 2018.

Certificates of deposit of $2,463,233 and $2,459,058, respectively, were deposited with the Office of the Commissioner of Insurance of Puerto Rico (the Commissioner of Insurance) to comply with the deposit requirements of the Insurance Code of the Commonwealth of Puerto Rico at December 31, 2018 and 2017.

(5) Fair Value Measurements

(a) Fair Value of Financial Instruments

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2018 and 2017:

	2018		2017	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets:				
Cash and cash equivalents	$ 84,549,291	84,549,291	170,610,451	170,610,451
Certificates of deposit	2,936,817	2,936,817	2,328,167	2,328,167
Investment securities	286,370,968	286,370,968	226,807,466	226,807,466
Receivables:				
Premiums, trade, and other, net	37,698,297	37,698,297	27,167,574	27,167,574
Amounts due from Centers for Medicaid and Medicare Services	37,271,732	37,271,732	—	—
Accrued interest receivable	1,847,340	1,847,340	1,086,812	1,086,812
Financial liabilities:				
Medical claim liabilities	162,221,308	162,221,308	163,252,518	163,252,518
Accounts payable and accrued expenses	65,233,426	65,233,426	57,041,777	57,041,777
Amounts due to Centers for Medicaid and Medicare Services	—	—	7,146,876	7,146,876
Long-term debt	155,777,717	155,777,717	165,382,596	165,382,596

The fair values of the financial instruments shown in the above table as of December 31, 2018 and 2017 represent management's best estimates of the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Company's own judgments about the

assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Company based on the best information available in the circumstances.

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

- Cash and cash equivalents, certificates of deposit, premiums, trade and other receivables, net, amounts due from/to CMS, accrued interest receivable, medical claim liabilities and accounts payable and accrued expenses: The carrying amounts approximate fair value because of the short maturity of these instruments.
- Investment securities: Equity securities classified as available-for-sale are measured using quoted market prices at the reporting date multiplied by the quantity held. Debt securities classified as available-for-sale are measured using quoted market prices multiplied by the quantity held when quoted market prices are available.
- Long-term debt: the long-term debt is not mark-to-market and is shown in the accompanying consolidated balance sheet at cost basis. The estimated fair value of the Company's long-term debt approximate carrying value based on its short maturity period (2019).
- Obligation under capital lease: The estimated fair value of the Company's indebtedness as of December 31, 2017 approximates carrying value based on the remaining maturity period of this instrument. There were no obligation under capital lease as of December 31, 2018.

(b) Fair Value Hierarchy

The fair value measurement framework establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

(Continued)

The following tables present assets and liabilities that are measured at fair value on a recurring basis (including items that are required to be measured at fair value and items for which the fair value option has been elected) at December 31, 2018 and 2017:

	Fair value measurements at December 31, 2018			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
U.S. Treasury securities and obligations of U.S. government instrumentalities and states	$ —	270,852,330	—	270,852,330
Obligations of the Commonwealth of PR and its instrumentalities	—	644,732	—	644,732
Corporate debt securities	—	12,712,073	—	12,712,073
Mortgage-backed securities	—	1,783,897	—	1,783,897
Common and preferred stocks	—	377,936	—	377,936
Certificates of deposit	2,936,817	—	—	2,936,817
Money market funds	7,101,470	—	—	7,101,470
	$ 10,038,287	286,370,968	—	296,409,255

	Fair value measurements at December 31, 2017			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Assets:				
U.S. Treasury securities and obligations of U.S. government instrumentalities and states	$ —	213,932,830	—	213,932,830
Corporate debt securities	—	10,563,788	—	10,563,788

(Continued)

	Fair value measurements at December 31, 2017 (continued)			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Mortgage-backed securities	$ —	1,951,698	—	1,951,698
Common and preferred stocks	—	359,150	—	359,150
Certificates of deposit	2,328,167	—	—	2,328,167
Money market funds	1,540,567	—	—	1,540,567
	$ 3,868,734	226,807,466	—	230,676,200

(6) Investment Income, Net

Components of net investment income, including realized gains and losses on sale of securities for the years ended December 31, 2018 and 2017 were as follows:

	2018	2017
Short-term investments	$ 2,240,760	680,792
Bonds	4,699,454	1,813,323
Other-than-temporary impairment	—	(1,711,193)
Real capital gain (losses)	1,182,357	—
Other	830,284	317,924
Common and preferred stocks	24,778	82,230
	8,977,633	1,183,076
Less investment expenses	342,597	209,779
	$ 8,635,036	973,297

During 2018, the Company collected principal amount from an investment security issued by an instrumentality of the Commonwealth of Puerto Rico in the amount of $1,182,357, which was previously considered other than temporarily impaired. The resulting capital gain was reported for the same amount in the accompanying statement of income.

(7) Reinsurance Activity

In accordance with general industry practices, the Company annually purchases reinsurance to protect from the impact of large unforeseen losses and prevent sudden and unpredictable fluctuations in net income and capitalization of its insurance operations. Reinsurance contracts do not relieve the Company from its obligations to policyholders. In the event that the reinsurance company might be unable to meet its

(Continued)

obligations under existing reinsurance agreements, the Company would be liable for such defaulted amounts. The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

The Company cedes all risk under health insurance policies for the commercial business only in excess of $500,000 per insured person, per calendar year, and per policy, covering catastrophic conditions such as cancer, neonatal conditions, and organ transplants. The maximum reinsured benefit is $2 million per covered person, per contract year.

In the case of life insurance policies, the Company retains the first $30,000 and cedes 100% of the risks in excess of $30,000 per insured, per policy on life, waiver of premium, and accidental death and dismemberment insurance. The maximum reinsured benefit for life, waiver of premium, and accidental death, and dismemberment insurance varies with the size and insured lives of the groups.

There was no reinsurance recoverable in 2018 and 2017.

