

TRIPLE-S MANAGEMENT CORP

Form 10-K

March 05, 2010

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2009**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**COMMISSION FILE NUMBER 001-33865**

**Triple-S Management Corporation**

**Puerto Rico  
(STATE OF INCORPORATION)**

**66-0555678  
(I.R.S. ID)**

**1441 F.D. Roosevelt Avenue, San Juan, PR 00920  
(787) 749-4949**

**Securities registered pursuant to Section 12(b) of the Act:**

|  |  |
|--|--|
| <b>Title of each class</b>             | <b>Name of each exchange on which registered</b> |
| Class B common stock, \$1.00 par value | New York Stock Exchange                          |

**Securities registered pursuant to Section 12(g) of the Act:** Class A common stock, \$1.00 par value

Indicate by check mark if the registrant is well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

|  |   |  |  |
|--|---|--|--|
| Large accelerated filer <input type="checkbox"/> | Accelerated filer <input checked="" type="checkbox"/> | Non-accelerated filer <input type="checkbox"/> | Smaller reporting company <input type="checkbox"/> |
|--|---|--|--|

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).  Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant (assuming solely for the purposes of this calculation that all Directors and executive officers of the registrant are affiliates ) as of June 30, 2009 was approximately \$317,428,972 for the Class B common stock (the only one that trade in a public market) and \$9,042,809 for the Class A common stock (value at par value of \$1.00 since it is not a publicly traded stock).

As of February 23, 2010, the registrant had 9,042,809 of its Class A common stock outstanding and 20,110,391 of its Class B common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held April 23, 2010 are incorporated by reference into Parts II and III of this Annual Report on Form 10-K.

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**Triple-S Management Corporation**  
**FORM 10-K**  
For The Fiscal Year Ended December 31, 2009  
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**Table of Contents****Part I*****Item 1. Business*****General Description of Business and Recent Developments**

Triple-S Management Corporation ( Triple-S , TSM , the Company , the Corporation , we , us or our ) is the managed care company in Puerto Rico, serving approximately 1.3 million members across all regions, and holds a leading market position covering approximately 34% of the population. We have the exclusive right to use the Blue Cross and Blue Shield ( BCBS ) names and marks throughout Puerto Rico and U.S. Virgin Islands and 50 years of experience in the managed care industry. We offer a broad portfolio of managed care and related products in the commercial, Medicare and the government of Puerto Rico Health Insurance Plan (similar to Medicaid) (the Reform ) markets.

We serve a full range of customer segments, from corporate accounts, federal and local government employees and individuals to Medicare recipients and Reform enrollees, with a wide range of managed care products. We market our managed care products through both an extensive network of independent agents and brokers located throughout Puerto Rico as well as an internal salaried sales force.

We also offer complementary products and services, including life insurance, accident and disability insurance and property and casualty insurance. We are a leading provider of life insurance policies in Puerto Rico.

Substantially all premiums generated by our insurance subsidiaries are from customers within Puerto Rico. In addition, all of our long-lived assets, other than financial instruments, including the deferred policy acquisition costs and value of business acquired and the deferred tax assets, are located within Puerto Rico.

On July 1, 2009, the Corporation and Triple-S Salud, Inc. ( TSS ), our managed care subsidiary, obtained the licensing rights to the Blue Cross brand in Puerto Rico and the BCBS brands in the U.S. Virgin Islands from the Blue Cross and Blue Shield Association ( BCBSA ) pursuant to license agreements with BCBSA. According to the license agreements, the Corporation and TSS acquired the right to sell, market and administer health care plans and related services under the brands in Puerto Rico and the U.S. Virgin Islands. The license agreements became effective upon the closing of the acquisition by TSS of certain managed care assets of La Cruz Azul de Puerto Rico, Inc. ( LCA ) in Puerto Rico and the U.S. Virgin Islands on such date.

On December 8, 2008, we announced the conversion of seven million issued and outstanding Class A shares into Class B shares effective immediately, in conjunction with the expiration of the lockup agreements signed by holders of Class A shares at the time of the Company 's initial public offering. We also announced the immediate commencement of our \$40 million share repurchase program, authorized by the Board of Directors in late October 2008. Our share repurchase program was completed on December 1, 2009 and conducted in accordance with Rule 10b-18 under the Securities Exchange Act of 1934, as amended.

In this Annual Report on Form 10-K, references to shares or common stock refer collectively to our Class A and Class B common stock, unless the context indicates otherwise. All share and per share amounts in this Annual Report on Form 10-K have been restated to reflect the 3,000-for-one common stock split effected by us on May 1, 2007.

**Industry Overview*****Managed Care***

In response to an increasing focus on health care costs by employers, the government and consumers, there has been a growth in alternatives to traditional indemnity health insurance, such as Health Maintenance Organizations ( HMOs ) and Preferred Provider Organizations ( PPOs ). Through the introduction of these alternatives the managed care industry attempted to contain the cost of health care by negotiating contracts with hospitals, physicians and other providers to deliver health care to plan members at favorable rates. These products usually feature medical management and other quality and cost optimization measures such as pre-admission review and approval for certain non-emergency services, pre-authorization of certain outpatient surgical procedures, network credentialing to determine that network doctors and hospitals have the required certifications and expertise, and various levels of care management programs to help members better understand and navigate the medical system.

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In addition, providers may have incentives to achieve certain quality measures or may share medical cost risk. Members generally pay co-payments, coinsurance and deductibles when enrollees receive services. While the distinctions between the various types of plans have lessened over recent years, PPO products generally provide reduced benefits for out-of-network services, while traditional HMO products generally provide little to no reimbursement for non-emergency out-of-network utilization. An HMO plan may also require members to select one of the network primary care physicians to coordinate their care and approve any specialist or other services. The government of the United States of America (the U.S. government or federal government ) provides hospital and medical insurance benefits to eligible people aged 65 and over as well as certain other qualified persons through the Medicare program, including the Medicare Advantage program. The federal government also offers prescription drug benefits to Medicare eligibles, both as part of the Medicare Advantage program and on a stand-alone basis, pursuant to Medicare Part D (also referred to as PDP stand-alone product or PDP ). In addition, the government of the Commonwealth of Puerto Rico (the government of Puerto Rico ) provides managed care coverage to the medically indigent population of Puerto Rico, as defined by law, through the Reform program.

Recently we have noticed, economic factors and greater consumer awareness have resulted in (a) the increasing popularity of products that offer larger more extensive networks, more member choice related to coverage, physicians and hospitals, greater access to preventive care and wellness programs, and a desire for greater flexibility for customers to assume larger deductibles and co-payments in return for lower premiums and/or (b) products with lower benefits and a narrower network in exchange for lower premiums. We believe we are well positioned to respond to these market preferences due to the breadth and flexibility of our product offering and size of our provider networks.

The BCBSA had 39 independent licensees as of December 31, 2009. We are licensed by BCBSA to use the Blue Cross Blue Shield name and mark in Puerto Rico and U.S. Virgin Islands. The number of members enrolled in BCBS plans has been steadily increasing, from 65.2 million in 1994 to 99.4 million at December 31, 2009, which represents 32.2% of the U.S. population. The BCBS plans work cooperatively in a number of ways that create significant market advantages, especially when competing for very large, multi-state employer groups. For example, all BCBS plans participate in the BlueCard program, which effectively creates a national Blue network. Each plan is able to take advantage of other BCBS plans' broad provider networks and negotiated provider reimbursement rates where a member covered by a policy in one state or territory lives or travels outside such state or territory in which the policy under which he or she is covered is written. The BlueCard program is a source of revenue for TSS from services provided in Puerto Rico to individuals who are customers of other BCBS plans and also provides us a significant network in the U.S, creating a significant competitive advantage for us because Puerto Ricans frequently travel to the continental United States.

***Life Insurance***

Total annual premiums in Puerto Rico in 2008 for the life insurance market approximated \$877 million. The main products in the market are ordinary life, cancer and other dreaded diseases, term life, disability and annuities. The main distribution channels are independent agents. In recent years banks have established general agencies to cross sell many life insurance products, such as term life and credit life.

***Property and Casualty Insurance Segment***

The total property and casualty market in Puerto Rico in terms of gross premiums written for 2008 was approximately \$2.0 billion. Property and casualty insurance companies compete for the same accounts through aggressive pricing, more favorable policy terms and better quality of services. The main lines of business in Puerto Rico are personal and commercial auto, commercial multi peril, fire and allied lines and other general liabilities. Approximately 69% of the market is written by the top six companies in terms of market share, and approximately 88% of the market is written by companies incorporated under the laws of, and which operate principally in Puerto Rico.

The Puerto Rican property and casualty insurance market is highly dependent on reinsurance and some local carriers have diversified their operations outside Puerto Rico.

***Puerto Rico's Economy***

Puerto Rico's economy experienced a considerable transformation during the past sixty-five years, passing from an agriculture economy to an industrial one. Virtually every sector in the economy participated in this expansion. Factors

contributing to this expansion include government-sponsored economic developments programs, increases



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in the level of federal transfer payments, and the relatively low cost of borrowing. In some years, these factors were aided by a significant rise in the construction investment driven by infrastructure projects, private investment, primarily in housing, and relatively low oil prices. Nevertheless, the significant oil price increases during the past four years, the continuous contraction of the manufacturing sector, and budgetary pressures on government finances have triggered a general contraction in the economy. Puerto Rico's economy is currently in a recession that began in the fourth quarter of fiscal year 2006, during which the real gross national product grew by only 0.5%. For fiscal years 2007 and 2008, the real gross national product contracted by 1.2% and 2.8%, respectively. For fiscal year 2009, the real gross national product also contracted by 3.7%, which is 1.1% less than the Puerto Rico Planning Board's (the Planning Board) projected reduction of 4.8% published in August 2009. In August 2009, the Planning Board made an upward revision of its gross national product forecast for fiscal year 2010 by projecting an increase of 0.7%, after considering the impact of U.S. and local economic stimulus measures. The Planning Board, however, has stated that it is currently working on a revised fiscal year 2010 gross national product forecast that would take into account the preliminary results for fiscal year 2009, the delay in the disbursement of economic stimulus funds and other economic factors that may require downward revision of its projections and may show a continued reduction in gross national product during fiscal year 2010.

Personal income, both aggregate and per capita, has increased consistently each fiscal year from 1947 to 2009. In fiscal year 2009, aggregate personal income was \$58.9 billion and personal income per capita was \$14,905. Average total employment decreased from 1,218,000 in fiscal year 2008 to 1,168,000 for fiscal year 2009. The average unemployment rate increased from 11.0% in fiscal year 2008 to 13.4% in fiscal 2009. The average unemployment rate for the first five months of fiscal year 2010 is 15.6%.

The economy of Puerto Rico is closely linked to that of the continental United States, as most of the external factors that affect the Puerto Rico economy (other than the price of oil) are determined by the policies and results of the U. S. These external factors include exports, direct investment, the amount of federal transfer payments, the level of interest rates, the rate of inflation, and tourist expenditures. In the past, the economy of Puerto Rico has generally followed economic trends in the overall United States economy. However, in recent years economic growth in Puerto Rico has lagged behind growth in the United States.

The dominant sectors of the Puerto Rico economy in terms of production and income are manufacturing and services. The manufacturing sector has undergone fundamental changes over the years as a result of increased emphasis on higher wage, high technology industries, such as pharmaceuticals, biotechnology, computers, microprocessors, professional and scientific instruments, and certain high technology machinery and equipment. The services sector, which includes finance, insurance, real estate, wholesale and retail trade, transportation, communications and public utilities, and other services, plays a major role in the economy. It ranks second to manufacturing in contribution to the gross domestic product and leads all sectors in providing employment.

On March 12, 2009, the government of Puerto Rico approved various temporary revenue raising measures, including a modification to the alternative minimum tax on corporations that limits deductions for expenses incurred outside Puerto Rico and a 5% surcharge on corporations, including insurance companies. These modifications and additional taxes will apply for tax years beginning after December 31, 2008 and before January 1, 2012.

Future growth in the Puerto Rico economy will depend on several factors including the condition of the United States economy, the relative stability in the price of oil imports, the exchange value of the United States dollar, the level of interest rates and changes to existing tax incentive legislation. The major factors affecting the economy at this point are, among others, the high oil prices, the slowdown of economic activity in the U.S., and the continuing economic uncertainty generated by the fiscal crisis affecting the government of Puerto Rico and by the government's Fiscal Stabilization Plan. See Item 1A. Risk Factors Risks Related to Our Business The geographic concentration of our business in Puerto Rico may subject us to economic downturns in the region.

**Products and Services*****Managed Care***

Through our subsidiary TSS, we offer a broad range of managed care products, including HMOs, PPOs, Medicare Supplement, Medicare Advantage and Medicare Part D. Managed care products represented 89.8%, 89.2% and 87.7% of our consolidated premiums earned, net for the years ended December 31, 2009, 2008 and 2007. We design our

products to meet the needs and objectives of a wide range of customers, including employers, individuals and government entities. Our customers either contract with us to assume underwriting risk or they self-

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fund underwriting risk and rely on us for provider network access, medical cost management, claim processing, stop-loss insurance and other administrative services. Our products vary with respect to the level of benefits provided, the costs paid by employers and members, including deductibles and co-payments, and the extent to which our members' access to providers is subject to referral or preauthorization requirements.

Managed care generally refers to a method of integrating the financing and delivery of health care within a system that manages the cost, accessibility and quality of care. Managed care products can be further differentiated by the types of provider networks offered, the ability to use providers outside such networks and the scope of the medical management and quality assurance programs. Our members receive medical care from our networks of providers in exchange for premiums paid by the individuals or their employers, a government entity in case of the Medicare Advantage or Reform plan and, in some instances, a cost-sharing payment between the employer and the member. We reimburse network providers according to pre-established fee arrangements and other contractual agreements.

We currently offer the following managed care plans:

*Health Maintenance Organization ( HMO ).* We offer HMO plans that provide members with health care coverage for a fixed monthly premium in addition to applicable member co-payments. Health care services can include emergency care, inpatient hospital and physician care, outpatient medical services and supplemental services, such as dental, vision, behavioral and prescription drugs, among others. Members must select a primary care physician within the network to provide and assist in managing care, including referrals to specialists.

*Preferred Provider Organization ( PPO ).* We offer PPO managed care plans that provide our members and their dependent family members with health care coverage in exchange for a fixed monthly premium. In addition, we provide our PPO members with access to a larger network of providers than our HMO. In contrast to our HMO product, we do not require our PPO members to select a primary care physician or to obtain a referral to utilize in-network specialists. We also provide coverage for PPO members who access providers outside of the network. Out-of-network benefits are generally subject to a higher deductible and coinsurance. We also offer national in-network coverage to our PPO members through the BlueCard program.

*BlueCard.* For our members who purchase our PPO and selected members under ASO arrangements, we offer the BlueCard program. The BlueCard program offers these members in-network benefits through the networks of the other BCBS plans in the United States and certain U.S. territories. In addition, the BlueCard worldwide program provides our PPO members with coverage for medical assistance worldwide. We believe that the national and international coverage provided through this program allows us to compete effectively with large national insurers.

*Medicare Supplement.* We offer Medicare Supplement products, which provide supplemental coverage for many of the medical expenses that the Medicare Parts A and B programs does not cover, such as deductibles, coinsurance and specified losses that exceed this program's maximum benefits.

*Prescription Drug Benefit Plans.* Every Medicare beneficiary must be given the opportunity to select a prescription drug plan through Medicare Part D, largely funded by the federal government. We are required to offer a Medicare Part D prescription drug plan to our enrollees in every area in which we operate. We offer prescription drug benefits under Medicare Part D in our Medicare Advantage plans as well as on a stand-alone basis. We also offer a Drug Discount Card for local government employees and individuals. The Drug Discount Card program is not insurance, but rather provides access to discounts from contracted pharmacies. As of December 31, 2009, we had enrolled approximately 26,100 members in the Drug Discount Card program. We plan to continue extending the program to members in group plans without drug coverage during 2010.