The effect of reinsurance on premiums earned for the years ended December 31, 2018 and 2017 was as follows:

	2018	2017
Gross	$ 2,216,862,446	2,001,933,460
Ceded	(1,986,280)	(1,400,980)
Net premium earned	$ 2,214,876,166	2,000,532,480

(8) Equipment and Leasehold Improvements, Net

Equipment and leasehold improvements as of December 31, 2018 and 2017 consist of the following:

	Useful lives in years	2018	2017
Furniture and fixtures	10	$ 5,002,700	4,584,857
Computer and communication equipment (note 15)	5	8,047,393	8,876,239
Software	3	25,744,553	22,759,392
Leasehold improvements	3	6,372,285	5,861,024
Other assets	5	313,785	381,919
		45,480,716	42,463,431
Less accumulated depreciation and amortization		(36,275,585)	(33,584,946)
Equipment and leasehold improvements, net		$ 9,205,131	8,878,485

(Continued)

(9) Medical Claim Liabilities

The activity in the medical claim liabilities during 2018 and 2017 is as follows:

	2018	2017
Medical claim liabilities at beginning of year	$ 163,252,518	159,375,987
Incurred claims:		
Current period events	1,863,722,565	1,699,536,180
Prior period events	(16,573,263)	(22,651,246)
Total incurred	1,847,149,302	1,676,884,934
Payment for claims:		
Current period insured events	1,714,853,360	1,550,959,003
Prior period insured events	133,327,152	122,049,400
Total paid	1,848,180,512	1,673,008,403
Medical claim liabilities at end of year	$ 162,221,308	163,252,518

The above table shows the components of changes in medical claim liabilities. Medical claim liabilities include claims in process as well as provisions for the estimate of incurred but not reported claims and provisions for disputed claims obligations. Such estimates are computed using actuarial principles and assumptions that consider among other things, contractual requirements, historical utilization trends and payment patterns, benefit changes, medical inflation, seasonality, membership, and other relevant factors.

Because medical claims liabilities includes various actuarially developed estimates, the Company's actual medical costs and claims expense may be more or less than the Company's previously developed estimates. As a result of changes in estimates of insured events in prior years, the incurred claims for prior period insured events during 2018 and 2017 were lower due to a favorable development of medical claim liability that is attributable to lower than expected cost per service and trends. Management believes that the amount of medical claims liabilities is reasonable and adequate to cover the Company's liability for

(Continued)

unpaid medical claims and for medical claims incurred but not yet reported as of December 31, 2018 and 2017.

Incurred claims and allocated claims adjustment expenses, net of reinsurance				As of December 31, 2018
	Incurred amount			
Incurred year	2016	2017	2018	Total of IBNR liabilities plus expected development of reported claims
2016	$ 1,790,174,823	$ 1,775,500,310	$ 1,767,566,969	$ 3,052,259
2017		1,699,536,180	1,693,507,965	6,139,119
2018			1,863,722,565	148,869,205
			Total $ 5,324,797,499	

Cumulative paid claims and allocated claim adjustments expenses, net of reinsurance			
Incurred year	2016	2017	2018
2016	$ 1,643,092,098	$ 1,765,141,498	$ 1,764,514,713
2017		1,550,959,003	1,687,368,843
2018			1,714,853,360
		Total	5,166,736,916
All outstanding liabilities before 2016, net of reinsurance			4,160,725
Liabilities for claims and claims adjustment expense, net			$ 162,221,308

(10) Indebtedness

Senior Secured Term Loan Facility

In September 2010, the Company repaid all borrowings outstanding and canceled all commitments under its term loan facility with Banco Popular de Puerto Rico and replaced such facility with a new $175 million five-year senior secured term loan facility (the Term Loan) with Jefferies Finance LLC as administrative agent and collateral trustee. On September 6, 2012, U.S. Bank National Association substituted Jefferies Finance LLC as administrative agent and collateral trustee under the Term Loan.

During 2015, the Company negotiated a series of amendments to the Term Loan which, among other things, extended the final maturity date from September 17, 2015 to March 17, 2017, deferred principal and interest payments to December 30, 2015 and amended the interest rate applicable to the Term Loan.

On January 20, 2016, the Company and the Lenders, among others, entered into a Restructuring and Exchange Agreement (the Exchange Agreement) pursuant to which, among other things, (i) the Term Loan

was restructured pursuant to an Amended and Restated Credit Agreement dated January 20, 2016 (the A&R Credit Agreement), (ii) the Company agreed to contribute substantially all of its operating assets, agreements and obligations to a newly formed subsidiary, MCS Healthcare Holdings, LLC, (MCS HH) as a contribution to capital in exchange for 100% of the membership interests in the same, (iii) the Company agreed to amend its articles of incorporation, (iv) 28,876,807 of the Company's common shares were issued to the Lenders, and (v) the Lenders agreed to exercise their Company warrants (note 12). Under the A&R Credit Agreement, the Company and MCS HH were coborrowers of the long-term debt. As of September 30, 2015, there was $135,305,431 aggregate principal amount of the Term Loan outstanding, and $28,870,139 of accrued interest and fees owed under the related loan. As part of the Exchange Agreement, all outstanding interest, fees and expenses owed under the Term Loan as of September 30, 2015 were capitalized and added to the principal amount. As of January 20, 2016, there was $135,305,431 aggregate principal amount of the Term Loan outstanding, and $36,065,472 of accrued interest and fees owing under the related loan. As of December 31, 2018 and 2017, the aggregate principal amount of term loans outstanding under the Term Loan was $155,777,717 and $165,382,596, respectively. During 2018 and 2017, the Company recorded deferred interest expenses of approximately $352 thousand and $1.2 million that resulted from the restructuring transaction which are amortized into expense over the life of the debt.

During the years ended December 31, 2018 and 2017, the Company amortized and recorded $854,879 and $849,224, respectively, as part of interest expense.