*Administrative Services Only.* In addition to our fully insured plans, we also offer our PPO products on a self-funded or ASO basis, under which we provide claims processing and other administrative services to employers. Employers choosing to purchase our products on an ASO basis fund their own claims but their employees are able to access our provider network at our negotiated discounted rates. We administer the payment of claims to the providers but we do not bear any insurance risk in connection with claims costs because we are reimbursed in full by the employer. For certain self-funded plans, we provide stop loss insurance pursuant to which we assume some of the medical risk for a premium. The administrative fee charged to self-funded groups is generally based on the size of the group and the scope of services provided.



**Table of Contents*****Life Insurance***

We offer a wide variety of life, accident, disability and health and annuity products in Puerto Rico through our subsidiary Triple-S Vida, Inc. ( TSV ). Life insurance premiums represented 5.3%, 5.5% and 6.0% of our consolidated premiums earned, net for the years ended December 31, 2009, 2008 and 2007. TSV markets in-home service life and supplemental health products through a network of company-employed agents. Ordinary life, cancer and dreaded diseases ( Cancer line of business), and pre-need life products are marketed through independent agents. TSV is the leader distributor of life products in Puerto Rico. We are the principal home service company in Puerto Rico and offer guaranteed issue, funeral and cancer policies to the lower and middle income market segments directly to people in their homes. We also market our group life and disability coverages through our managed care subsidiary's network of exclusive agents. During the year ended December 31, 2009, we generated our premiums in the life insurance segment primarily from the following lines of business:

| <b>Line of Business</b> | <b>Percentage of Total<br/>Segment Revenues<br/>for<br/>the Year Ended<br/>December 31, 2009</b> |
|-------------------------|--|
| Home service            | 57%  |
| Ordinary life           | 18   |
| Cancer                  | 15   |
| Other                   | 10   |

***Property and Casualty Insurance***

We offer a wide range of property and casualty insurance products through our subsidiary Triple-S Propiedad, Inc. ( TSP ). Property and casualty insurance premiums represented 5.1%, 5.5% and 6.5% of our consolidated premiums earned, net for the years ended December 31, 2009, 2008 and 2007. Our predominant lines of business are commercial multi-peril, commercial property mono-line, auto physical damage, auto liability and dwelling policies. The segment's commercial lines target small to medium size accounts. We generate a majority of our dwelling business through our strong relationships with financial institutions. During the year ended December 31, 2009, we generated our premiums in the property and casualty insurance segment primarily from the following lines of business:

| <b>Line of Business</b>                    | <b>Percentage of Total<br/>Segment Revenues<br/>for<br/>the Year Ended<br/>December 31, 2009</b> |
|--|--|
| Commercial multi-peril                     | 46%  |
| Auto                                       | 21   |
| Dwelling and commercial property mono-line | 18   |
| Other                                      | 15   |

Due to our geographical location, property and casualty insurance operations in Puerto Rico are subject to natural catastrophic activity, in particular hurricanes and earthquakes. As a result, local insurers, including us, rely on the international reinsurance market. The property and casualty insurance market is affected by the cost of reinsurance, which varies with the catastrophic experience.

We maintain a comprehensive reinsurance program as a means of protecting our surplus in the event of a catastrophe. Our policy is to enter into reinsurance agreements with reinsurers considered to be financially sound. Practically all our reinsurers have an A.M. Best rating of A- or better, or an equivalent rating from other rating agencies. During the year ended December 31, 2009, 41.3% of the premiums written in the property and casualty insurance segment were ceded to reinsurers. Although these reinsurance arrangements do not relieve us of our direct obligations to our insureds, we believe that the risk of our reinsurers not paying balances due to us is low.

**Marketing and Distribution**

Our marketing activities concentrate on promoting our strong brand, quality care, customer service efforts, size and quality of provider networks, flexibility of plan designs, financial strength and breadth of product offerings. We

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distribute our products through several different channels, including our salaried and commission-based internal sales force, direct mail, independent brokers and agents and telemarketing staff. We also use our website to market our products.

***Branding and Marketing***

Our branding and marketing efforts include brand advertising, which focuses on the Triple-S name and the Blue Cross and Blue Shield mark, acquisition marketing, which focuses on attracting new customers, and institutional advertising, which focuses on our overall corporate image. We believe that the strongest element of our brand identity is the Triple-S name. We seek to leverage what we believe to be the high name recognition and comfort level that many existing and potential customers associate with this brand. Acquisition marketing consists of business-to-business marketing efforts which are used to generate leads for brokers and our sales force as well as direct-to-consumer marketing which is used to add new customers to our direct pay businesses. Institutional advertising is used to promote key corporate interests and overall company image. We believe these efforts support and further our competitive brand advantage. We will continue to utilize the Triple-S name and the Blue Cross and Blue Shield mark for all managed care products and services in Puerto Rico and U.S. Virgin Islands.

***Sales and Marketing***

We employ a wide variety of sales and marketing activities. Such activities are closely regulated by the Centers for Medicare and Medicaid Services (CMS) and Administration for Health Insurance of the Commonwealth of Puerto Rico (ASES, for its Spanish acronym). For example, our sales and marketing materials must be approved in advance by the applicable regulatory authorities, and they often impose other regulatory restrictions on our marketing activities.

***Distribution***

*Managed Care Segment.* We rely principally on our internal sales force and a network of independent brokers and agents to market our products. Individual policies and Medicare Advantage products are sold entirely through independent agents who exclusively sell our individual products, and group products are sold through our 50 person internal sales force as well as our approximately 760 independent brokers and agents. We believe that each of these marketing methods is optimally suited to address the specific needs of the customer base to which it is assigned. In the Reform sector, the government of Puerto Rico qualifies individuals as eligible, as defined by law, to participate in the Reform; eligible individuals may enroll in the program at our branch offices.

Strong competition exists among managed care companies for brokers and agents with demonstrated ability to secure new business and maintain existing accounts. The basis of competition for the services of such brokers and agents are commission structure, support services, reputation and prior relationships, the ability to retain clients and the quality of products. We pay commissions on a monthly basis based on premiums paid. We believe that we have good relationships with our brokers and agents, and that our products, support services and commission structure are highly competitive in the marketplace.

*Life Insurance Segment.* In our life insurance segment, we offer our insurance products through our own network of both company-employed and independent agents, as well as group life and disability insurance coverage through our managed care network of agents. We place a majority of our premiums (57% and 58% during the years ended December 31, 2009 and 2008, respectively) through direct selling to customers in their homes. TSV employs over 560 full-time active agents and managers and utilized approximately 600 independent agents and brokers. On individual policies we advance first year commissions at issue of policies and on group policies, we pay commissions on a monthly basis based on premiums received. In addition, TSV has over 200 agents that are licensed to sell certain of our managed care products.

*Property and Casualty Insurance Segment.* In our property and casualty insurance segment, business is exclusively subscribed through approximately 20 general agencies, including our insurance agency, Triple-S Insurance Agency, Inc. (TSIA), where business is placed by independent insurance agents and brokers. TSIA placed approximately 47% of our property and casualty insurance subsidiary, TSP, total premium volume during the year ended December 31, 2009. During the years ended December 31, 2008 and 2007, TSIA placed approximately 45% and 52% of our subsidiary's total premium volume, respectively. The general agencies contracted by our property and casualty insurance subsidiary remit premiums net of their respective commission.





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We offer our products in the managed care segment to three distinct market sectors in Puerto Rico. The following table sets forth enrollment information with respect to each sector at December 31, 2009:

| <b>Market Sector</b> | <b>Enrollment at<br/>December 31,<br/>2009</b> | <b>Percentage of<br/>Total<br/>Enrollment</b> |
|----------------------|--|---|
| Commercial           | 737,286  | 54.7%   |
| Reform               | 540,142  | 40.1  |
| Medicare Advantage   | 69,608   | 5.2   |
| Total                | 1,347,003                                      | 100.0%  |

**Commercial Sector**

The commercial accounts sector includes corporate accounts, federal government employees, individual accounts, local government employees, and Medicare Supplement.

*Corporate Accounts.* Corporate accounts consist of small (2 to 50 employees) and large employers (over 50 employees). Employer groups may choose various funding options ranging from fully-insured to self-funded financial arrangements or a combination of both. While self-funded clients participate in our managed care networks, the clients bear the claims risk, except to the extent that such self-funded clients maintain stop loss coverage.

*Federal Government Employees.* For more than 40 years, we have maintained our leadership in providing our managed care services to federal government employees in Puerto Rico. We provide our services to federal employees in Puerto Rico under the Federal Employees Health Benefits Program pursuant to a direct contract with the United States Office of Personnel Management ( OPM ). We are one of two companies in Puerto Rico that has such a contract with OPM. Every year, OPM allows other insurance companies to compete for this business, provided such companies comply with the applicable requirements for service providers. This contract is subject to termination in the event of noncompliance not corrected to the satisfaction of OPM.

*Individual Accounts.* We provide managed care services to individuals and their dependent family members who contract these services directly with us through our network of independent brokers. We provide individual and family contracts.

*Local Government Employees.* We provide managed care services to the local government employees of Puerto Rico through a government-sponsored program whereby the health plan assumes the risk of both medical and administrative costs for its members in return for a monthly premium. The government qualifies on an annual basis the managed care companies that participate in this program and sets the coverage, including benefits, co-payments and amount to be contributed by the government. Employees then select from one of the authorized companies and pays for the difference between the premium of the selected carrier and the amount contributed by the government.

*Medicare Supplement.* We offer Medicare Supplement products, which provide supplemental coverage for many of the medical expenses that the Medicare Parts A and B programs do not cover, such as deductibles, coinsurance and specified losses that exceed the Federal program's maximum benefits.

**Reform Sector**

In 1994, the government of Puerto Rico privatized the delivery of services to the medically indigent population in Puerto Rico, as defined by the government, by contracting with private managed care companies instead of providing health services directly to such population. The government divided Puerto Rico into eight geographical areas. Each of the eight geographical areas is awarded to a managed care company doing business in Puerto Rico through a competitive bid process. As of December 31, 2009, the Reform provided healthcare coverage to over 1.5 million people. Mental health and drug abuse benefits are currently offered to Reform beneficiaries by behavioral healthcare companies and are therefore not part of the benefits covered by us.



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The Reform program is similar to the Medicaid program, a joint federal and state health insurance program for medically indigent residents of the state. The Medicaid program is structured to provide states the flexibility to establish eligibility requirements, benefits provided, payment rates, and program administration rules, subject to general federal guidelines.

The government of Puerto Rico has adopted several measures to control the increase of Reform expenditures, which represented approximately 5.4% of total government expenditures during its fiscal year ended June 30, 2009, including closer and continuous scrutiny of participants (members) eligibility, decreasing the number of areas in order to take advantage of economies of scale and establishing disease management programs. In addition, the government of Puerto Rico began a pilot project in 2003 within one of the eight geographical areas under which it contracted services on an ASO basis with an Independent Practice Associations (IPA), instead of contracting on a fully insured basis. On October 31, 2006 the government decided to also change the contracting agreement for the Metro-North region, from a fully-insured agreement to ASO. We currently serve two regions out of the seven regions the government of Puerto Rico has under the fully-insured model; however, there can be no assurance that the government will not implement ASO programs in these regions in the future. If a similar ASO plan is adopted in any areas served by us during the contract period, we would not generate premiums in the Reform. In that event, it is possible, but not certain that we may still be able to collect administrative service fees should the area is awarded to us on an ASO basis. On the other hand, the government has expressed its intention to evaluate different alternatives of providing health services to Reform beneficiaries.

The government of Puerto Rico has also implemented a plan to allow dual-eligibles enrolled in the Reform to move from the Reform program to a Medicare Advantage plan under which the government, rather than the insured, will assume all of the premiums for additional benefits not included in Medicare Advantage programs, such as the deductibles and co-payments of prescription drug benefits.

We provide managed care services to Reform members in the North and Southwest regions on a fully-insured basis and in the Metro-North region on an ASO basis. We have participated in the Reform program since 1995. The premium rates for each Reform contract are negotiated annually. If the contract renewal process is not completed by a contract's expiration date, the contract may be extended by the government, upon acceptance by us, for any subsequent period of time if deemed to be in the best interests of the beneficiaries and the government. The terms of a contract, including premiums, can be renegotiated if the term of the contract is extended. Each contract is subject to termination in the event of non-compliance by the insurance company not corrected or cured to the satisfaction of the government entity overseeing the Reform, or in the event that the government determines that there is an insufficiency of funds to finance the Reform. For additional information please see Item 1A. Risk Factors - Risks Related to Our Business. We are dependent on a small number of government contracts to generate a significant amount of the revenues of our managed care business.

*Medicare Advantage Sector*

Medicare is a federal program administered by CMS that provides a variety of hospital and medical insurance benefits to eligible persons aged 65 and over as well as to certain other qualified persons. Medicare, with the approval of the Medicare Modernization Act, started promoting a managed care organizations (MCO) sponsored Medicare product that offers benefits similar or better than the traditional Medicare product, but where the risk is assumed by the MCOs. This program is called Medicare Advantage. We entered into the Medicare Advantage market in 2005 and have contracts with CMS to provide extended Medicare coverage to Medicare beneficiaries under our *Medicare Optimo*, *Medicare Selecto* and *Medicare Platino* policies. Under these annual contracts, CMS pays us a set premium rate based on membership that is risk adjusted for health status. Depending on the total benefits offered, for certain of our Medicare Advantage products the member will also be required to pay a premium.

Medicare also provides a prescription drug program (Medicare Part D). Medicare beneficiaries are given the opportunity to select a Medicare Part D prescription drug plan provided by MCOs or other Part D sponsors. The Medicare Advantage policies we offer also include Medicare Part D coverage to our members throughout our service area. Beginning in 2006, we also stand-alone Medicare Part D prescription drug benefits known as *FarmaMed*.

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***Life Insurance***

Our life and health insurance customers consist primarily of individuals, who hold approximately 360,000 policies, and we insure approximately 1,300 groups.

***Property and Casualty Insurance***

Our property and casualty insurance segment targets small to medium size accounts with low to average exposures to catastrophic losses. Our dwelling insurance line of business aims for rate stability and seeks accounts with a very low exposure to catastrophic losses. Our auto physical damage and auto liability customer bases consist primarily of commercial accounts.

**Underwriting and Pricing**

***Managed Care***

We strive to maintain our market leadership by trying to provide all of our managed care members with the best health care coverage at reasonable cost. Disciplined underwriting and appropriate pricing are core strengths of our business and we believe are an important competitive advantage. We continually review our underwriting and pricing guidelines on a product-by-product and customer group-by-group basis in order to maintain competitive rates in terms of both price and scope of benefits. Pricing is based on the overall risk level and the estimated administrative expenses attributable to the particular segment.

Our claims database enables us to establish rates based on our own experience and provides us with important insights about the risks in our service areas. We tightly manage the overall rating process and have processes in place to ensure that underwriting decisions are made by properly qualified personnel. In addition, we have developed and implemented a utilization review and fraud and abuse prevention program.

We have been able to maintain relatively high retention rates in the corporate accounts sector of our managed care business and since 2003 have maintained our overall market share. The retention rate in our corporate accounts, which is the percentage of existing business retained in the renewal process, has been over 95% in each of the last four years.

In our managed care segment, the rates are set prospectively, meaning that a fixed premium rate is determined at the beginning of each contract year and revised at renewal. We renegotiate the premiums of different groups in the corporate accounts subsector as their existing annual contracts become due. We set rates for individual contracts based on the most recent semi-annual community rating. We consider the actual claims trend of each group when determining the premium rates for the following contract year. Rates in the Reform and Medicare sectors and for federal and local government employees are generally set on an annual basis through negotiations with the U.S. Federal and Puerto Rico governments, as applicable.

***Life Insurance***

Our individual life insurance business has been priced using mortality, morbidity, lapses and expense assumptions which approximate actual experience for each line of business. We review pricing assumptions on a regular basis. Individual insurance applications are reviewed by using common underwriting standards in use in the United States, and only those applications that meet these commonly used underwriting requirements are approved for policy issuance. Our group life insurance business is written on a group-by-group basis. We develop the pricing for our group life business based on mortality and morbidity experience and estimated expenses attributable to each particular line of business.