Under the A&R Credit Agreement the principal portion of the Term Loan will not amortize. The outstanding principal balance of the Term Loan will be due on the final maturity date, May 31, 2019, and later extended to August 31, 2019 as further discussed below. The A&R Credit Agreement contained customary affirmative and negative covenants, guarantees, collateral, including the pledge of the capital stock of the subsidiaries of MCS, and events of default.

Also, MCS HH and MCS GIA became guarantors under the original security documents relating to the A&R Credit Agreement after subscribing a Reaffirmation, Amendment and Joinder Agreement dated January 20, 2016.

On June 29, 2018, the Company and the Lenders, among others, entered into the First Amendment and Waiver to the Amended and Restated Credit Agreement, whereby the Lenders, among other things, (i) extended the Loan Maturity Date to August 31, 2019, (ii) modified the interest rate of the Term Loan to 5.5% from January 1, 2018 to May 31, 2019, and to 7.5% after June 1, 2019, (iii) established special principal payments of $8,750,000 on June 29, 2018 and $10,000,000 on May 31, 2019, and (iv) waived the Event of Default caused by the failure to deliver the 2017 Audited Financial Statements within 150 days after year end.

On August 13, 2019, the Company repaid the principal outstanding as of that date of $145,425,570 and canceled all commitments under its Term Loan facility. On that same date, MCS HH replaced such facility with a new $100 million seven-year (the New Term Loan) under a Credit Agreement (the Credit Agreement) with Banco Popular as administrative agent (the Administrative Agent) and collateral trustee.

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Summary of the relevant provisions of the Credit Agreement follows:

Interest rate – The New Term Loan under the Credit Agreement shall bear a fluctuating interest equal to the 30-day LIBOR rate plus the applicable margin set forth in the following table:

Consolidated debt to EBITDA ratio	Applicable margin
Equal to or > 2.00:1	4.50 %
Equal to or > 1.25:1.00 but < 1.99:1.00	4.00
Equal to or > 0.75:1.00 but < 1.24:1.00	3.75
Below 0.74:1.00	3.50

As of August 13, 2019 (date of the initial loan disbursement) and until after the receipt by the Administrative Agent of the first set of audited financial statements and certificates delivered pursuant to the Credit Agreement, the applicable margin shall be 4.00% per annum. Any change in the Consolidated Debt to EBITDA Ratio shall be effective prospectively (with no retroactivity or claw-back) to adjust the applicable margin on the first day of the next succeeding calendar month after receipt by the Administrative Agent of the audited financial statements and certificates most recently delivered pursuant to the Credit Agreement.

Default rate – In case of any event of default, the unpaid principal balance under the Credit Agreement shall bear interest at a rate per annum equal to 2% over the applicable interest rate. Such rate shall be effective from the date of the default until the default is cured.

Mandatory Prepayments – Subject to certain conditions and exceptions in each case, MCS HH must make mandatory prepayments of the New Term Loan with the proceeds of (i) asset dispositions, which are not reinvested within 270 days, (ii) casualty insurance condemnation awards, which are not reinvested within 270 days, and (iii) upon the occurrence of a change in control.

Voluntary Prepayments – The senior secured term loan facility provides for voluntary prepayments of the New Term Loan, subject to certain conditions and restrictions.

Prepayment Premiums – Unless the prepayment is made by MCS HH with internally-generated cash, until the second anniversary of the Credit Agreement, mandatory and optional prepayments will be subject to prepayment premiums of up to 2%.

Covenants – The term loan facility under the Credit Agreement contains affirmative and negative covenants that, among other things, limit or restrict the ability of MCS HH and its subsidiaries to (in each case, subject to certain carve-outs and exceptions): create liens and encumbrances; incur debt; merge, dissolve, liquidate, or consolidate; make acquisitions and investments; dispose of or transfer assets; pay dividends or make other payments in respect of the capital stock of MCS HH; amend material documents; change the nature of its business; make certain payments of debt; engage in certain transactions with affiliates; enter into sale/leaseback transactions; and make capital expenditures.

Financial Covenants – The term loan facility under Credit Agreement contains customary financial covenants which require MCS HH to maintain certain ratios as of the last day of each fiscal quarter of each fiscal year (calculated on a trailing four quarter basis). In addition, under the Credit Agreement, MCSHH

(Continued)

shall cause its regulated subsidiaries to maintain at all times a risk based capital of not less than the amount required to be in compliance with applicable legal requirements

Guarantees and Collateral – The obligations of MCS HH under the Credit Agreement are guaranteed by all of the current and future wholly owned subsidiaries of MCSHH, except any subsidiary for which the giving of such guarantee (i) is not permitted by law, regulation, or contract, which, in the case of this clause (ii) include, without limitation, the following licensed subsidiaries of MCS: MCS-HMO, MCS Life and MCS Advantage. The obligations of MCS HH in respect to the New Term Loan are secured by a first priority security interest in substantially all of the material assets of MCS HH (the Collateral). The Collateral included a pledge of all the capital stock of MCS Advantage.

Events of Default – The term loan facility under the Credit Agreement contains customary events of default such as nonpayment of obligations under the New Term Loan, violation of affirmative and negative covenants, material inaccuracy of representations, defaults under other material debt, bankruptcy, ERISA, and judgment defaults and change of control.

Maturity Date – The term loan facility under Credit Agreement has a maturity date equal to the seventh (7th) anniversary from the effective date, August 13, 2019; however, that if such date is not a business day, the Maturity Date shall be the immediately preceding Business Day.

Repayment – The term loan facility under the Credit Agreement state that the aggregated principal amount of the Term Loan Note shall be payable in eighty three (83) consecutive equal monthly installments of principal to be calculated based on a ten (10) year amortization schedule and one final installment of principal that shall be in the amount necessary to repay in full the unpaid principal amount of the Term Loan Facility and all amounts outstanding under the Term Loan Note. Payment of the aggregate outstanding principal amount of the Term Loan Facility Notes shall commence on the first (1st) day of the first calendar month to occur immediately after the effective Date and shall continue on the first day of each calendar month thereafter until and including the Maturity Date. The following represents the schedule of future repayment of the long-term:

Year	Repayment Previous Credit Agreement	Repayment New Credit Agreement	Total
2019	$ 55,777,717	$ 3,333,333	$ 59,111,050
2020	—	10,000,000	10,000,000
2021	—	10,000,000	10,000,000
2022	—	10,000,000	10,000,000
2023	—	10,000,000	10,000,000
2024	—	10,000,000	10,000,000
2025	—	10,000,000	10,000,000
2026	—	36,666,667	36,666,667
			$ 155,777,717

(11) Income Taxes

The Company files its income tax return in Puerto Rico. According to local tax authority statutes of limitation dispositions, years 2014 through 2017 remain open for examination.

Under the Puerto Rico income tax law, the Company is not allowed to file consolidated tax returns with its subsidiaries.

Domestic insurance companies in Puerto Rico, as defined in the Insurance Code, are taxed either as a qualified domestic life insurance company or as an other-than-life insurance company. The Puerto Rico Internal Revenue Code, as amended (the Code) requires that in order to be treated as a domestic life insurance company, the Company should comply with certain requirements. Life insurance companies are taxed on its capital gains and are subject to alternative minimum tax, whereas other-than-life insurance companies are taxed similar to regular corporations; that are, subject to regular income tax, but with taxable income determined on the basis of the statutory annual statements filed with insurance regulatory authorities. During 2018 and 2017, MCS Life operated as a qualified domestic life insurance company, as defined by the Code. Any alternative minimum tax paid may be used as a credit against the excess, if any, of regular income tax over the alternative minimum tax in future years.

MCS-HMO and MCS Advantage are taxed as other-than-life insurance companies. Also, operations are subject to an alternative minimum income tax.

MCS HH elected to be treated as a partnership, therefore, considered a pass-through entity for income taxes.

MCS, Inc. and MCS GIA are subject to regular income tax and alternative minimum tax. The income tax expense (benefit) for the years ended December 31, 2018 and 2017 was composed of the following:

	2018	2017
Current	$ 28,995,350	40,966,627
Deferred	13,372,661	(14,472,887)
	$ 42,368,011	26,493,740

(Continued)

The income tax expense (benefit) differs from the amount computed by applying the Puerto Rico statutory income tax rate of 39% in 2018 and 2017 to the income before taxes as a result of the following:

	2018	2017
Computed "expected" tax expense	$ 38,104,837	47,151,900
Reduction in income taxes resulting from:		
Exempt interest income	(2,051,873)	(772,816)
Change in valuation allowance	8,498,278	(3,324,069)
Effect of being taxed as a qualified domestic life insurance company	(1,418,638)	(9,915,134)
Tax rate differential	626,283	(6,219,904)
Other disallowances and nondeductible expenses, net	(1,390,876)	(426,237)
Total income tax expense	$ 42,368,011	26,493,740

Deferred income taxes reflect the tax effects of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and income tax purposes. The tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities at December 31, 2018 and 2017 are presented below:

	2018	2017
Gross deferred tax assets:		
Allowance for doubtful receivables	$ 775,420	779,806
Net operating loss	15,441,589	19,018,092
Accrued expenses	215,493	2,350,389
Unrealized loss on available-for-sale securities	597,157	405,869
Net realized losses on sale of securities and impairment charges	603,067	536,507
Alternative minimum tax credits	11,168,233	10,393,391
Total gross deferred tax assets	28,800,959	33,484,054
Less valuation allowance	(26,310,214)	(17,811,936)
Net deferred tax assets	2,490,745	15,672,118
Gross deferred tax liabilities:		
Unrealized gain on available-for-sale securities	(292)	(449)
Net deferred tax asset	$ 2,490,453	15,671,669

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities (including the impact of available carryforward periods), projected future taxable income, and

(Continued)

tax-planning strategies in making this assessment. The alternative minimum tax credits and the allowance for doubtful accounts are mostly related to the results of the stand-alone operations of MCS Life and the Company. Based upon the level of historical taxable income and projections for future taxable income and losses considering that life insurance companies are taxed on capital gains and alternative minimum tax, management believes that it is more likely than not that MCS Life will not realize the benefits of these future deductible benefits and has established a valuation allowance for its corresponding deferred tax assets at December 31, 2018 and 2017. The net operating loss is related to the results of the stand-alone operations of MCS Inc., MCS HMO, and MCS GIA. Based upon the fact that MCS-HMO elected not to renew its MiSalud contract with the Administration and allowed it to expire as of June 30, 2011, management believes it is more likely than not that the Company will not realize the benefits of these deductible differences, net of the existing valuation allowance at December 31, 2018. In the case of the stand-alone operations of MCS, Inc. a valuation allowance is provided because changes in the Puerto Rico tax code of a corporate partner who holds, directly or indirectly, fifty (50) percent or more interest in the capital or the interest in the benefits of a partnership, or a special partnership, cannot claim the deduction for net loss on the operations of previous years against this company distributable income. In the case of the stand-alone operations of MCS GIA, management does not expect to realize this deductible difference and provided for a valuation allowance.

In December 2018, the Puerto Rico government enacted Act 257-2018 which, among other changes, (i) reduced the maximum corporate income tax rate to 37.5% in 2019, from 39%, (ii) increased the net operating losses deduction and carry forward deduction to 90% of taxable income, previously 80%, (iii) included a restriction of the use of partnership gains to offset current and accumulated operating losses generated by a corporate partner, (iv) required that the corporate income tax returns of "large taxpayers" be certified as prepared or reviewed by a Puerto Rico licensed certified public accountant, (v) increased the limitation on the partnership or special partnership loss deduction to 90% (from 80%) of the aggregated net income of partnerships or special partnerships, (vi) increased the limitation of capital losses carryover to 90% (previously 80%) of capital gains for the taxable year, and (vii) amended the formula to compute the alternative minimum tax (AMT), which now would be the greater of $500 or 23% of the AMT taxable income (previously 30%).