***Property and Casualty Insurance***

The property and casualty insurance sector is experiencing soft market conditions in Puerto Rico, principally as a result of the deregulation of commercial property rates since 2001. Lower reinsurance costs have also contributed to soft market conditions. Notwithstanding these conditions, our property and casualty segment has maintained its leadership position in the property insurance sector by following prudent underwriting and pricing practices.

Our core business is comprised of small and medium-sized accounts. We have attained positive results through attentive risk assessment and strict adherence to underwriting guidelines, combined with maintenance of competitive

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rates on above-par risks designed to maintain a relatively high retention ratio. Underwriting strategies and practices are closely monitored by senior management and constantly updated based on market trends, risk assessment results and loss experience. Commercial risks in particular are fully reviewed by our professionals.

**Quality Initiatives and Medical Management**

We utilize a broad range of focused traditional cost containment and advanced care management processes across various product lines. We continue to enhance our management strategies, which seek to control claims costs while striving to fulfill the needs of highly informed and demanding managed care consumers. One of these strategies is the reinforcement of population and case management programs, which empower consumers by educating them and engaging them in actively maintaining or improving their own health. Early identification of patients and inter-program referrals are the focus of these programs, which allow us to provide integrated service to our customers based on their specific conditions. The population management programs include programs which target asthma, congestive heart failure, hypertension, diabetes, and a prenatal program which focuses on preventing prenatal complications and promoting adequate nutrition. A medication therapy management program aimed at plan members who are identified as having a potential for high drug usage was also developed. In addition, we have had a contract with McKesson Health Solutions ( McKesson ) since 1998 pursuant to which they provide to us a 24-hour telephone-based triage program and health information services. McKesson also provides utilization management services for the Reform and Medicare sectors. We intend to expand to the Commercial sector the programs not currently offered in that sector. Other strategies include innovative partnerships and business alliances with other entities to provide new products and services such as an employee assistance program and the promotion of evidence-based protocols and patient safety programs among our providers. We also employ registered nurses and social workers to manage individual cases and coordinate healthcare services. We have implemented a hospital concurrent review program, the goal of which is to monitor the appropriateness of high admission rate diagnoses and unnecessary stays. These services and programs include pre-certification and concurrent review hospital discharge services for acute patients, as well as early referral of potential candidates for the population and case management programs.

In addition, we have developed and provide a variety of services and programs for the acute, chronic and complex populations. The services and programs seek to enhance quality by eliminating inappropriate hospitalizations or services. We also encourage the usage of formulary and generic drugs, instead of non-formulary therapeutic equivalent drugs, through benefit design and member and physician interactions and have implemented a three-tier formulary which offers three co-payment levels: the lowest level for generic drugs, a higher level for brand-name drugs and the highest level for brand-name drugs that are not on the formulary. We have also established an exclusive pharmacy network with discounted rates. In addition, through arrangements with our pharmacy benefit manager, we are able to obtain discounts and rebates on certain medications based on formulary listing and market share.

We have designed a comprehensive Quality Improvement Program ( QIP ). This program is designed with a strong emphasis on continuous improvement of clinical and service indicators, such as Health Employment Data Information Set ( HEDIS ) and Consumer Assessment of Healthcare Providers and Systems ( CAHPS ) measures. Our QIP also includes a Physician Incentive Program ( PIP ) and a Hospital Quality Incentive Program ( HQIP ), which are directed to support corporate quality initiatives, utilizing clinical and benchmark criteria developed by governmental agencies and professional organizations. The PIP encourages the participation of members on chronic care improvement programs and the achievement of specific clinical outcomes. The HQIP, a pilot of which began in 2008, encourages participating hospitals to achieve the national benchmarks related to the five core measures established by CMS and the Joint Commission.

**Information Systems**

We have developed and implemented integrated and reliable information technology systems that we believe have been critical to our success. Our systems collect and process information centrally and support our core administrative functions, including premium billing, claims processing, utilization management, reporting, medical cost trending, as well as certain member and provider service functions, including enrollment, member eligibility verification, claims status inquiries, and referrals and authorizations.

In addition, we selected Quality Care Solutions, Inc. (QCSI) to assess and implement a new core business application for our managed care segment. QCSI was subsequently acquired by The Trizetto Company. In the  
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second quarter of 2010, we expect that our Managed Care segment will begin transitioning to our new electronic data processing system. This transition will continue into 2011, when we expect to complete the full migration, at a total cost of approximately \$64.0 million.

This new core business application is intended to provide functionality and flexibility to allow us to offer new services and products and facilitate the integration of future acquisitions. It also designed to improve customer service, enhance claims processing and contain operational expenses.

**Provider Arrangements**

Approximately 97% of member services are provided through one of our contracted provider networks and the remaining percentage of member services are provided by out-of-network providers. Our relationships with managed care providers, physicians, hospitals, other facilities and ancillary managed care providers are guided by standards established by applicable regulatory authorities for network development, reimbursement and contract methodologies. As of December 31, 2009, we had provider contracts with 5,185 primary care physicians, 3,615 specialists and 64 hospitals.

We contract with our managed care providers in different forms, including capitation-based reimbursement. For certain ancillary services, such as behavioral health services, and primary services in the Reform business and *Medicare Optimo* product, we generally enter into capitation arrangements with entities that offer broad based services through their own contracts with providers. We attempt to provide market-based reimbursement along industry standards. We seek to ensure that providers in our networks are paid in a timely manner, and we provide means and procedures for claims adjustments and dispute resolution. We also provide a dedicated service center for our providers. We seek to maintain broad provider networks to ensure member choice while implementing effective management programs designed to improve the quality of care received by our members.

We promote the use of electronic claims billing to our providers. Approximately 90% of claims are submitted electronically through our fully automated claims processing system, and our first-pass rate, or the rate at which a claim is approved for payment after the first time it is processed by our system without human intervention, for physician claims has averaged 84% and 87% in 2009 and 2008, respectively.

We believe that physicians and other providers primarily consider member volume, reimbursement rates, timeliness of reimbursement and administrative service capabilities along with the non-hassle factor or reduction of non-value added administrative tasks when deciding whether to contract with a managed care plan. As a result of our established position in the Puerto Rican market, the strength of the Triple-S name and our association with the BCBSA, we believe we have strong relationships with hospital and provider networks leading to a strong competitive position in terms of hospital count, number of providers and number of in-network specialists.

*Hospitals.* We generally contract for hospital services to be paid on an all-inclusive per diem basis, which includes all services necessary during a hospital stay. Negotiated rates vary among hospitals based on the complexity of services provided. We annually evaluate these rates and revise them, if appropriate.

*Physicians.* Fee-for-service is our predominant reimbursement methodology for physicians in our PPO products and the referred services by the IPAs under capitation agreement. Our physician rate schedules applicable to services provided by in-network physicians are pegged to a resource-based relative value system fee schedule and then adjusted for competitive rates in the market. This structure is similar to reimbursement methodologies developed and used by the federal Medicare system and other major payers. Payments to physicians under the Medicare Advantage program are based on Medicare fees. In the Reform and certain products in the Medicare businesses, we contracted with IPAs in the form of capitation-based reimbursement for certain risks. We have a network of IPAs which provide managed care services to our members in exchange for a capitation fee. The IPA assumes the costs of certain primary care services provided and referred by its primary care physicians (PCPs), including procedures and in-patient services not related to risks assumed by us. We retain other risks under these arrangements, such as: neonatal, obstetrical, AIDS, cancer, cardiovascular and dental services, among others.

Services are provided to our members through our network providers with whom we contract directly. Members seeking medical treatment outside of Puerto Rico are served by providers in these areas through the BlueCard program, which offers access to the provider networks of the other BCBS plans.

*Subcontracting.* We subcontract our triage call center, certain utilization management, mental and substance abuse health services, and pharmacy benefits management services through contracts with third parties.



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In addition, we contract with a number of other ancillary service providers, including laboratory service providers, home health agency providers and intermediate and long-term care providers, to provide access to a wide range of services. These providers are normally paid on either a fee schedule or fixed per day or per case basis.

### **Competition**

The insurance industry in Puerto Rico is highly competitive and is comprised of both local and national entities. The approval of the Gramm-Leach-Bliley Act of 1999, which applies to financial institutions in the United States, including those domiciled in Puerto Rico, has opened the insurance market to new competition by allowing financial institutions such as banks to enter into the insurance business. Several banks in Puerto Rico have established subsidiaries that operate as insurance agencies, brokers and reinsurers.

### **Managed Care**

The managed care industry is highly competitive, both nationally and in Puerto Rico. Competition continues to be intense due to aggressive marketing, business consolidations, a proliferation of new products and increased quality awareness and price sensitivity among customers. Industry participants compete for customers based on the ability to provide a total value proposition which we believe includes quality of service and flexibility of benefit designs, access to and quality of provider networks, brand recognition and reputation, price and financial stability.

We believe that our competitive strengths, including our leading presence in Puerto Rico, our Blue Cross Blue Shield license, the size and quality of our provider network, the broad range of our product offerings, our strong complementary businesses and our experienced management team, position us well to satisfy these competitive requirements.

Competitors in the managed care segment include national and local managed care plans. We currently have approximately 1.3 million members enrolled in our managed care segment at December 31, 2009, representing approximately 34% of the population of Puerto Rico. Our market share in terms of premiums written in Puerto Rico was estimated at approximately 28% for the nine-month period ended September 30, 2009. We offer a variety of managed care products, and are the leader by market share in almost every sector, as measured by the share of premiums written. Our main competitors are Medical Card Systems Inc., Aveta Inc. (or MMM Healthcare), and Humana Inc.

### **Life Insurance**

We are one of the leading providers of life insurance products in Puerto Rico. In 2008, we were the largest life insurance company in Puerto Rico, as measured by direct premiums, with a market share of approximately 12%. In the life insurance segment we are the only life insurance company that distributes our products through home service. However, we face competition in each of our product lines. In the life insurance sector, excluding annuities, we were the largest company with a market share of approximately 17%, and our main competitors are Massachusetts Mutual, Cooperativa de Seguros de Vida de Puerto Rico and AXA Equitable Life. In the cancer sector, we were the third largest company with a market share of approximately 16%, and our main competitors are AFLAC (sector leader) and Trans-Oceanic Life Insurance Company.

### **Property & Casualty Insurance**

The property and casualty insurance market in Puerto Rico is extremely competitive. In addition, soft market conditions have prevailed in Puerto Rico. In the local market, such conditions mostly affected commercial risks, precluding rate increases and even provoking lower premiums on both renewals and new business. Property and casualty insurance companies tend to compete for the same accounts through more favorable price and/or policy terms and better quality of services. We compete by reasonably pricing our products and providing efficient services to producers, agents and clients.

In the nine-month period ended September 30, 2009, we were the fifth largest property and casualty insurance company in Puerto Rico, as measured by direct premiums, with a market share of approximately 9%. Our nearest competitor in the property and casualty insurance market in Puerto Rico was Chartis Insurance Company of Puerto Rico (formerly American International Insurance Company of Puerto Rico). The market leaders in the property and casualty insurance market in Puerto Rico were Universal Insurance Group, Cooperativa de Seguros Múltiples de Puerto Rico, and MAPFRE Corporation.



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**Blue Cross and Blue Shield License**

We have the exclusive right to use the BCBS name and mark for the sale, marketing and administration of managed care plans and related services in Puerto Rico and U.S. Virgin Islands. We believe that the BCBS name and mark are valuable brands of our products and services in the marketplace. The license agreements, which have a perpetual term (but which are subject to termination under circumstances described below), contain certain requirements and restrictions regarding our operations and our use of the BCBS name and mark.

Upon the occurrence of any event causing the termination of our license agreements, we would cease to have the right to use the BCBS name and mark in Puerto Rico and U.S. Virgin Islands. We also would no longer have access to the BCBSA networks of providers and BlueCard Program. We would expect to lose a significant portion of our membership if we lose these licenses. Loss of these licenses could significantly harm our ability to compete in our markets and could require payment of a significant fee to the BCBSA. Furthermore, if our licenses were terminated, the BCBSA would be free to issue a new license to use the BCBS name and marks in Puerto Rico and U.S. Virgin Islands to another entity, which would have a material adverse affect on our business, financial condition and results of operations. See Item 1A. Risk Factors Risks Related to Our Business The termination or modification of our license agreements to use the BCBS name and mark could have a material adverse effect on our business, financial condition and results of operations.

Events which could result in termination of our license agreements include, but are not limited to:  
failure to maintain our total adjusted capital at 200% of Health Risk-Based Capital Authorized Control Level, as defined by the National Association of Insurance Commissioners ( NAIC ) Risk Based Capital ( RBC ) Model Act;

failure to maintain liquidity of greater than one month of underwritten claims and administrative expenses, as defined by the BCBSA, for two consecutive quarters;

failure to satisfy state-mandated statutory net worth requirements;

impending financial insolvency; and

a change of control not otherwise approved by the BCBSA or a violation of the BCBSA voting and ownership limitations on our capital stock.

The BCBSA license agreements and membership standards specifically permit a licensee to operate as a for-profit, publicly-traded stock company, subject to certain governance and ownership requirements.

Pursuant to our license agreements with BCBSA, at least 80% of the revenue that we earn from health care plans and related services in Puerto Rico, and at least 66.7% of the revenue that we earn from (or at least 66.7% of the enrollment for) health care plans and related services both in the United States and in Puerto Rico together, must be sold, marketed, administered, or underwritten through use of the Blue Cross Blue Shield name and mark. This may limit the extent to which we will be able to expand our health care operations, whether through acquisitions of existing managed care providers or otherwise, in areas where a holder of an exclusive right to the Blue Cross Blue Shield name and mark is already present. Currently, the Blue Cross and Blue Shield name and mark is licensed to other entities in all markets in the continental United States, Hawaii, and Alaska.

Pursuant to the rules and license standards of the BCBSA, we guarantee our subsidiaries contractual and financial obligations to their respective customers. In addition, pursuant to the rules and license standards of the BCBSA, we have agreed to indemnify the BCBSA against any claims asserted against it resulting from our contractual and financial obligations.

Each license requires an annual fee to be paid to the BCBSA. The fee is determined based on a per-contract charge from products using the BCBS name and mark. The annual BCBSA fee for the year 2010 is \$1,717,677. During the years ended December 31, 2009 and 2008, we paid fees to the BCBSA in the amount of \$1,345,489 and \$1,079,172, respectively. The BCBSA is a national trade association of 39 Member Plans, the primary function of which is to promote and preserve the integrity of the BCBS names and marks, as well as to provide certain coordination among the Member Plans. Each Member Plan is an independent legal organization and is not responsible for obligations of

other BCBSA Member Plans. With a few limited exceptions, we have no right to market products and services using the BCBS names and marks outside our BCBS licensed territory.

*BlueCard.* Under the rules and license standards of the BCBSA, other member plans must make available their provider networks to members of the BlueCard Program in a manner and scope as consistent as possible to

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what such member would be entitled to in his or her home region. Specifically, the Host Plan (located where the member receives the service) must pass on discounts to BlueCard members from other Member Plans that are at least as great as the discounts that the providers give to the Host Plan's local members. The BCBSA requires us to pay fees to any Host Plan whose providers submit claims for health care services rendered to our members who receive care in their service area. Similarly, we are paid fees for submitting claims and providing other services to members of other Member Plans who receive care in our service area.

**Claim Liabilities**

We are required to estimate the ultimate amount of claims which have not been reported, or which have been received but not yet adjudicated, during any accounting period. These estimates, referred to as claim liabilities, are recorded as liabilities on our balance sheet. We estimate claim reserves in accordance with Actuarial Standards of Practice promulgated by the Actuarial Standards Board, the committee of the American Academy of Actuaries that establishes the professional guidelines and standards for actuaries to follow. A degree of judgment is involved in estimating reserves. We make assumptions regarding the propriety of using existing claims data as the basis for projecting future payments. For additional information regarding the calculation of claim liabilities, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates *Claim Liabilities*.

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### **Investments**

Our investment philosophy is to maintain a largely investment-grade fixed income portfolio, provide adequate liquidity for expected liability durations and other requirements, and maximize total return through active investment management.

We evaluate the interest rate risk of our assets and liabilities regularly, as well as the appropriateness of investments relative to our internal investment guidelines. We operate within these guidelines by maintaining a diversified portfolio, both across and within asset classes.

Investment decisions are centrally managed by investment professionals based on the guidelines established by management and approved by our Investment and Financing Committee of the Board of Directors (the Investment and Financing Committee). Our internal investment group is comprised of the CFO, a Vice president and Treasurer, an investment analyst, and a treasury operations analyst. The internal investment group uses an external investment consultant and manages our short-term investments, fixed income portfolio and equity securities of Puerto Rican corporations that are classified as available for sale. In addition, we use GE Asset Management and State Street Global Advisor as portfolio managers for our trading securities.

The Investment and Financing Committee monitors and approves investment policies and procedures. The investment portfolio is managed following those policies and procedures, and any exception must be reported to the Investment and Financing Committee.

For additional information on our investments, see Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

### **Trademarks**

We consider our trademarks of Triple-S and SSS to be very important and material to all segments in which we engaged. In addition to these, other trademarks used by our subsidiaries that are considered important have been duly registered with the Department of State of Puerto Rico and the United States Patent and Trademark Office. It is our policy to register all our important and material trademarks in order to protect our rights under applicable corporate and intellectual property laws. In addition, we have the exclusive right to use the Blue Cross and Blue Shield name and mark in Puerto Rico. See Blue Cross and Blue Shield License.

### **Regulation**

The operations of our managed care business are subject to comprehensive and detailed regulation in Puerto Rico, as well as U.S. Federal regulation. Supervisory agencies include the Office of the Commissioner of Insurance of the Commonwealth of Puerto Rico (the Commissioner of Insurance), the Division of Banking and Insurance of the Office of the Lieutenant Governor of the U.S. Virgin Islands, the Health Department of the Commonwealth of Puerto Rico and ASES, which administers the Reform Program for the Commonwealth of Puerto Rico. Federal regulatory agencies that oversee our operations include CMS, the Office of the Inspector General (OIG) of HHS, the Office of Civil Rights of HHS, the U.S. Department of Justice, the U.S. Department of Labor, and the Office of Personnel Management (OPM). These government agencies have the right to:

grant, suspend and revoke licenses to transact business;

regulate many aspects of the products and services we offer;

assess fines, penalties and/or sanctions;

monitor our solvency and adequacy of our financial reserves; and

regulate our investment activities on the basis of quality, diversification and other quantitative criteria, within the parameters of a list of permitted investments set forth in applicable insurance laws and regulations.

Our operations and accounts are subject to examination and audits at regular intervals by these agencies. In addition, the U.S. Federal and local governments continue to consider and enact many legislative and regulatory proposals that have impacted, or would materially impact, various aspects of the health care system. Some of the more significant current issues that may affect our managed care business include:



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initiatives to provide greater access to coverage for uninsured and under-insured populations without adequate funding to health plans or to be funded through taxes or other negative financial levy on health plans;

payments to health plans that are tied to achievement of certain quality performance measures;

other efforts or specific legislative changes to the Medicare or Reform programs, including changes in the bidding process or other means of materially reducing premiums;

local government regulatory changes;

increased government enforcement of or changes in interpretation or application of fraud and abuse laws; and

regulations that increase the operational burden on health plans or laws that increase a health plan's exposure to liabilities, including efforts to expand the tort liability of health plans care;

Since early 2009, President Obama and various members of Congress have proposed varied legislation designed to reform aspects of the health care and insurance system in the United States. The initial health care reform proposal presented by President Obama attempted to address increasing access to health care coverage, reducing the cost of care, and improving the quality of care rendered. The health care reform plan proposal was to be financed in large part by reduced expenditures for the Medicare program. Consistent with President Obama's plan proposal, Congress has previously supported financing health care reform by reducing Medicare Advantage funding. Throughout 2009, Congress debated various health reform proposals and held hearings on such proposals. At this time, no health reform proposals have been enacted into law nor does the passage into law of such a proposal appear imminent. Nevertheless, because of the unsettled nature of these proposals, the numerous steps to implement any proposal that may be enacted into law, and the possibility that some amount of the existing reform proposal efforts may be implemented through other means, such as CMS initiatives, that do not require authorizing legislation, we cannot predict the impact, if any, of such proposals on our business provide assurances that if any such proposal were to be enacted whether such proposal would or would not have a material impact on our business in the future.

The enactment of this proposal could have a material adverse effect on the profitability or marketability of our business, financial condition and results of operations.

The Federal government and the government of Puerto Rico, including the Commissioner of Insurance, have adopted laws and regulations that govern our business activities in various ways. These laws and regulations may restrict how we conduct our business and may result in additional burdens and costs to us. Areas of governmental regulation include:

licensure;

policy forms, including plan design and disclosures;

premium rates and rating methodologies;

underwriting rules and procedures;

benefit mandates;

eligibility requirements; security of electronically transmitted individually identifiable health information; geographic service areas; market conduct; utilization review; payment of claims, including timeliness and accuracy of payment; special rules in contracts to administer government programs; transactions with affiliated entities; limitations on the ability to pay dividends; rates of payment to providers of care; transactions resulting in a change of control; member rights and responsibilities; fraud and abuse; sales and marketing activities; quality assurance procedures; privacy of medical and other information and permitted



disclosures; rates of payment to providers of care; surcharges on payments to providers; provider contract forms; delegation of financial risk and other financial arrangements in rates paid to providers of care; agent licensing; financial condition (including reserves); reinsurance; issuance of new shares of capital stock; corporate governance; and permissible investments.

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These laws and regulations are subject to amendments and changing interpretations in each jurisdiction. Failure to comply with existing or future laws and regulations could materially and adversely affect our operations, financial condition and prospects.

### ***Puerto Rico Insurance Laws***

Our insurance subsidiaries are subject to the regulations and supervision of the Commissioner of Insurance. The regulations and supervision of the Commissioner of Insurance consist primarily of the approval of certain policy forms, the standards of solvency that must be met and maintained by insurers and their agents, and the nature of and limitations on investments, deposits of securities for the benefit of policyholders, methods of accounting, periodic examinations and the form and content of reports of financial condition required to be filed, among others. In general, such regulations are for the protection of policyholders rather than security holders.

Puerto Rico insurance laws prohibit any person from offering to purchase or sell voting stock of an insurance company with capital contributed by stockholders (a stock insurer) which constitutes 10% or more of the total issued and outstanding stock of such company or of the total issued and outstanding stock of a company that controls an insurance company, without the prior approval of the Commissioner of Insurance. The proposed purchaser or seller must disclose any changes proposed to be made to the administration of the insurance company and provide the Commissioner of Insurance with any information reasonably requested. The Commissioner of Insurance must make a determination within 30 days of the later of receipt of the petition or of additional information requested. The determination of the Commissioner of Insurance will be based on its evaluation of the transaction's effect on the public, having regard to the experience and moral and financial responsibility of the proposed purchaser, whether such responsibility of the proposed purchaser will affect the effectiveness of the insurance company's operations and whether the change of control could jeopardize the interests of insureds, claimants or the company's other stockholders. Our articles of incorporation prohibit any institutional investor from owning 10% or more of our voting power, any person that is not an institutional investor from owning 5% or more of our voting power, and any person from beneficially owning shares of our common stock or other equity securities, or a combination thereof, representing a 20% or more ownership interest in us. To the extent that a person, including an institutional investor, acquires shares in excess of these limits, our articles provide that we will have the power to take certain actions, including refusing to give effect to a transfer or instituting proceedings to enjoin or rescind a transfer, in order to avoid a violation of the ownership limitation in the articles.

Puerto Rico insurance laws also require that stock insurers obtain the Commissioner of Insurance's approval prior to any merger or consolidation. The Commissioner of Insurance cannot approve any such transaction unless it determines that such transaction is just, equitable, consistent with the law and no reasonable objection exists. The merger or consolidation must then be authorized by a duly approved resolution of the board of directors and ratified by the affirmative vote of two-thirds of all issued and outstanding shares of capital stock with the right to vote thereon. The reinsurance of all or substantially all of the insurance of an insurance company by another insurance company is also deemed to be a merger or consolidation.

Puerto Rico insurance laws further prohibit insurance companies and insurance holding companies, among other entities, from soliciting or receiving funds in exchange for any new issuance of its securities, other than through a stock dividend, unless the Commissioner of Insurance has granted a solicitation permit in respect of such transaction. The Commissioner of Insurance will issue the permit unless it finds that the funds proposed to be secured are excessive for the purpose intended, the proposed securities and their distribution would be inequitable, or the issuance of the securities would jeopardize the interests of policyholders or securityholders.

In addition, Puerto Rico insurance laws limit insurance companies' ability to reinsure risk. Insurance companies can only accept reinsurance in respect of the types of insurance which they are authorized to transact directly. Also, except for life and disability insurance, insurance companies cannot accept any reinsurance in respect of any risk resident, located, or to be performed in Puerto Rico which was insured as direct insurance by an insurance company not then authorized to transact such insurance in Puerto Rico. As a result, insurance companies can only reinsure their risks with insurance companies in Puerto Rico authorized to transact the same type of insurance or with a foreign insurance company that has been approved by the Commissioner of Insurance. Insurance companies cannot reinsure 75% or more of their direct risk with respect to any type of insurance without first obtaining the approval of the Commissioner of Insurance.



**Table of Contents*****Privacy of Financial and Health Information***

Puerto Rico law requires that managed care providers maintain the confidentiality of financial and health information. The Commissioner of Insurance has promulgated regulations relating to the privacy of financial information and individually identifiable health information. Managed care providers must periodically inform their clients of their privacy policies and allow such clients to opt-out if they do not want their financial information to be shared. However, the regulations related to the privacy of health information do not apply to managed care providers, such as us, who comply with the provisions of HIPAA. Also, Puerto Rico law requires that managed care providers provide patients with access to their health information within a specified time and that they not charge more than a predetermined amount for such access. The law imposes various sanctions on managed care providers that fail to comply with these provisions.

***Managed Care Provider Services***

Puerto Rico law requires that managed care providers cover and provide specific services to their subscribers. Such services include access to a provider network that guarantees emergency and specialized services. In addition, the Office of the Solicitor for the Beneficiaries of the Reform is authorized to review and supervise the operations of entities contracted by the Commonwealth of Puerto Rico to provide services under the Reform. The Solicitor may investigate and adjudicate claims filed by beneficiaries of the Reform against the various service providers contracted by the Commonwealth of Puerto Rico. See Business Customers Medicare Supplement and Reform Sector sections included in this Item for more information.

***Capital and Reserve Requirements***

Since 2009, local insurers and health organizations are required by the Insurance Code to submit to the Puerto Rico Commissioner of Insurance RBC reports following the NAIC's RBC Model Act and accordingly are subject to the relevant measures and actions as required based on their capital levels in relation to the determined risk based capital. In February 2010 entered into effect Insurance Regulation No. 92, which establishes the guidelines to implement RBC requirements. Rule 92 provides for gradual compliance and a transition period of five years, including dividend payment restriction and exemption to comply with requirements.

In addition, our managed care subsidiary is subject to the capital and surplus licensure requirements of the BCBSA. The capital and surplus requirements of the BCBSA are based on the RBC Model Act. These capital and surplus requirements are intended to assess capital adequacy taking into account the risk characteristics of an insurer's investments and products. The RBC Model Act set forth the formula for calculating the risk-based capital requirements, which are designed to take into account risks, insurance risks, interest rate risks and other relevant risks with respect to an individual insurance company's business.

The RBC Model Act requires increasing degrees of regulatory oversight and intervention as an insurance company's risk-based capital declines. The level of regulatory oversight ranges from requiring the insurance company to inform and obtain approval from the domiciliary insurance commissioner of a comprehensive financial plan for increasing its risk-based capital to mandatory regulatory intervention requiring an insurance company to be placed under regulatory control, in rehabilitation or liquidation proceeding. The RBC Model Act provides for four different levels of regulatory attention depending on the ratio of the company's total adjusted capital (defined as the total of its statutory capital, surplus, asset valuation reserve and dividend liability) to its risk-based capital. The company action level is triggered if a company's total adjusted capital is less than 200% but greater than or equal to 150% of its risk-based capital. At the company action level, a company must submit a comprehensive plan to the regulatory authority which discusses proposed corrective actions to improve its capital position. A company whose total adjusted capital is between 250% and 200% of its risk-based capital is subject to a trend test. The trend test calculates the greater of any decrease in the margin (i.e., the amount in dollars by which a company's adjusted capital exceeds its risk-based capital) between the current year and the prior year and between the current year and the average of the past three years, and assumes that the decrease could occur again in the coming year. If a similar decrease in margin in the coming year would result in a risk-based capital ratio of less than 190%, then company action level regulatory action will occur.

The regulatory action level is triggered if a company's total adjusted capital is less than 150% but greater than or equal to 100% of its risk-based capital. At the regulatory action level, the regulatory authority will perform a special

examination of the company and issue an order specifying corrective actions that must be followed. The authorized control level is triggered if a company's total adjusted capital is less than 100% but greater than or equal to 70% of its risk-based capital, at which level the regulatory authority may take any action it deems

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necessary, including placing the company under regulatory control. The mandatory control level is triggered if a company's total adjusted capital is less than 70% of its risk-based capital, at which level the regulatory authority must place the company under its control.

We and our insurance subsidiaries currently meet and exceed the minimum capital requirements of the Commissioner of Insurance and the BCBSA, as applicable. Regulation of financial reserves for insurance companies and their holding companies is a frequent topic of legislative and regulatory scrutiny and proposals for change. It is possible that the method of measuring the adequacy of our financial reserves could change and that could affect our financial condition.

In addition to its catastrophic reinsurance coverage, TSP is required by local regulatory authorities to establish and maintain a reserve supported by a trust fund (the Trust) to protect policyholders against their dual exposure to hurricanes and earthquakes. The funds in the Trust are solely to be used to pay catastrophe losses whenever qualifying catastrophic losses exceed 5% of catastrophe premiums or when authorized by the Commissioner of Insurance. Contributions to the Trust, and accordingly additions to the reserve, are determined by a rate (1% in 2009, 2008 and 2007), imposed by the Commissioner of Insurance on the catastrophe premiums written in that year. As of December 31, 2009 and 2008, we had \$33.7 million and \$31.3 million, respectively, invested in securities deposited in the Trust. The income generated by investment securities deposited in the Trust becomes part of the Trust fund balance and are therefore considered an addition to the reserve. For additional details see note 18 of the audited consolidated financial statements.

***Dividend Restrictions***

We are subject to the provisions of the General Corporation Law of Puerto Rico ( PRGCL ), which contains certain restrictions on the declaration and payment of dividends by corporations organized pursuant to the laws of Puerto Rico. These provisions provide that Puerto Rico corporations may only declare dividends charged to their surplus or, in the absence of such surplus, net profits of the fiscal year in which the dividend is declared and/or the preceding fiscal year. The PRGCL also contains provisions regarding the declaration and payment of dividends and directors liability for illegal payments.

***Guaranty Fund Assessments***

We are required by Puerto Rico law and by the BCBSA guidelines to participate in certain guarantee associations. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Other Contingencies - Guaranty Association for additional information.

***Federal Regulation***

Our business is subject to extensive federal law and regulation. New laws, regulations or guidance or changes to existing laws, regulations or guidance or their enforcement, may materially impact our business financial condition and results of operations.

**Table of Contents***The Medicare Advantage and Medicare Part D Programs*

Medicare is the health insurance program for retired United States citizens aged 65 and older, qualifying disabled persons, and persons suffering from end-stage renal disease. Medicare is funded by the federal government and administered by CMS.