As of December 31, 2018, the expiration of the Company's regular net operating losses (NOL), and capital losses is as follows:

Expiration date		NOL amount	Capital losses amount
2021	$	—	53,899
2022		—	39,586
2023		17,730,172	2,773,775
2024		411,612	—
2025		22,475,036	—
2026		322,569	—
2027		226,692	—
2028		11,490	—
Total	$	41,177,571	2,867,260

(Continued)

(12) Capital Stock

At December 31, 2018 and 2017, the common stock of the Company was $6,225.

At December 31, 2018 and 2017, there are 300,000,000 shares authorized of common stock and 10,000,000 shares of authorized preferred stock. There are 63,208,637 common stock shares outstanding at both, December 31, 2018 and 2017. As of December 31, 2018 and 2017, the outstanding shares consist of 62,248,035 issued and 960,602 shares held in treasury stocks. There was no preferred stock outstanding as of December 31, 2018 and 2017. The par value per share of common stock and the preferred stock is $.0001.

(a) Stock Options

On October 23, 2007, the Company adopted a nonqualified stock option plan for selected key officers for the granting of options to purchase up to 1,471,381 shares of Company stock. The board of directors fixes the exercise price per share. Options granted are exercisable in annual increments of 25% of the number of shares, subject to the option and continued employment from the officers, among other restrictions, with exception of one grantee whose vesting period is in annual increments of 50% of the number of shares. The options expire at the tenth anniversary of the plan. During 2008 and 2007, certain key officers were granted 50,000 and 300,000 options, respectively, under the provisions of this plan at an exercise price of $7.10 per share. The $7.10 exercise price was reduced to $4.56 during 2011 upon approval by the board of directors to those grantees who remained employed by the Company in 2010. Also, in 2010, a total of 155,496 options under this plan were granted to certain key officers at an exercise price of $10.26. During 2018 and 2017, no options were exercised.

The fair value of the options was determined using the Black-Scholes option pricing model using risk-free interest rates of approximately 4%, 55% volatility, no dividend yield, estimated stock prices based on the acquisitions of treasury stock, offers from third parties, independent company valuations, the term of the options, and the volatility risk for the options granted under the 2007 Plan.

Stock option activity of MCS, Inc.'s Stock Option Plans for the years ended December 31, 2017 and December 31, 2018 is as follows:

	Number of shares		Weighted average exercise price
Balance at December 31, 2016	290,372	$	7.2174
Granted	—		—
Forfeited	(105,000)		4.5600
Exercised	—		—
Balance at December 31, 2017	185,372		8.7226

(Continued)

	(continued)	
	Number of shares	Weighted average exercise price
Granted	—	$ —
Forfeited	—	—
Exercised	—	—
Balance at December 31, 2018	185,372	$ 8.7226

At December 31, 2018 and 2017, the range of exercise prices and weighted average remaining contractual life of outstanding options was $4.56 – $10.26.

At December 31, 2018 and 2017, the number of options exercisable was 185,372, and the weighted average exercise price of those options was $8.7226.

(b) Common Stock Granted to Lenders

Pursuant to the Exchange Agreement, 28,876,807 of the common stocks of the Company were issued to the Lenders at fair value (note 10).

(13) Employee Benefit Plan

The Company provides a savings and profit sharing plan (the Plan) for the benefit of its employees. Under the Plan, the employees are entitled to contribute up to 10% of their salaries and wages, and the Company matches 25% of the employees' contributions of up to 6% of salary and wages with a cap of $4,500. The Company charged to operations $770,258 and $572,966 for employer matching contributions during 2018 and 2017, respectively. In addition, the Plan provides for voluntary employer profit sharing contributions for up to 2% of the employees' salaries and wages and upon achievement of financial and operating objectives. For 2018 the Company paid $537,100 as voluntary profit sharing contribution. For 2017 the Company paid $550,300 as voluntary profit sharing contribution.

(14) Regulatory Requirements

Under applicable Puerto Rico Insurance Laws and Regulations, MCS Life is required to maintain a minimum statutory capital, as defined, of $2,500,000. MCS-HMO and MCS Advantage are required to maintain a minimum deposit, as defined, of $600,000. At December 31, 2018 and 2017, all companies were in compliance with such requirements.

The accumulated earnings of the subsidiaries are restricted as to the payment of dividends by statutory limitations applicable to domestic insurance companies. Such limitations restrict the payment of dividends by insurance companies generally to unrestricted unassigned surplus funds reported for statutory purposes.

In 2008, the Commonwealth of Puerto Rico enacted Law No. 32 (the Law) to add a new Chapter 45, Risk-Based Capital (Chapter 45), to the Insurance Code of Puerto Rico. Subsequently, the Commissioner of Insurance approved the Rule 92, *Standards for Implementing the Provisions Related to Risk-Based*

Capital (Rule 92 or the Rule), to establish the standards for implementing the provisions related to the requirements of the Law. Rule 92 became effective in February 2010. The Risk-Based Capital (RBC) Model serves as a benchmark for the regulation of insurance companies by state insurance regulators. RBC provides for targeted surplus levels based on formulas that specify various weighting factors that are applied to the financial balances or various levels of activity based on the perceived degree of risk and are set forth in the RBC requirements. Such formulas focus on four general types of risk, which includes the risk with respect to the Insurance Subsidiaries' assets (asset or default risk), the risk of adverse insurance experience with respect to the Insurance Subsidiaries liabilities and obligations (insurance or underwriting risk), the interest rate risk with respect to the Insurance Subsidiaries' business (asset/liability matching), and all other business risks (management, regulatory action, and contingencies). The amount determined under such formulas is called the authorized control level RBC (ACLC).