The original Medicare program, created in 1965, known as Medicare Fee-for-service, offers both hospital insurance, known as Medicare Part A, and medical insurance, known as Medicare Part B. In general, Medicare Part A covers hospital care and some nursing home, hospice and home care. Although there is no monthly premium for Medicare Part A, beneficiaries are responsible for significant deductibles and co-payments. All United States citizens eligible for Medicare are automatically enrolled in Medicare Part A when they turn 65. Enrollment in Medicare Part B is voluntary. In general, Medicare Part B covers outpatient hospital care, physician services, laboratory services, durable medical equipment, and some other preventive tests and services. Beneficiaries that enroll in Medicare Part B pay a monthly premium that is usually withheld from their Social Security checks. Medicare Part B generally pays 80% of the cost of services and beneficiaries pay the remaining 20% after the beneficiary has satisfied a \$135 deductible. To fill the gaps in traditional fee-for-service Medicare coverage, individuals often purchase Medicare supplement products, commonly known as Medigap, which is regulated but not funded by CMS, to cover deductibles, co-payments, and coinsurance.

Initially, Medicare was offered only on a fee-for-service basis. Under the Medicare fee-for-service payment system, a Medicare beneficiary can choose any licensed physician and use the services of any hospital, healthcare provider, or facility that has signed a participation agreement and meets applicable certification requirements with Medicare. CMS reimburses providers if Medicare covers the service and the service is medically necessary and other applicable coverage criteria. There is currently no fee-for-service coverage for certain preventive services, including annual physicals and well visits, eyeglasses, hearing aids, dentures and most dental services.

As an alternative to the traditional fee-for-service Medicare program, since the 1980s, Medicare has also offered Medicare managed care benefits provided through contracted private health plans. Prior to 1997, CMS reimbursed health plans participating in the Medicare program primarily on the basis of the demographic data of the plans members. Beginning in 1997, CMS gradually phased in a risk adjustment payment methodology that based the CMS monthly premium payments to plans on various clinical and demographic factors. Beginning in 2003, Congress introduced a new Medicare managed care approach.

*The 2003 Medicare Modernization Act*

In December 2003, Congress passed the Medicare Prescription Drug, Improvement and Modernization Act, which is known as the Medicare Modernization Act (MMA). The MMA transformed Medicare's managed care program-known as Medicare Part C or Medicare Advantage-and also introduced a prescription drug program known as Medicare Part D.

Under Medicare Part C, Medicare Advantage plans contract with CMS and in exchange for a monthly payment per member from CMS, agree to provide a minimum benefits package that is equivalent to the benefits provided by Medicare under the traditional fee-for-service Medicare program and to provide additional benefits to the extent a Medicare Advantage plan is able to do so.

As of January 1, 2006, such contracts are awarded and premiums are set based upon a proscribed bidding. Local Medicare Advantage plans annually submit bids based upon their expected costs to provide the minimum Medicare Part A and Part B benefits in their applicable service areas. The bids are then compared to a county level benchmark amount that is based upon the historic cost of providing Medicare fee for service benefits adjusted by CMS over time.

If the bid is less than the benchmark, CMS will pay the plan its bid amount, risk adjusted based on its risk scores, plus a rebate equal to 75% of the actual amount by which the benchmark exceeds the bid, resulting in an annual adjustment in reimbursement rates. Plans are required to use the rebate to provide beneficiaries with supplemental benefits, reductions in cost sharing, or reductions in premiums for Part D benefits or other supplemental benefits. It is fairly common for Medicare Advantage plans to provide additional benefits to enrollees such as lower deductibles and co-payments than those required by traditional fee-for-service Medicare, and plan members to not need to purchase supplemental Medigap policies because those types of benefits are covered under the Medicare Advantage benefits package. Because Medicare Advantage plans frequently employ a managed care





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model, members are often required to use only the service and provider network contracted by the Medicare Advantage plan for non-emergency care. In some geographic areas, however, and for plans employing an open access model, members may be required to pay a monthly premium. For our products such additional benefits include increased preventive services, and dental and vision benefits.

If a Medicare Advantage plan's bid is greater than the benchmark, the plan receives the benchmark as payment from Medicare and is required to charge a premium to enrollees equal to the difference between the bid amount and the benchmark. Currently the bids that TSS has submitted each year for its products have been below the CMS benchmark, meaning TSS has not been required to charge its members a premium.

The Medicare Advantage premium amount is risk adjusted by enrollee depending in the documented health characteristics of each enrollee. The monthly payment amounts from CMS to each Medicare Advantage plan are based on a fixed premium amount per member per month that is set each year by CMS. That fixed amount is then risk adjusted by member based upon each member's documented health characteristics. In order to facilitate the risk adjustment system, CMS requires all Medicare Advantage plans to collect and submit diagnosis code information to CMS twice a year for reconciliation with CMS's internal database. The resulting risk adjusted payments are further adjusted by a budget neutrality factor, which is currently scheduled to be phased out by 2011.

Under Medicare Part D, every Medicare beneficiary is able to select a Medicare prescription drug plan provided through private Medicare Part D plans that have contracted with the federal government to offer and run a Medicare Part D benefit plan under terms and conditions dictated by CMS in 34 geographic regions. Medicare Part D has replaced state level Medicaid prescription drug coverage for dual-eligibles, that is beneficiaries eligible for participation under both the Medicare and Medicaid programs. The Medicare Part D prescription drug benefit payments to plans are determined through a competitive bidding process, and enrollee premiums also are based upon plan bids. The bids are based upon a plan's expected costs for a Medicare beneficiary of average health; CMS adjusts payments to plans based on enrollees' health and other factors. The program is funded by the federal government with some risk-sharing between Medicare Part D plans and the federal government through risk corridors designed to limit the profits or losses of the drug plans and reinsurance for catastrophic drug costs, as described below. The government payment amount to plans is based on the national weighted average monthly bid for basic Part D coverage, adjusted for member demographics and risk factor payments. The beneficiary will be responsible for the difference between the government subsidy and his or her plan's bid, together with the amount of his or her plan's supplemental premium (before rebate allocations), subject to the co-pays, deductibles and late enrollment penalties, if applicable, described below. Additional subsidies are provided for dual-eligible beneficiaries and specified low-income beneficiaries. Medicare also subsidizes 80% of drug spending above an enrollee's catastrophic threshold.

The Medicare Part D benefits are available to Medicare Advantage plan enrollees as well as Medicare fee-for-service enrollees. Medicare Advantage plan enrollees who elect to participate may pay a monthly premium for this Medicare Part D prescription drug benefit ( MA-PD ) while fee-for-service beneficiaries will be able to purchase a stand-alone prescription drug plan ( PDP ) from a list of CMS-approved PDPs available in their area. Any Medicare Advantage member enrolling in a stand-alone PDP, however, will automatically be disenrolled from the Medicare Advantage plan altogether, thereby resuming traditional fee-for-service Medicare for Medicare Parts A and B coverage. Under the standard Part D drug coverage for 2010, beneficiaries enrolled in a stand-alone PDP will pay a \$310 deductible, co-insurance payments equal to 25% of the drug costs between \$310 and the initial annual coverage limit of \$2,780 and all drug costs between \$2,780 and \$6,440, which is commonly referred to as the Part D doughnut hole or coverage gap . After the beneficiary has incurred \$4,350 in out-of-pocket drug expenses, the MMA provides catastrophic stop loss coverage that will cover approximately 95% of the beneficiary's remaining out-of-pocket drug costs for that year. MA-PDs are not required to match these limits, but are required to provide, at a minimum, coverage that is actuarially equivalent to this standard drug coverage benefit design. Medicare Part D plans also may offer supplemental drug coverage for additional benefits not subsidized by Medicare programs payments. The deductible, co-pay and coverage amounts are adjusted by CMS on an annual basis. We are required as a Medicare Advantage coordinated care plan to offer qualified Part D prescription drug coverage of our MA plan service areas. We currently offer prescription drug benefits through our Medicare Advantage plans and also offer a stand-alone PDP. Among the options in Medicare Advantage, we offer four MA-PD plans with no initial deductible, one of which has

generic coverage with a \$5 co-payment during the doughnut hole period. On the PDP side, we currently offer three plans, two of which have no initial deductible and one of which has generic coverage with a \$5 co-payment during the doughnut hole period.

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*Dual-Eligible Beneficiaries.* A dual-eligible beneficiary is a person who is eligible for both Medicare and Medicaid, because of age or other qualifying status, and Reform, because of economic status. The government of Puerto Rico established a model that wraps-around benefits included in the Reform that were not included in MA benefits. Dual-eligible beneficiaries in Puerto Rico have the option to participate in this model called *Platino*. Health plans that offer *Platino* products receive premiums from CMS and the government of Puerto Rico. In this plan the government, rather than the insured, will assume all of the premiums for additional benefits not included in traditional Medicare programs, such as prescription drug benefits. By managing utilization and implementing disease management programs, many Medicare Advantage plans can profitably care for dual-eligible members. The MMA provides subsidies and reduced or eliminated deductibles for certain low-income beneficiaries, including dual-eligible individuals. Pursuant to the MMA, dual-eligible individuals receive their drug coverage from the Medicare program rather than the Reform program. Companies offering stand-alone PDPs with bids at or below the regional weighted average bid resulting from the annual bidding process received a pro-rata allocation and auto-enrollment of the dual-eligible beneficiaries within the applicable region.

*Sales and Marketing.* Our sales and marketing activities are closely regulated by CMS and ASES. For example, our sales and marketing materials must be approved in advance by the applicable regulatory authorities, and these regulatory authorities impose other regulatory restrictions on our marketing activities.

*Fraud and Abuse Laws.* Entities, such as TSS, that receive federal funds from government health care programs, such as Medicare and Medicaid, are subject to a wide variety of federal fraud and abuse laws and enforcement activities. Such laws include the federal anti-kickback laws and false claims act.

*Anti-kickback Laws.* The federal anti-kickback laws prohibit the payment, solicitation, offering or receipt of any form of remuneration (including kickbacks, bribes, and rebates) in exchange for the referral of federal healthcare program patients or any item or service that is reimbursed by any federal health care program. In addition, the federal regulations include certain safe harbors that describe relationships that have been determined by CMS not to violate the federal anti-kickback laws. Relationships that do not fall within one of the enumerated safe harbors are not a per se violation of the law, but will be subject to enhanced scrutiny by regulatory authorities. Failure to comply with the anti-kickback provisions may result in civil damages and penalties, criminal sanctions, and administrative remedies, such as exclusion from the applicable federal health care program.

*Federal False Claims Act.* Federal regulations also strictly prohibit the presentation of false claims or the submission of false information to the federal government. Under the federal False Claims Act, any person or entity that has knowingly presented or caused to be presented a false or fraudulent request for payment from the federal government or who has made a false statement or used a false record in the submission of a claim may be subject to treble damages and penalties of up to \$11,000 per claim. The federal government has taken the position that claims presented in relationships that violate the anti-kickback statute may also be considered to be violations of the federal False Claims Act. Furthermore, the federal False Claims Act permits private citizen whistleblowers to bring actions on behalf of the federal government for violations of the Act and to share in the settlement or judgment that may result from the lawsuit.

***HIPAA and Gramm-Leach-Bliley Act***

Health care entities, such as TSS, are subject to laws, including HIPAA and the Gramm-Leach-Bliley Act, that require the protection of certain Health and other information. The Health Insurance Portability and Accountability Act of 1996 ( HIPAA ) authorizes HHS to issue standards for administrative simplification, as well as privacy and security of medical records and other individually identifiable health information. The regulations under the HIPAA Administrative Simplification section impose a number of additional obligations on issuers of health insurance coverage and health benefit plan sponsors. HIPAA Administrative Simplification section requirements apply to self-funded group plans, health insurers and HMOs, health care clearinghouses and health care providers who transmit health information electronically ( covered entities ). Regulations promulgated pursuant to the Stimulus (as defined below) also require that business associates acting for or on behalf of HIPAA-covered entities comply with many of the HIPAA standards regarding the privacy and security of individually identifiable health information. The regulations of the Administrative Simplification section establish significant criminal penalties and civil sanctions for noncompliance.

HHS has released rules mandating the use of new standard formats with respect to certain health care transactions (e.g. health care claims information, plan eligibility, referral certification and authorization, claims

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status, plan enrollment and disenrollment, payment and remittance advice, plan premium payments and coordination of benefits). HHS also has published rules requiring the use of standardized code sets and unique identifiers by employers and providers. Our managed care subsidiary believes that it is in material compliance with all relevant requirements.

HHS also sets standards relating to the privacy of individually identifiable health information. In general, these regulations restrict the use and disclosure of medical records and other individually identifiable health information held by health plans and other affected entities in any form, whether communicated electronically, on paper or orally, subject only to limited exceptions. In addition, the regulations provide patients new rights to understand and control how their health information is used. HHS has also published security regulations designed to protect member health information from unauthorized use or disclosure. Our managed care subsidiary is currently in material compliance with these security regulations.

The American Recovery and Reinvestment Act of 2009 (H.R. 1, S. 1) ( the Stimulus ), signed by President Obama on February 17, 2009, contains several provisions that expand the scope and enforcement of HIPAA. Many of those Stimulus provisions that affect and expand HIPAA became effective on February 17, 2010. The Secretary of HHS has promulgated regulations clarifying certain aspects of the Stimulus pertaining to HIPAA and it is expected that the Secretary of HHS will issue additional regulations pertaining to HIPAA in the near future. We have updated our internal policies and operations to comply with the Stimulus pertaining to HIPAA. We will monitor the further implementation of the Stimulus and the regulations promulgated thereunder, and we will modify our policies and operations as necessary to comply with these future amendments. See Item 1. Business Regulation Legislative and Regulatory *Initiatives* for additional information.

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HHS has released rules mandating the use of standard formats in electronic health care transactions (for example, health care claims submission and payment, plan eligibility, precertification, claims status, plan enrollment and disenrollment, payment and remittance advice, plan premium payments and coordination of benefits). HHS also has published rules requiring the use of standardized code sets and unique identifiers for employers and providers. By 2013, the federal government will require that healthcare organizations, including health insurers, upgrade to updated and expanded standardized code sets used for describing health conditions. The Regulation requires a conversion from the ICD-9 diagnosis and procedure code set to the ICD-10 diagnosis and procedure code set. Our managed care subsidiary has initiated a project to comply with the ICD-10 capabilities by the October 1, 2013 (effective date), that will require a substantial investment.

The Gramm-Leach-Bliley Act applies to financial institutions in the United States, including those domiciled in Puerto Rico. The Gramm-Leach-Bliley Act generally placed restrictions on the disclosure of non-public information to non-affiliated third parties, and required financial institutions including insurers, to provide customers with notice regarding how their non-public personal information is used, including an opportunity to opt out of certain disclosures. The Gramm-Leach-Bliley Act also gives banks and other financial institutions the ability to affiliate with insurance companies, which has led to new competitors in the insurance and health benefits fields in Puerto Rico.

***Employee Retirement Income Security Act of 1974***

The provision of services to certain employee welfare benefit plans is subject to the Employee Retirement Income Security Act of 1974, as amended ( ERISA ) a complex set of laws and regulations subject to interpretation and enforcement by the Internal Revenue Service and the Department of Labor ( DOL ). ERISA regulates certain aspects of the relationships between us, the employers who maintain employee welfare benefit plans subject to ERISA and participants in such plans. Some of our administrative services and other activities may also be subject to regulation under ERISA. In addition, certain states require licensure or registration of companies providing third-party claims administration services for benefit plans. We provide a variety of products and services to employee welfare benefit plans that are covered by ERISA. Plans subject to ERISA can also be subject to state laws and the question of whether ERISA preempts a state law has been, and will continue to be, interpreted by many courts.

***Other Government Programs***

We participate in the Health Reform of the government of Puerto Rico (the Reform ) to provide health coverage to medically indigent citizens in Puerto Rico. See Item 1. Business Customers Reform Sector .

**Table of Contents*****Legislative and Regulatory Initiatives******Puerto Rico Initiatives***

The Commissioner of Insurance is currently evaluating the adoption of Rule No. 83, titled Norms and Procedures to Regulate Insurance and Health Maintenance Holding Company Systems and the Criteria to Evaluate the Change of Control. The most recent draft of Rule No. 83 contains certain reporting requirements as well as restrictions on transactions between an insurer or HMO and its affiliates. Rule No. 83 would generally require insurance companies and HMOs within an insurance holding company system to register with the Commissioner of Insurance if they are domiciled in the Commonwealth and to file with the Commissioner of Insurance certain reports describing capital structure, ownership, financial condition, certain intercompany transactions and general business operations. In addition, Rule No. 83 would require prior notice, reporting and regulatory approval of certain material transactions and intercompany transfers of assets as well as certain transactions between insurance companies, HMOs, their parent holding companies and affiliates. Among other restrictions, Rule No. 83 would restrict the ability of our regulated subsidiaries to pay dividends.

Additionally, Rule No. 83 would restrict the ability of any person to obtain control of an insurance company or HMO without prior regulatory approval. According to Rule No. 83, no person may make an offer to acquire or to sell the issued and outstanding voting stock of an insurance company, which constitutes 10% or more of the issued and outstanding stock of an insurance company, or of the total stock issued and outstanding of a holding company of an insurance company, without (i) filing the appropriate documentation with the Commissioner of Insurance and (ii) obtaining the prior approval of the Commissioner of Insurance. This requirement is similar to that contained in the Insurance Code and referred to under Regulation Puerto Rico Insurance Laws.

***Federal Initiatives***

Since early 2009, President Obama and various members of Congress have proposed varied legislation designed to reform aspects of the health care and insurance system in the United States. The initial health care reform proposal presented by President Obama attempted to address increasing access to health care coverage, reducing the cost of care, and improving the quality of care rendered. The health care reform plan proposal was to be financed in large part by reduced expenditures for the Medicare program. Consistent with President Obama's plan Proposal, Congress has previously supported financing health care reform by reducing Medicare Advantage funding. Throughout 2009, Congress debated various health reform proposals and held hearings on such proposals. At this time, no health reform proposals have been enacted into law nor does the passage into law of such a proposal appear imminent. Nevertheless, because of the unsettled nature of these proposals, the numerous steps to implement any proposal that may be enacted into law, and the possibility that some amount of the existing reform proposal efforts may be implemented through other means, such as CMS initiatives, that do not require authorizing legislation, we cannot predict the impact, if any, of such proposals on our business provide assurances that if any such proposal were to be enacted whether such proposal would or would not have a material impact on our business in the future.

**Financial Information About Segments**

Operating revenues (with intersegment premiums/service revenues shown separately), operating income and total assets attributable to the reportable segments are set forth in note 27 to the audited consolidated financial statements for the years ended December 31, 2009, 2008 and 2007.

**Employees**

As of January 31, 2010, we had 2,321 full-time employees and 400 temporary employees. Our managed care subsidiary has a collective bargaining agreement with the Unión General de Trabajadores, which represents approximately 45% of our managed care subsidiary's 777 regular employees. The collective bargaining agreement expires on July 31, 2012. The Corporation considers its relations with employees to be good.

**Available Information**

We are an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934, as amended) and are required, pursuant to Item 101 of Regulation S-K, to provide certain information regarding its website and the availability of certain documents filed with or furnished to the United States Securities and Exchange Commission (the SEC). Our Internet website is [www.triplesmanagement.com](http://www.triplesmanagement.com). We make available free of charge, or through





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our Internet website, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with or furnish it to the SEC. We also include on our Internet website our Corporate Governance Guidelines, our Standards of Ethical Business Conduct and the charter of each standing committee of our Board of Directors. In addition, we intend to disclose on our Internet website any amendments to, or waivers from, our Standards of Ethical Business Conduct that are required to be publicly disclosed pursuant to rules of the SEC and the New York Stock Exchange ( NYSE ). The SEC maintains an internet site (www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The website addresses listed above are provided for the information of the reader and are not intended to be an active link. We will provide free of charge copies of our filings to any shareholder that requests them at the following address: Triple-S Management Corporation; Office of the Secretary of the Board; PO Box 363628; San Juan, P.R. 00936-3628.

**Special Note Regarding Forward-Looking Statements**

This Annual Report on Form 10-K contains forward-looking statements, as such term is defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that include information about possible or assumed future sales, results of operations, developments, regulatory approvals or other circumstances and may be found in the Items of this Annual Report on Form 10-K entitled Item 1. Business , Item 1A. Risk Factors , 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Annual Report on Form 10-K. Statements that use the terms believe , expect , plan , intend , estimate may , will , shall , should and similar expressions, whether in the positive or negative, are intended to identify forward-looking statements.

All forward-looking statements in this Annual Report on Form 10-K reflect our current views about future events and are based on assumptions and subject to risks and uncertainties. Consequently, actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in Item 1A. Risk Factors and elsewhere in this Annual Report on Form 10-K.

In addition, we operate in a highly competitive, constantly changing environment that is significantly influenced by very large organizations that have resulted from business combinations, aggressive marketing and pricing practices of competitors and regulatory oversight. The following is a summary of factors, the results of which, either individually or in combination, if markedly different from our planning assumptions, could cause our results to differ materially from those expressed in any forward-looking statements contained in this Annual Report on Form 10-K:

trends in health care costs and utilization rates;

ability to secure sufficient premium rate increases;

competitor pricing below market trends of increasing costs;

re-estimates of our policy and contract liabilities;

changes in government regulation of managed care, life insurance or property and casualty insurance;

significant acquisitions or divestitures by major competitors;

introduction and use of new prescription drugs and technologies;

a downgrade in our financial strength ratings;

litigation or legislation targeted at managed care, life insurance or property and casualty insurance companies;

ability to contract with providers consistent with past practice;

ability to successfully implement our disease management and utilization management programs;

volatility in the securities markets and investment losses and defaults;

general economic downturns, major disasters and epidemics.

The foregoing list should not be construed to be exhaustive. We believe the forward-looking statements in this Annual Report on Form 10-K are reasonable; however, there is no assurance that the actions, events or results anticipated by the forward-looking statements will occur or, if any of them do, what impact they will have on our results of operations or financial condition. In view of these uncertainties, you should not place undue reliance on any forward-looking statements, which are based on our current expectations. Further, forward-looking statements

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speak only as of the date they are made, and, other than as required by applicable law, including the securities laws of the United States, we do not intend to update or revise any of them in light of new information or future events.

***Item 1A. Risk Factors***

We must deal with several risk factors during the normal course of business. You should carefully consider the following risks and all other information set forth on this Annual Report on Form 10-K. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that are currently deemed immaterial may also impair our business operations. The occurrence of any of the following risks could materially affect our business, financial condition, operating results, and cash flows.

**Risks Relating to our Capital Stock*****Certain of our current and former providers may bring materially dilutive claims against us.***

Beginning with our founding in 1959 and until 1994, we encouraged, and at times required, the doctors and dentists that comprised our provider network to acquire our shares. Between approximately 1985 and 1994, our predecessor managed care subsidiary, Seguros de Servicios de Salud de Puerto Rico, Inc. ( SSS ) generally entered into an agreement with each new physician or dentist who joined our provider network to sell the provider shares of SSS at a future date (each agreement, a share acquisition agreement ). These share acquisition agreements were necessary because there were not enough authorized shares of SSS available during this period and afterwards for issuance to all new providers. Each share acquisition agreement committed SSS to sell, and each new provider to purchase, five \$40-par-value shares of SSS at \$40 per share after SSS had increased its authorized share capital in compliance with the Puerto Rico Insurance Code and was in a position to issue new shares. Despite repeated efforts in the 1990s, SSS was not successful in obtaining shareholder approval to increase its share capital, other than in connection with the Corporation's reorganization in 1999, when SSS was merged into a newly-formed entity having authorized capital of 25,000 \$40-par-value shares, or twice the number of authorized shares of SSS. SSS's shareholders did not, however, authorize the issuance of the newly formed entity's shares to providers or any other third party. In addition, subsequent to the reorganization, our shareholders did not approve attempts to increase our share capital in 2002 and 2003.

Notwithstanding the fact that TSS and its predecessor, SSS, were never in a position to issue new shares to providers as contemplated by the share acquisition agreements because shareholder approval for such issuance was never obtained, and the fact that SSS on several occasions in the 1990s offered providers the opportunity to purchase shares of its treasury stock and such offers were accepted by very few providers, providers who entered into share acquisition agreements may claim that the share acquisition agreements entitled them to acquire our or TSS's shares at a subscription price equivalent to that provided for in the share acquisition agreements. SSS entered into share acquisition agreements with approximately 3,000 providers, the substantial majority of whom never came to own shares of SSS. Such share acquisition agreements provide for the purchase and sale of approximately 15,000 shares of SSS. If we or TSS were required to issue a significant number of shares in respect of these agreements, the interest of our existing shareholders would be substantially diluted. As of the date of this Annual Report on Form 10-K, only one judicial claim to enforce any of these agreements has been commenced. Additionally, we have received inquiries with respect to less than 700 shares under share acquisition agreements. The share numbers set forth in this paragraph reflect the number of SSS shares provided for in the share acquisition agreements. Those agreements do not include anti-dilution protections and we do not believe that the amounts of any claims under the agreements with SSS should be multiplied to reflect our 3,000-for-one stock split. We cannot provide assurances, however, that claimants will not successfully seek to increase the size of their claims by reference to the stock split.

We have been advised by our counsel that, on the basis of a reasoned analysis, while the matter is not free from doubt and there are no applicable controlling precedents, we should prevail in any litigation of these claims because, among other defenses, the condition precedent to SSS's obligations under the share acquisition agreements never occurred, and any obligation it may, or we may be deemed to, have had under the share acquisition agreements should be understood to have expired prior to our corporate reorganization, which took effect in 1999, although the share acquisition agreements do not expressly provide for any expiration.

We believe that we should prevail in any litigation with respect to these matters; however, we cannot predict the outcome of any such litigation, including with respect to the magnitude of any claims that may be asserted by any



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plaintiff, and the interests of our shareholders could be materially diluted to the extent that claims under the share acquisition agreements are successful.

***Heirs of certain of our former shareholders may bring materially dilutive claims against us.***

For much of our history, we and our predecessor entity have restricted the ownership or transferability of our shares, including by reserving to us or our predecessor a right of first refusal with respect to share transfers and by limiting ownership of such shares to physicians and dentists. In addition, we and our predecessor, consistent with the requirements of our and our predecessor's bylaws, have sought to repurchase shares of deceased shareholders at the amount originally paid for such shares by those shareholders. Nonetheless, former shareholders' heirs who were not eligible to own or be transferred shares because they were not physicians or dentists at the time of their purported inheritance (non-medical heirs), may claim an entitlement to our shares or to damages with respect to the repurchased shares notwithstanding applicable transfer and ownership restrictions. Our records indicate that there may be as many as approximately 450 former shareholders whose non-medical heirs may claim to have inherited up to 10,500,000 shares after giving effect to the 3,000-for-one stock split. As of the date of this Annual Report on Form 10-K, four judicial claim seeking the return of or compensation for less than 80 shares (prior to giving effect to the 3,000-for-one stock split) had been brought by non-medical heirs of former shareholders whose shares were repurchased upon their death. These heirs purport to represent as a class all non-medical heirs of deceased shareholders whose shares we repurchased. In addition, we have received inquiries from non-medical heirs with respect to less than 700 shares (or 2,100,000 shares after giving effect to the 3,000-for-one stock split).

We believe that we should prevail in litigation with respect to these matters; however, we cannot predict the outcome of any such litigation regarding these non-medical heirs. The interests of our existing shareholders could be materially diluted to the extent that any such claims are successful.

***The dual class structure may not successfully protect against significant dilution of your shares of Class B common stock.***

We designed our dual class structure of capital stock to offset the potential impact on the value of our Class B common stock attributable to any issuance of shares of common stock for less than market value in respect of a successful claim against us under any share acquisition agreement or by a non-medical heir. We believe that this mechanism will effectively protect investors in our shares of Class B common stock against any potential dilution attributable to the issuance of any shares in respect of such claims at below market prices. We cannot, however, provide any assurances that this mechanism will be effective under all circumstances.

While we expect to prevail against any such claims brought against us and, to the extent that we do not prevail, would expect to issue Class A common stock in respect of any such claim, there can be no assurance that the claimants in any such lawsuit will not seek to acquire Class B common stock. The issuance of a significant number of shares of Class B common stock, if followed by a material further issuance of shares of common stock to separate claimants, could impair the effectiveness of the anti-dilution protections of the Class B common stock. In addition, we cannot provide any assurances that the anti-dilution protections afforded our Class B common stock will not be challenged by share acquisition providers and/or non-medical heir claimants to the extent that these protections limit the percentage ownership of us that may be acquired by such claimants. We believe that such a challenge should not prevail, but cannot provide any assurances of the outcome.

In the event that claimants acquire shares of our managed care subsidiary, TSS, at less than fair value, we will not be able to prevent dilution of the value of the Class B shareholders' ownership interest in us to the extent that the net value received by such claimants exceeds the value of our outstanding shares of Class A common stock. Finally, the anti-dilution protection afforded by the dual class structure may cease to be of further effect five years following the completion of our initial public offering, at which time all remaining shares of Class A common stock may, at the sole discretion of our board of directors and after considering relevant factors, including market conditions at the time, be converted into shares of Class B common stock even if we have not resolved all claims against us by such time.

***Future sales of our Class B common stock, or the perception that such future sales may occur, may have an adverse impact on its market price.***

Sales of a substantial number of shares of our common stock in the public market, or the perception that large sales could occur, could cause the market price of our Class B common stock to decline. Either of these limits our



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future ability to raise capital through an offering of equity securities. There are 20,110,391 shares of Class B common stock and 9,042,809 shares of Class A common stock outstanding as of December 31, 2009. Our Class A common stock is no longer subject to contractual lockup; thus, such shares are freely tradable without restriction or further registration under the Securities Act by persons other than our affiliates within the meaning of Rule 144 under the Securities Act, although such shares will continue not to be listed on the NYSE and will not be fungible with our listed shares of Class B common stock. In addition, at any time following the fifth anniversary of our initial public offering, or such earlier date after the first anniversary of the initial public offering as all claims with respect to which anti-dilution protections are afforded to shares of Class B common stock have been resolved, all or any portion of our shares of Class A common stock may at the sole discretion of our board of directors and after considering relevant factors, including market conditions at the time, be converted to shares of Class B common stock.

**Risks Related to Our Business*****Our inability to contain managed care costs may adversely affect our business and profitability.***

Substantially all of our managed care revenue is generated by premiums consisting of monthly payments per member that are established by contracts with our commercial customers, the government of Puerto Rico (for the Reform program) or the CMS (for our Medicare Advantage and PDP plans), all of which are typically renewable on an annual basis. If our medical expenses exceed our estimates, except in very limited circumstances or as a result of risk score adjustments for member acuity in the case of the Medicare Advantage products, we will be unable to increase the premiums we receive under these contracts during the then-current terms. As a result, our profitability in any year depends, to a significant degree, on our ability to adequately predict and effectively manage our medical expenses related to the provision of managed care services through underwriting criteria, medical management, product design and negotiation of favorable provider contracts with hospitals, physicians and other health care providers. The aging of the population and other demographic characteristics and advances in medical technology continue to contribute to rising health care costs. Government-imposed limitations on Medicare and Reform reimbursement have also caused the private sector to bear a greater share of increasing health care costs. Also, we have in the past and may in the future enter into new lines of business in which it may be difficult to estimate anticipated costs. Numerous factors affecting the cost of managed care, including changes in health care practices, inflation, new technologies such as genetic laboratory screening for diseases including breast cancer, electronic recordkeeping, the cost of prescription drugs, clusters of high cost cases, changes in the regulatory environment including the implementation of HIPAA amendments under the Stimulus, as well as others, such as implementation of President Obama's health care reform plan, may adversely affect our ability to predict and manage managed care costs, as well as our business, financial condition and results of operations.