The Law requires, among other things, that all insurance companies, including health service organizations, authorized to conduct business in Puerto Rico to comply with the RBC requirements as adopted by the National Association of Insurance Commissioners (NAIC), to annually file an RBC report with the NAIC and the Commissioner of Insurance on or before March 31, and to maintain a minimum RBC level of 200% of the ACLC for other-than-life insurance companies and 300% for life insurance companies. At December 31, 2018, the Company's insurance subsidiaries MCS Life and MCS Advantage were in compliance with the RBC requirements established by Rule 92 with an actual RBC level of 439% and 363%, respectively. At December 31, 2017, the Company's insurance subsidiaries MCS Life and MCS Advantage were in compliance with the RBC requirements established by Rule 92 with an actual RBC level of 434% and 323%, respectively.

The Insurance Subsidiaries are regulated by the Commissioner of Insurance and are required to prepare financial statements using accounting practices prescribed or permitted by the Commissioner of Insurance, which practices differ from GAAP.

Selected statutory financial information for the insurance subsidiaries at December 31, 2018 and 2017 is approximately as follows:

	2018		
	MCS life	**MCS advantage**	**MCS-HMO**
Net income (loss)	$ 4,150,106	53,346,362	(11,471)
Capital and surplus	45,234,706	205,154,385	574,014

	2017		
	MCS fife	**MCS advantage**	**MCS-HMO**
Net income	$ 22,131,963	53,139,631	30,443
Capital and surplus	43,259,695	156,109,661	583,127

(15) Lease Commitments

The Company leases its office facilities and certain equipment under noncancelable operating lease agreements. Rental expense under such lease agreements amounted to approximately $6,200,000 and $5,900,000 for 2018 and 2017, respectively.

Minimum rental commitment payable in future years under the operating lease agreements at December 31, 2018 is as follows:

Year ending December 31:	
2019	$ 6,678,766
2020	1,051,915
2021	582,620
2022	287,047
2022	45,058
	$ 8,645,406

(16) Comprehensive Income

The related tax effects allocated to the accumulated balances of the unrealized gains (losses) on securities that are included as comprehensive income (loss) in the accompanying consolidated statements of stockholders' equity and comprehensive income (loss) in 2018 and 2017 are as follows:

	2018		
	Before-tax amount	Deferred tax benefit	Net-of-tax amount
Unrealized holding (losses) gains on securities arising during the period	$ (957,225)	191,445	(765,780)
Less reclassification adjustment for (losses) gains realized in income	—	—	—
Net change in unrealized gain (loss)	$ (957,225)	191,445	(765,780)

	2017		
	Before-tax amount	Deferred tax benefit	Net-of-tax amount
Unrealized holding (losses) gains on securities arising during the period	$ (1,856,890)	371,378	(1,485,512)
Less reclassification adjustment for (losses) gains realized in income	577,639	(115,528)	462,111
Net change in unrealized gain (loss)	$ (1,279,251)	255,850	(1,023,401)

(Continued)

(17) Significant Risks and Uncertainties Including Business and Credit Concentrations

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash equivalents, certificates of deposit, premiums receivables, accrued interest receivable, other receivables, and investments in debt and equity securities. The Company invests its excess cash primarily in money market funds. Although a majority of its cash accounts exceed the federally insured deposit amount, management does not anticipate nonperformance by financial institutions and reviews the financial viability of these institutions on a periodic basis. The Company attempts to limit its risk in investment securities by maintaining a diversified portfolio. The components of investment securities are shown in note 4.

The healthcare industry is impacted by health trends and as well as being significantly impacted by government regulations. Changes in government regulations may significantly affect medical claims costs and the Company's performance.

MCS Advantage provides its health plan to residents of Puerto Rico eligible for Medicare benefits under current Puerto Rico and Federal laws and regulations and the premium for the health services provided is mainly generated from contracts with CMS as described in note 1. Changes in such laws and regulations could affect the premiums to be received by the Company under such contracts and the population eligible to participate in the plan. Earned premium revenue relating to premiums received from CMS amounted to approximately $1,875 million and $1,644.9 million for the years ended December 31, 2018 and 2017, respectively.

Also, MCS Advantage provides enhanced benefit coverage to Medicaid-eligible members under the Medicare Platino Program sponsored by ASES. Earned premium revenue relating to premiums received from ASES amounted to approximately $11.2 million and $10.9 million for the years ended December 31, 2018 and 2017, respectively.

Medicare Advantage payment benchmarks have been cut over the last several years, including 2015, with additional funding reductions to be phased-in through 2017. These reductions could be impacted by changes in star ratings, risk scores, and other company-specific variables. Additionally, Congress passed the Budget Control Act of 2011, which as amended by the American Taxpayer Relief Act of 2012, triggered automatic across-the-board budget cuts (known as sequestration), including a 2% reduction in Medicare Advantage and Medicare Part D payments beginning April 1, 2013. The impact of sequestration cuts to the Medicare Advantage revenues will be partially mitigated by reductions in provider reimbursements for those care providers with rates indexed to Medicare Advantage revenues or Medicare fee-for-service reimbursement rates, as well as by reduced incentive payments for those network doctors who receive shares of a surplus pool.

In addition, Medicare Advantage plans are required to have a minimum medical loss ratio of 85% and are required to remit to CMS any amount below that percentage. Based on CMS guidance MCS Advantage for the 2018 and 2017, the MLR was above the minimum as defined in the applicable regulations.

Medicare Advantage rates will be enhanced by CMS quality bonuses for achieving high quality scores (star ratings) from CMS for improving specified clinical and operational performance standards starting in 2014. CMS quality bonus payments will be paid only to four and five star plans. Under the quality bonus program, MCS Advantage was rated three and a half stars rating for 2017. For 2018, MCS Advantage's plans were rated by CMS at an overall four stars.

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The Patient Protection and Affordable Care Act (ACA) imposes an assessment on entities that issue health insurance for each calendar year beginning on or after January 1, 2014. Pursuant to Section 9010 of the ACA, a reporting entity's portion of the assessment is paid no later than September 30 of the applicable calendar year (the fee year) beginning in 2014. The amount of the assessment for the reporting entity is based on the ratio of the amount of an entity's subject net health premiums written for any U.S. health risk during the preceding calendar year (data year) to the aggregate amount of subject net health premiums written by all subject U.S. health insurance providers during the preceding calendar year. For the year 2018, the Company was assessed for such fee approximately $39 million, which is included in general and administrative expenses in the consolidated statements of operations for the year ended December 31, 2018. For the year ended December 31, 2017 and 2019, this fee was waived by the Federal Government.

(18) Contingencies

(a) Legal

The Company is a defendant in legal actions arising in the ordinary course of business. Management, after consultation with its legal counselors, is of the opinion that the ultimate aggregate liability, if any, resulting from such pending legal actions, would not be material in relation to the financial position and results of operations of the Company.

The Company is involved in various other lawsuits arising, for the most part, from claims by providers related to the Company's operations. These litigations involve allegations of nonpayment, insufficient, or tardy payment of claims for services rendered, noncompliance with state regulatory regimes, rescission of insurance coverage, and others. Where the Company believes that a loss is both probable and estimable, such amounts have been recorded. The Company intends to vigorously defend these claims and legal actions.

In addition, the Company is a defendant in various claims by the Administration in connection with alleged noncompliance with several provisions of the 2010-2011 contract with the Administration. The claims propose fines of approximately $25 million against the Company. The Company intends to vigorously defend these claims. Management could not estimate a range of loss at this time.

Estimating the probable losses or a range of probable losses resulting from litigation, government actions, and other legal proceedings is inherently difficult and requires an extensive degree of judgment, particularly where the matters involve indeterminate claims for monetary damages, may involve fines or penalties that are discretionary in amount, involve a large number of claimants or regulatory authorities, are in the early stages of the proceedings, are subject to appeal or could result in a change in business practices. In addition, because most legal proceedings are resolved over long periods of time, potential losses are subject to change due to, among other things, new developments, changes in litigation strategy, the outcome of intermediate procedural and substantive rulings and other parties' settlement posture and their evaluation of the strength or weakness of their case against us. As a result, the Company is currently unable to predict the ultimate outcome of, or reasonably estimate the losses or a range of losses resulting from the matters described above, and it is reasonably possible that the outcome of one or more of them could be material to us.

(b) Guaranty Fund

Pursuant to the Puerto Rico Insurance Code, MCS Life is a member of the Puerto Rico Insurance Guaranty Association for Life and Disability. As a member, MCS Life is required to provide funds for the

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payment of claims and unearned premiums reimbursements for policies issued by insurance companies declared insolvent by the Commissioner of Insurance. There were no assessments during the year, 2018 and 2017.

(c) Audits from CMS and the Commissioner of Insurance

Under the terms of the agreement with CMS, the Company is subject to audits of compliance with Federal regulations including financial and operational aspects of its plans. CMS uses various payment mechanisms to allocate and adjust premium payments to the Company and other companies' Medicare plans by considering the applicable health status of Medicare members as supported by information maintained and provided by healthcare providers. The Company collects claim and encounter data from providers and generally relies on providers to appropriately code their submissions and document their medical records. CMS pays increased premiums to MA plans for members who have certain medical conditions identified with specific diagnosis codes.

CMS conducts audits of selected MA plans to validate the provider coding practices and resulting economics under the actuarial risk adjustment model used to calculate the individual member based premium paid to MA plans. In that regard, CMS has instituted risk adjustment data validation (RADV) audits of various Medicare Advantage plans, including certain of the Company's plans for calendar year (CY) 2012 and 2013.

In February 2012, CMS published a Notice of Final Payment Error Calculation Methodology for Part C Medicare Advantage Risk Adjustment Data Validation Contract Level Audits (the Notice). The Notice outlines the methodology that CMS will use to determine RADV audit premium refunds payable by Medicare Advantage plans for contract years 2012 and forward. Premiums refunds may result in adjustments to payments made by CMS to MA plans. The Notice provides limited information on how the final payment adjustment under its methodology will be implemented. However, the Notice provides that, in calculating the economic impact of audit results for an MA contract, if any, the results of the audit sample will be extrapolated to the entire MA contract based upon a comparison to "benchmark" audit data in Medicare FFS (referred to as the FFS Adjuster).

On September 14, 2015, May 6, 2016 and February 26, 2019 CMS notified the Company that contract H5577 had been selected by CMS for the CY 2012, CY 2013 and CY 2014 Medicare Part C Contract-Level Risk Adjustment Data Validation (RADV) Audits. The final methodology, including the first application of extrapolated audit results to determine audit settlements, is expected to be applied to the aforementioned round of RADV contract level audits being conducted by CMS. The Company is currently unable to fully predict the financial impact of the amounts of any refunds or adjustments to, Medicare Advantage premium payments made to the Company. Any premium refunds or adjustments resulting from regulatory audits, whether as a result of RADV or other audits by CMS, could be material and could adversely affect the Company's operating results, financial position, and cash flows. As of December 31, 2018, CMS has not issued a report on this matter.

(19) Industry Tax

The Patient Protection and Affordable Care Act and a reconciliation measure, the Health Care and Education Reconciliation Act of 2010 (together, Health Reform Legislation or ACA) include an annual insurance industry tax (Industry Tax) to be levied proportionally across the insurance industry for risk-based products beginning in 2014.

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The Company estimates its liability for the Industry Tax based on a ratio of the Company's net premiums written compared to the U.S. health insurance industry total net premiums, both for the previous calendar year. The Company records in full the estimated liability for the Industry Tax at the beginning of the calendar year with a corresponding deferred cost that is amortized to operating costs on the consolidated statements of operations using a straight-line method over the calendar year. The liability is recorded as accounts payable and accrued expenses and the corresponding deferred cost is recorded in prepaid expenses and other current assets on the consolidated balance sheets. As of December 31, 2018, the Industry Tax was fully paid and expensed. Selling, general and administrative expenses for the year ended December 31, 2018 includes an expense of approximately $39 million. The Industry Tax is deductible for Puerto Rico income taxes. For the year ended December 31, 2017 and 2019, this fee was waived by the Federal Government.