***Our inability to implement increases in premium rates on a timely basis may adversely affect our business and profitability.***

In addition to the challenge of managing managed care costs, we face pressure to contain premium rates. Our customers may move to a competitor at policy renewal to obtain more favorable premiums. Future Medicare and Reform premium rate levels may be affected by continuing government efforts to contain medical expense or other budgetary constraints. In particular, the government of Puerto Rico has adopted several measures to control Reform expenditures, such as closer and continuous scrutiny of participants' eligibility, redesign of benefits, co-payments, deductibles, and requiring the establishment of disease management programs. Changes in the Medicare and Reform programs, including with respect to funding, may lead to reductions in the amount of reimbursement, elimination of coverage for certain benefits, or reductions in the number of persons enrolled in or eligible for Medicare and the Reform. A limitation on our ability to increase or maintain our premium levels could adversely affect our business, financial condition and results of operations.

The property and casualty insurance industry is under soft market conditions for commercial lines and consequently is highly competitive, and we believe that it will remain highly competitive for the foreseeable future. Competitors may offer products at prices and on terms that are not consistent with economic standards in an effort to maintain or increase their business. The property and casualty insurance industry has historically been cyclical, with periods characterized by intense price competition and less restrictive underwriting standards followed by periods of higher premium rates and more selective underwriting standards. The competitive environment in which we operate





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is also impacted by current general economic conditions, which could reduce the volume of business available to us, as well as to our competitors.

***Our profitability may be adversely affected if we are unable to maintain our current provider agreements and to enter into other appropriate agreements.***

Our profitability is dependent upon our ability to contract on favorable terms with hospitals, physicians and other managed care providers. We face heavy competition from other managed care plans to enter into contracts with hospitals, physicians and other providers in our provider networks. Consolidation in our industry, both on the provider side and on the managed care side, only exacerbates this competition. Currently certain providers are pressing for legislation that would allow them to negotiate service fees by group. The failure to maintain or to secure new cost-effective managed care provider contracts may result in a loss in membership or higher medical costs. In addition, our inability to contract with providers could adversely affect our business.

***A reduction in the enrollment in our managed care programs could have an adverse effect on our business and profitability.***

A reduction in the number of enrollees in our managed care programs could adversely affect our business, financial condition and results of operations. Factors that could contribute to a reduction in enrollment include: failure to obtain new customers or retain existing customers; premium increases and benefit changes; our exit from a specific market; reductions in workforce by existing customers; negative publicity and news coverage; failure to maintain the Blue Cross Blue Shield license; and any general economic downturn that results in business failures.

***We are dependent on a small number of government contracts to generate a significant amount of the revenues of our managed care business.***

Our managed care business participates in government contracts that generate a significant amount of our consolidated premiums earned, net, as follows:

***Reform:*** We participate in the government of Puerto Rico Health Reform Program to provide health coverage to medically indigent citizens in Puerto Rico. Our results of operations have depended to a significant extent on our participation in the Reform program. During each of the years ended December 31, 2009, 2008 and 2007, the Reform program has accounted for 18.6%, 20.1% and 22.1%, respectively, of our consolidated premiums earned, net. During the 2009 period, we were the sole Reform provider in two of the eight Reform regions in Puerto Rico on a fully-insured basis. We are also the sole Reform provider in another Reform region on an ASO basis. Since we obtained our first Reform contract in 1995, we have been the sole provider for two to three regions each year. The contract for each geographical area is subject to termination in the event of any non-compliance by the insurance company which is not corrected or cured to the satisfaction of the government entity overseeing the Reform, or on 90 days prior written notice in the event that the government determines that there is an insufficiency of funds to finance the Reform. These contracts typically have one-year terms that expire on June 30 of each year, except for the Metro-North region contract which had an October 30 expiration date. Upon the expiration of the contract for a geographical area, the government of the Commonwealth of Puerto Rico usually commences an open bidding process for such area. We intend to continue to participate in the Reform program, but we may not be able to retain the right to service a particular geographical area in which we currently operate after the expiration of our current or any future contracts. Our two fully-insured contracts with the government of Puerto Rico that terminated in June 30, 2009, were first extended until October 31, 2009 and then to December 31, 2009. In December 2009, all of our three government contracts, the two that are fully-insured and the one ASO contract, were extended until June 30, 2010. The premium rates of the Reform business were last increased in July 2008.

***Medicare:*** We provide services through our Medicare Advantage products pursuant to a limited number of contracts with CMS. These contracts generally have terms of one year and must be renewed each year. Each of our contracts with CMS is terminable for cause if we breach a material provision of the contract or violate relevant laws or regulations. If we are unable to renew, or to successfully re-bid or compete for any of these contracts, or if the process for bidding materially changes or if any of these contracts are terminated, our business could be materially impaired. During each of the years ended December 31, 2009,



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2008 and 2007, contracts with CMS represented 27.4%, 25.9% and 17.2% of our consolidated premiums earned, net, respectively, and 33.9%, 12.4% and 34.6% of our consolidated operating income, respectively. *Commercial:* Our managed care subsidiary is a qualified contractor to provide managed care coverage to federal government employees within Puerto Rico. Such coverage is provided pursuant to a contract with the OPM that is subject to termination in the event of noncompliance not corrected to the satisfaction of the OPM. During each of the years ended December 31, 2009, 2008 and 2007 premiums generated under this contract represented 6.7%, 7.3% and 8.2% of our consolidated premiums earned, net, respectively. The operating income generated under this contract represented 1.2% during the year ended December 31, 2009 and 1.1% of our consolidated operating income, during each of the years ended December 31, 2008 and 2007.

If any of these contracts is terminated for any reason, including by reason of any noncompliance by us, or not renewed or replaced by a comparable contract, our premiums would be materially adversely affected. The further loss or non-renewal of any of our Reform contracts could have a material adverse effect on our operating results and could result in the downsizing of certain personnel, the cancellation of lease agreements of certain premises and of certain contracts, and severance payments, among others.

***A change in our managed care product mix may impact our profitability.***

Our managed care products that involve greater potential risk, such as fully insured arrangements, generally tend to be more profitable than ASO products and those managed care products where employer groups retain the risk, such as self-funded financial arrangements. There has been a trend in recent years among our Commercial customers of moving from fully-insured plans to ASO, or self-funded arrangements. In addition, the government of Puerto Rico began a pilot project in 2006 in one of the eight geographical areas under which it contracted for Reform services on an ASO basis for certain members instead of contracting on a fully-insured basis. There can be no assurance that the government will not implement such a program in the fully-insured areas served by us. As of December 31, 2009, 66.1% of our managed care customers had fully insured arrangements and 33.9% had ASO arrangements, as compared to approximately 69.5% and 30.5%, respectively, as of December 31, 2008. Unfavorable changes in the relative profitability or customer participation among our various products could have a material adverse effect on our business, financial condition, and results of operations.

***Our failure to accurately estimate incurred but not reported claims would affect our reported financial results.***

A portion of the claim liabilities recorded by our insurance segments represents an estimate of amounts needed to pay and adjust anticipated claims with respect to insured events that have occurred, including events that have not yet been reported to us. These amounts are based on estimates of the ultimate expected cost of claims and on actuarial estimation techniques. Judgment is required in actuarial estimation to ascertain the relevance of historical payment and claim settlement patterns under each segment's current facts and circumstances. Accordingly, the ultimate liability may be in excess of or less than the amount provided. We regularly compare prior period liabilities to re-estimated claim liabilities based on subsequent claims development; any difference between these amounts is adjusted in the operations of the period determined. Additional information on how each reportable segment determines its claim liabilities, and the variables considered in the development of this amount, is included elsewhere in this Annual Report on Form 10-K under Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates. Actual experience will likely differ from assumed experience, and to the extent the actual claims experience is less favorable than estimated based on our underlying assumptions, our incurred losses would increase and future earnings could be adversely affected.

***The termination or modification of our license agreements to use the BCBS name and mark could have a material adverse effect on our business, financial condition and results of operations.***

We are a party to a license agreement with the BCBSA which entitle us to the exclusive use of the BCBS name and mark in Puerto Rico and U.S. Virgin Islands. We believe that the Blue Cross and Blue Shield name and mark are valuable identifiers of our products and services in the marketplace. The termination of this license agreement or changes in the terms and conditions of a license agreement could adversely affect our business, financial condition and results of operations.

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Our license agreement with the BCBSA contains certain requirements and restrictions regarding our operations and our use of the BCBS name and mark. Failure to comply with any of these requirements and restrictions could result in a termination of a license agreement. The standards under a license agreement may be modified in certain instances by the BCBSA. From time to time there have been proposals considered by the BCBSA to modify the terms of a license agreement to restrict various potential business activities of licensees. To the extent that such amendments to the license agreement are adopted in the future, they could have a material adverse effect on our future expansion plans or results of operations.

Upon any event causing termination of the license agreements, we would no longer have the right to use the BCBS name and mark in Puerto Rico and U.S. Virgin Islands. Furthermore, the BCBSA would be free to issue a license to use the BCBS name and mark in Puerto Rico and U.S. Virgin Islands to another entity. Events that could cause the termination of a license agreement with the BCBSA include failure to comply with minimum capital requirements imposed by the BCBSA, a change of control or violation of the BCBSA ownership limitations on our capital stock, impending financial insolvency and the appointment of a trustee or receiver or the commencement of any action against a licensee seeking its dissolution. Accordingly, termination of a license agreement could have a material adverse effect on our business, financial condition and results of operations.

In addition, the BCBSA requires us to comply with certain specified levels of risk based capital ( RBC ). RBC is designed to identify weakly capitalized companies by comparing each company s adjusted surplus to its required surplus (the RBC ratio ). Although we are currently in compliance with these requirements, we may be unable to continue to comply in the future. Failure to comply with these requirements could result in the revocation or loss of our BCBS license.

Upon termination of a license agreement, the BCBSA would impose a Re-establishment Fee upon us, which would allow the BCBSA to re-establish a Blue Cross Blue Shield presence in the vacated service area with another managed care company. The fee is currently \$91.23 per licensed enrollee. If the re-establishment fee were applied to our total Blue Cross Blue Shield enrollees as of December 31, 2009, we would be assessed approximately \$122.9 million by the BCBSA.

See Item 1. Business Blue Cross and Blue Shield License for more information.

***Our ability to manage our exposure to underwriting risks in our life insurance and property and casualty insurance businesses depends on the availability and cost of reinsurance coverage.***

Reinsurance is the practice of transferring part of an insurance company s liability and premium under an insurance policy to another insurance company. We use reinsurance arrangements to limit and manage the amount of risk we retain, to stabilize our underwriting results and to increase our underwriting capacity. In the year ended December 31, 2009, 41.3%, or \$67.5 million, of the premiums written in the property and casualty insurance segment and 5.7%, or \$6.1 million, of the premiums written in the life insurance segment were ceded to reinsurers. In the year ended December 31, 2008, 42.9%, or \$72.1 million, of the premiums written in the property and casualty insurance segment and 7.6%, or \$7.6 million, of the premiums written in the life insurance segment were ceded to reinsurers. The premiums ceded and the availability and cost of reinsurance is subject to changing market conditions and may vary significantly over time. Any decrease in the amount of our reinsurance coverage will increase our risk of loss. We may be unable to maintain our desired reinsurance coverage or to obtain other reinsurance coverage in adequate amounts and at favorable rates. If we are unable to renew our expiring coverage or obtain new coverage, it will be difficult for us to manage our underwriting risks and operate our business profitably.

It is also possible that the losses we experience on insured risks for which we have obtained reinsurance will exceed the coverage limits of the reinsurance. See Risks Related to Our Business Large-scale natural disasters may have a material adverse effect on our business, financial condition and results of operations. If the amount of our reinsurance coverage is insufficient, our insurance losses could increase substantially.

***If our reinsurers do not pay our claims or do not pay them in a timely manner, we may incur losses.***

We are subject to loss and credit risk with respect to the reinsurers with whom we deal. In accordance with general industry practices, our property and casualty and life insurance subsidiaries annually purchase reinsurance to lessen the impact of large unforeseen losses and mitigate sudden and unpredictable changes in our net income and shareholders equity. Reinsurance contracts do not relieve us from our obligations to policyholders. In the event that



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all or any of the reinsurance companies are unable to meet their obligations under existing reinsurance agreements or pay on a timely basis, we will continue to be liable to our policyholders notwithstanding such defaults or delays. If our reinsurers are not capable of fulfilling their financial obligations to us, our insurance losses would increase, which would negatively affect our financial condition and results of operations.

***A downgrade in our A.M. Best rating or our inability to increase our A.M. Best rating could affect our ability to write new business or renew our existing business in our property and casualty segment.***

Ratings assigned by A.M. Best are an important factor influencing the competitive position of the property and casualty insurance companies in Puerto Rico. In 2009, A.M. Best maintained our property and casualty insurance subsidiary's rating of A- (the fourth highest of A.M. Best's 16 financial strength ratings) with a stable outlook. A.M. Best ratings represent independent opinions of financial strength and ability to meet obligations to policyholders and are not directed toward the protection of investors. Financial strength ratings are used by brokers and customers as a means of assessing the financial strength and quality of insurers. A.M. Best reviews its ratings periodically and we may not be able to maintain our current ratings in the future. A downgrade of our property and casualty subsidiary's rating could severely limit or prevent us from writing desirable property business or from renewing our existing business. The lines of business that property and casualty subsidiary writes and the market in which it operates are particularly sensitive to changes in A.M. Best financial strength ratings.

***Significant competition could negatively affect our ability to maintain or increase our profitability.***

***Managed Care***

The managed care industry in Puerto Rico is very competitive. If we are unable to compete effectively while appropriately pricing the business subscribed, our business and financial condition could be materially affected. Competition in the insurance industry is based on many factors, including premiums charged, services provided, speed of claim payments and reputation. This competitive environment has produced and will likely continue to produce significant pressures on the profitability of our managed care company. In addition, the managed care market in Puerto Rico, other than the Medicare Advantage market, is mature. According to the U.S. Census Bureau, Puerto Rico's population grew by 0.3% between July 2008 and 2009, less than half the national population rate growth of 0.9% during the same period. As a result, in order to increase our profitability we must increase our membership in the new Medicare Advantage program, increase market share in the commercial sector, improve our operating profit margins, make acquisitions or expand geographically. In Puerto Rico, several managed care plans and other entities were awarded contracts for Medicare Advantage or stand-alone Medicare prescription drug plans. These other plans entered that market in 2006 and 2007. We anticipate that they can aggressively market their benefits to our current and our prospective members. Although we believe that we market an attractive offering, there are no assurances that we will be able to compete successfully with these other plans for new members, or that our current members will not choose to terminate their relationship with us and enroll in these other plans. Concentration in our industry also has created an increasingly competitive environment, both for customers and for potential acquisition targets, which may make it difficult for us to grow our business. The parent companies of some of our competitors are larger and have greater financial and other resources than we do. We may have difficulty competing with larger managed care companies, which can create downward price pressures on premium rates. We may not be able to compete successfully against current and future competitors. Competitive pressures faced by us may adversely affect our business, financial condition and results of operations.

Future legislation at the federal and local levels also may result in increased competition in our market. While we do not anticipate that any of the current legislative proposals of which we are aware would increase the competition we face, future legislative proposals, if enacted, might do so.

***Complementary Products***

The property and casualty insurance market in Puerto Rico is extremely competitive. Due to the relatively low level of economic growth in Puerto Rico, there are few new sources of business in this segment. As a result, property and casualty insurance companies compete for the same accounts through aggressive pricing, more favorable policy terms and better quality of services. We also face heavy competition in the life and disability insurance market.

We believe these trends will continue. There can be no assurance that these competitive pressures will not adversely affect our business, financial condition and results of operations.



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As a holding company, we are largely dependent on rental payments, dividends and other payments from our subsidiaries, although the ability of our regulated subsidiaries to pay dividends or make other payments to us is subject to the regulations of the Commissioner of Insurance, including maintenance of minimum levels of capital, as well as covenant restrictions in their indebtedness.

We are a holding company whose assets include, among other things, all of the outstanding shares of common stock of our subsidiaries, including our regulated insurance subsidiaries. We principally rely on rental income and dividends from our subsidiaries to fund our debt service, dividend payments and operating expenses, although our subsidiaries do not declare dividends every year. We also benefit to a lesser extent from income on our investment portfolio.