(20) Subsequent Event

The Company has evaluated the existence of additional subsequent events for recognition or disclosure through August 30, 2019, the date these statutory financial statements were available to be issued. The entity did not find any additional subsequent events that required disclosure.

Schedule 1

MEDICAL CARD SYSTEM, INC. AND SUBSIDIARIES

Consolidating Schedules

Balance Sheet Information

December 31, 2018

Assets	Medical Card System, Inc.	MCS Healthcare Holdings LLC	MCS Life Insurance Company	MCS Health Management Options, Inc.	MCS Advantage, Inc.	MCS GIA	Total	Eliminations and reclassifications entries Dr. (Cr.)	Consolidated
Current assets:									
Cash and cash equivalents	$ —	—	12,987,038	271,962	71,266,862	23,429	84,549,291	—	84,549,291
Certificates of deposit	—	—	1,471,384	615,433	850,000	—	2,936,817	—	2,936,817
Investment in securities available for sale	—	—	54,291,459	31,370	232,048,139	—	286,370,968	—	286,370,968
Total cash, cash equivalents, and investments	—	—	68,749,881	918,765	304,165,001	23,429	373,857,076	—	373,857,076
Receivables:									
Premiums, trade, and other, net	—	—	23,013,528	—	14,684,769	—	37,698,297	—	37,698,297
Amounts due from Centers for Medicaid and Medicare Services	—	—	—		37,271,732	—	37,271,732	—	37,271,732
Due from affiliates	—	3,931,232	—	—	1,214,181	—	5,145,413	(5,145,413)	—
Accrued interest receivable	—	—	179,711	128	1,307,501	—	1,487,340	—	1,487,340
Total receivables	—	3,931,232	23,193,239	128	54,478,183	—	81,602,782	(5,145,413)	76,457,369
Prepaid expenses and other assets	—	2,680,541	2,654,000	—	9,738,233	—	15,072,774	—	15,072,774
Prepaid income taxes	—	—	2,280,335	701,560	—	1,726	2,983,621	—	2,983,621
Total current assets	—	6,611,773	96,877,455	1,620,453	368,381,417	25,155	473,516,253	(5,145,413)	468,370,840
Equipment and leasehold improvements, net	90,992,358	257,512,996	—	—	—	—	9,205,131	—	9,205,131
Investment in subsidiaries	1,561,676	—	62,166	—	866,903	—	348,505,354	(348,505,354)	—
Deferred tax assets, net							2,490,745	(292)	2,490,453
Total assets	$ 92,554,034	273,329,900	96,939,621	1,620,453	369,248,320	25,155	833,717,483	(353,651,059)	480,066,424

See accompanying independent auditors' report.

Schedule 1

MEDICAL CARD SYSTEM, INC. AND SUBSIDIARIES

Consolidating Schedules

Balance Sheet Information

December 31, 2018

Liabilities and Stockholders' Equity (Deficit)	Medical Card System, Inc.	MCS Healthcare Holdings LLC	MCS Life Insurance Company	MCS Health Management Options, Inc.	MCS Advantage, Inc.	MCS GIA	Total	Eliminations and reclassifications entries Dr. (Cr.)	Consolidated
ibilities:									
Current liabilities:	$ —	—	30,287,573	444,977	131,488,758	—	162,221,308	—	162,221,308
Medical claim liabilities	—	26,559,825	15,072,999	—	23,500,532	100,070	65,233,426	—	65,233,426
Accounts payable and accrued expenses									
Amounts due to Centers for Medicaid and Medicare Services	—	—	—	—	—	—	—	—	—
Income taxes payable	399,019	—	—	—	5,218,447	—	5,617,466	—	5,617,466
Current installments of long-term debt	—	59,111,050	—	—	—	—	59,111,050	—	59,111,050
Deferred tax liabilities	—	—	—	—	—	—	—	—	—
Due to affiliates	938,508	—	3,815,941	—	—	390,964	5,145,413	5,145,413	—
Total current liabilities	1,337,527	85,670,875	49,176,513	444,977	160,207,737	491,034	297,328,663	5,145,413	292,183,250
Long-term debt, excluding current installments	—	96,666,667	—	—	—	—	96,666,667	—	96,666,667
Deferred tax liabilities	—	—	—	292	—	—	292	292	—
Total liabilities	1,337,527	182,337,542	49,176,513	445,269	160,207,737	491,034	393,995,622	5,145,705	388,849,917
ockholders' equity (deficit):									
Common stock	6,225	—	2,500,000	10,000	1	1,000	2,517,226	2,511,001	6,225
Additional paid-in capital	11,928,868	1,000	7,760,000	1,430,000	639,999	—	21,759,867	9,830,999	11,928,868
Treasury stock	(3,632,774)	—	—	—	—	—	(3,632,774)	—	(3,632,774)
Retained (accumulated deficit) earnings	85,301,644	93,378,814	37,751,772	(265,986)	210,540,545	(466,879)	426,239,910	340,938,266	85,301,644
Accumulated other comprehensive income (loss), net of tax	(2,387,456)	(2,387,456)	(248,664)	1,170	(2,139,962)	—	(7,162,368)	(4,774,912)	(2,387,456)
Total stockholders' (deficit) equity	91,216,507	90,992,358	47,763,108	1,175,184	209,040,583	(465,879)	439,721,861	348,505,354	91,216,507
	$ 92,554,034	273,329,900	96,939,621	1,620,453	369,248,320	25,155	833,717,483	353,651,059	480,066,424

e accompanying independent auditors' report.