Our insurance subsidiaries are subject to the regulations of the Commissioner of Insurance. See **Risks Related to Our Business**. Our insurance subsidiaries are subject to minimum capital requirements. Our failure to meet these standards could subject us to regulatory actions. These regulations, among other things, require insurance companies to maintain certain levels of capital, thereby restricting the amount of earnings that can be distributed. Our subsidiaries ability to make any payments to us will also depend on their earnings, the terms of their indebtedness, if any, business and other legal restrictions. Furthermore, our subsidiaries are not obligated to make funds available to us, and creditors of our subsidiaries have a superior claim to such subsidiaries' assets. Our subsidiaries may not be able to pay dividends or otherwise contribute or distribute funds to us in an amount sufficient for us to meet our financial obligations. In addition, from time to time, we may find it necessary to provide financial assistance, either through subordinated loans or capital infusions to our subsidiaries.

In addition, we are subject to RBC requirements by the BCBSA. See **Risks Related to Our Business**. The termination or modification of our license agreements to use the BCBS name and mark could have a material adverse effect on our business, financial condition and results of operations.

***Our results may fluctuate as a result of many factors, including cyclical changes in the insurance industry.***

Results of companies in the insurance industry, and particularly the property and casualty insurance industry, historically have been subject to significant fluctuations and uncertainties. The industry's profitability can be affected significantly by:

rising levels of actual costs that are not known by companies at the time they price their products;

volatile and unpredictable developments, including man-made and natural catastrophes;

changes in reserves resulting from the general claims and legal environments as different types of claims arise and judicial interpretations relating to the scope of insurers' liability develop; and

fluctuations in interest rates, inflationary pressures and other changes in the investment environment, which affect returns on invested capital.

Historically, the financial performance of the insurance industry has fluctuated in cyclical periods of low premium rates and excess underwriting capacity resulting from increased competition, followed by periods of high premium rates and a shortage of underwriting capacity resulting from decreased competition. Fluctuations in underwriting capacity, demand and competition, and the impact on us of the other factors identified above, could have a negative impact on our results of operations and financial condition. We believe that underwriting capacity and price competition in the current market is increasing. This additional underwriting capacity may result in increased competition from other insurers seeking to expand the kinds or amounts of business they write or cause some insurers to seek to maintain market share at the expense of underwriting discipline. We may not be able to retain or attract customers in the future at prices we consider adequate.

***If we do not effectively manage the growth of our operations, we may not be able to achieve our profitability targets.***

Our growth strategy includes enhancing our market share in Puerto Rico, entering new geographic markets, introducing new insurance products and programs, further developing our relationships with independent agencies or brokers and pursuing acquisition opportunities. Our strategy is subject to various risks, including risks associated with



our ability to:

identify profitable new geographic markets to enter;

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operate in new geographic areas, as we have very limited experience operating outside Puerto Rico;

obtain licenses in new geographic areas in which we wish to market and sell our products;

successfully implement our underwriting, pricing, claims management and product strategies over a larger operating region;

properly design and price new and existing products and programs and reinsurance facilities for markets in which we have no direct experience;

identify, train and retain qualified employees;

identify, recruit and integrate new independent agencies and brokers and expand the range of Triple-S products carried by our existing agents and brokers;

develop a network of physicians, hospitals and other managed care providers that meets our requirements and those of applicable regulators; and

augment our internal monitoring and control systems as we expand our business.

We also may encounter difficulties in the implementation of our growth strategies. For instance, our BCBSA license entitles us to use the Blue Cross Blue Shield name and mark only in Puerto Rico and U.S. Virgin Islands. In addition, we may enter into markets or product lines in which we have little or no prior experience. For example, we plan to expand our operations outside Puerto Rico. Any such risks or difficulties could limit our ability to implement our growth strategies or result in diversion of senior management time and adversely affect our financial results.

***We face intense competition to attract and retain employees and independent agents and brokers.***

We are dependent on retaining existing employees, attracting and retaining additional qualified employees to meet current and future needs and achieving productivity gains. Our life insurance subsidiary, TSV, has historically experienced a very high level of turnover in its home service agents, through which it places a majority of its premiums, and we expect this trend to continue. Our inability to retain existing employees or attract additional employees could have a material adverse effect on our business, financial condition and results of operations.

In addition, in order to market our products effectively, we must continue to recruit, retain and establish relationships with qualified independent agents and brokers. We may not be able to recruit, retain and establish relationships with agents and brokers. Independent agents and brokers are typically not exclusively dedicated to us and may frequently also market our competitors' managed care products. We face intense competition for the services and allegiance of independent agents and brokers. If such agents and brokers do not help us to maintain our current customer accounts or establish new accounts, our business and profitability could be adversely affected.

***Our investment portfolios are subject to varying economic and market conditions.***

We have exposure to market risk and credit risk in our investment activities. The fair values of our investments vary from time to time depending on economic and market conditions. Fixed maturity securities expose us to interest rate risk as well as credit risk. Equity securities expose us to equity price risk. Interest rates are highly sensitive to many factors, including governmental monetary policies and domestic and international economic and political conditions. These and other factors also affect the equity securities owned by us. The outlook of our investment portfolio depends on the future direction of interest rates, fluctuations in the equity securities market and in the amount of cash flows available for investment. For additional information, see Item 7A. Quantitative and Qualitative Disclosures About Market Risk for an analysis of our exposure to interest and equity price risks and the procedures in place to manage these risks. Our investment portfolios may lose money in future periods, which could have a material adverse effect on our financial condition.

In addition, our insurance subsidiaries are subject to local laws and regulations that require diversification of our investment portfolios and limit the amount of investments in certain riskier investment categories, such as below-investment-grade fixed income securities, mortgage loans, and real estate and equity investments, amongst

others, which could generate higher returns on our investments. If we fail to comply with these laws and regulations, any investments exceeding regulatory limitations would be treated as non-admitted assets for purposes of measuring statutory surplus and risk-based capital.

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***The securities and credit markets recently have been experiencing extreme volatility and disruption.***

Adverse conditions in the U.S. and global capital markets can significantly and adversely affect the value of our investments in debt and equity securities, and other investments, our profitability and/or our financial position, and we do not expect these conditions to improve in the near future.

The global capital markets, including credit markets, have experienced extreme volatility. As an insurer, we have a substantial investment portfolio that is comprised particularly of debt securities of issuers located in the U.S. As a result, the income we earn from our investment portfolio is largely driven by the level of interest rates in the U.S, financial markets, and volatility, uncertainty and/or disruptions in the global capital markets, particularly the U.S. credit markets, and governments' monetary policy, particularly the easing of U.S. monetary policy, can significantly and adversely affect the value of our investment portfolio, our profitability and/or our financial position by:

Significantly reducing the value of the debt securities we hold in our investment portfolio, and creating net realized capital losses that reduces our operating results and/or net unrealized capital losses that reduce our shareholders' equity.

Reducing interest rates on high quality short-term debt securities and thereby materially reducing our net investment income and operating results.

Making it more difficult to value certain of our investment securities, for example if trading becomes less frequent, which could lead to significant period-to-period changes in our estimates of the fair values of those securities and cause period-to-period volatility in our operating results and shareholders' equity.

Reducing our ability to issue other securities.

The volatility and disruption in the securities and credit markets has impacted our investment portfolio. We evaluate our investment securities for other-than-temporary impairment on a quarterly basis. This review is subjective and requires a high degree of judgment. It also requires us to make certain assessments about the potential recovery of the assets we hold. For the purpose of determining gross realized gains and losses, the cost of investment securities is based upon specific identification. During the years ended December 31, 2009 and 2008, we realized losses associated with other-than-temporary impairments of \$7.1 million and \$16.5 million, respectively. The gross unrealized losses of our available-for-sale and held-to-maturity securities were \$14.9 million and \$19.3 million at December 31, 2009 and 2008, respectively. The gross unrealized gains of our available-for-sale and held-to-maturity securities were \$26.4 million and \$27.2 million at December 31, 2009 and 2008, respectively. Given current market conditions, there is a continuing risk that further declines in fair value may occur and additional material realized losses from sales or other-than-temporary impairments may be recorded in future periods.

We believe our cash balances, investment securities, operating cash flows, and funds available under our credit agreement, taken together, provide adequate resources to fund ongoing operating and regulatory requirements. However, continuing adverse securities and credit market conditions could significantly affect the availability of credit.

***The geographic concentration of our business in Puerto Rico may subject us to economic downturns in the region.***

Substantially all of our business activity is with insureds located throughout Puerto Rico, and as such, we are subject to the risks associated with the Puerto Rico economy. The major factors affecting the economy are, among others, high oil prices, the slowdown of economic activity in the United States, the continuing economic uncertainty generated by the budgetary deficiency affecting the government of Puerto Rico and the effects on the economy of a recently implemented sales tax.

The government of Puerto Rico government is currently facing a structural deficit between recurring government revenues and expenses. On March 9, 2009, the Governor signed the multi-year Fiscal Stabilization and Economic Reconstruction Plan, which provides for additional revenue generation measures, sets forth a cost reduction plan, including a reduction in public-sector employment, and provides for a number of financial initiatives geared towards achieving a balanced budget in four years. Since the government is an important source of employment in Puerto Rico, these measures could have the effect of intensifying the current recessionary cycle.



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If economic conditions in Puerto Rico continue to deteriorate, we may experience a reduction in existing and new business, which could have a material adverse effect on our business, financial condition and results of operations.

***We may not be able to retain our executive officers and significant employees, and the loss of any one or more of these officers and their expertise could adversely affect our business.***

Our operations are highly dependent on the efforts of our senior executives, each of whom has been instrumental in developing our business strategy and forging our business relationships. While we believe that we could find replacements, the loss of the leadership, knowledge and experience of our executive officers could adversely affect our business. Replacing many of our executive officers might be difficult or take an extended period of time because a limited number of individuals in the industries in which we operate have the breadth and depth of skills and experience necessary to operate and expand successfully a business such as ours. We do not currently maintain key-man life insurance on any of our executive officers.

***The success of our business depends on developing and maintaining effective information systems.***

Our business and operations may be affected if we do not maintain and upgrade our information systems and the integrity of our proprietary information. We are materially dependent on our information systems for all aspects of our business operations, including monitoring utilization and other factors, supporting our managed care management techniques, processing provider claims and providing data to our regulators, and our ability to compete depends on our ability to continue to adapt technology on a timely and cost-effective basis. Malfunctions in our information systems, communication and energy disruptions, security breaches or the failure to maintain effective and up-to-date information systems could disrupt our business operations, alienate customers, contribute to customer and provider disputes, result in regulatory violations and possible liability, increase administrative expenses or lead to other adverse consequences. The use of member data by all of our businesses is regulated at federal and local levels. These laws and rules change frequently and developments require adjustments or modifications to our technology infrastructure.

Our information systems and applications require continual maintenance, upgrading and enhancement to meet our operational needs. If we are unable to maintain or expand our systems, we could suffer from, among other things, operational disruptions, such as the inability to pay claims or to make claims payments on a timely basis, loss of members, difficulty in attracting new members, regulatory problems, and increases in administrative expenses. We selected Quality Care Solutions, Inc., a wholly owned subsidiary of Trizzetto, Inc, to assess and implement new core business applications for our managed care segment. We completed an initial assessment during 2007 and commenced the implementation of the new application in 2008. We expect our Managed Care segment to begin transitioning to the new application in 2010. The transitioning process is expected to continue into 2011, when we expect to complete the full migration. If we are unsuccessful in implementing these improvements in a timely manner or if these improvements do not meet our customers requirements, we may not be able to recoup these costs and expenses and effectively compete in our industry.

Our business requires the secure transmission of confidential information over public networks. Advances in computer capabilities, new discoveries in the field of cryptography or other event or developments could result in compromises or breaches of our security system and patient data stored in our information systems. Anyone who circumvents our security measures could misappropriate our confidential information or cause interruptions in services or operations. The Internet is a public network and data is sent over this network from many sources. In the past, computer viruses or software programs that disable or impair computers have been distributed and have rapidly spread over the Internet. Computer viruses could be introduced into our systems, or those of our providers or regulators, which could disrupt our operations, or make our systems inaccessible to our providers or regulators. We may be required to expend significant capital and other resources to protect against the threat of security breaches or to alleviate problems caused by breaches. Because of the confidential health information we store and transmit, security breaches could expose us to a risk of regulatory action, litigation, possible liability and loss. Our security measures may be inadequate to prevent security breaches, and our business operations would be adversely affected by cancellation of contracts and loss of members if they are not prevented.

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***We face risks related to litigation.***

In addition to the litigation risks discussed above in **Risks Relating to Our Capital Stock**, we are, or may be in the future, a party to a variety of legal actions that affect any business, such as employment and employment discrimination-related suits, employee benefit claims, breach of contract actions, tort claims and intellectual property-related litigation. In addition, because of the nature of our business, we may be subject to a variety of legal actions relating to our business operations, including the design, management and offering of our products and services. These could include:

claims relating to the denial of managed care benefits;

medical malpractice actions;

allegations of anti-competitive and unfair business activities;

provider disputes over compensation and termination of provider contracts;

disputes related to self-funded business;

disputes over co-payment calculations;

claims related to the failure to disclose certain business practices;

claims relating to customer audits and contract performance; and

claims by regulatory agencies or whistleblowers for regulatory non-compliance, including but not limited to fraud.

We are a defendant in various lawsuits, some of which involve claims for substantial and/or indeterminate amounts and the outcome of which is unpredictable. While we are defending these suits vigorously, we will incur expenses in the defense of these suits. Any adverse judgment against us resulting in such damage awards could have an adverse effect on our cash flows, results of operations and financial condition. See **Item 3. Legal Proceedings**.

***Large-scale natural disasters may have a material adverse effect on our business, financial condition and results of operations.***

Puerto Rico has historically been at a relatively high risk of natural disasters such as hurricanes and earthquakes. If Puerto Rico were to experience a large-scale natural disaster, claims incurred by our managed care, property and casualty and life insurance segments would likely increase and our properties may incur substantial damage, which could have a material adverse effect on our business, financial condition and results of operations.

***Non-financial covenants in our secured term loan and note purchase agreements may restrict our operations.***

We are a party to a secured loan with a commercial bank for an aggregate amount of \$41.0 million, for which we had an outstanding balance of \$22.7 million as of December 31, 2009. Also, we have an aggregate principal amount of \$145.0 million of senior unsecured notes outstanding, consisting of \$50.0 million aggregate principal amount of 6.30% notes due 2019, \$60.0 million aggregate principal amount of 6.60% notes due 2020 and \$35.0 million aggregate principal amount of 6.70% notes due 2021 (collectively, the notes). The secured term loan and the note purchase agreements governing the notes contain non-financial covenants that restrict, among other things, the granting of certain liens, limitations on acquisitions and limitations on changes in control. These non-financial covenants could restrict our operations. In addition, if we fail to make any required payment under our secured term loan or note purchase agreements governing the notes or to comply with any of the non-financial covenants included therein, we would be in default and the lenders or holders of our debt, as the case may be, could cause all of our outstanding debt obligations under our secured term loan or note purchase agreements to become immediately due and payable, together with accrued and unpaid interest and, in the case of the secured term loan, cease to make further extensions of credit. If the indebtedness under our secured term loan or note purchase agreements is accelerated, we

may be unable to repay or re-finance the amounts due and our business may be materially adversely affected.



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### ***We may incur additional indebtedness in the future. Covenants related to such indebtedness could also adversely affect our ability to pursue desirable business opportunities.***

We may incur additional indebtedness in the future. Our debt service obligations may require us to use a portion of our cash flow to pay interest and principal on debt instead of for other corporate purposes, including funding future expansion. If our cash flow and capital resources are insufficient to service our debt obligations, we may be forced to seek extraordinary dividends from our subsidiaries, sell assets, seek additional equity or debt capital or restructure our debt. However, these measures might be prohibited by applicable regulatory requirements or unsuccessful or inadequate in permitting us to meet scheduled debt service obligations.

We may also incur future debt obligations that might subject us to restrictive covenants that could affect our financial and operational flexibility. Our breach or failure to comply with any of these covenants could result in a default under our secured term loan and note purchase agreements and the acceleration of amounts due thereunder. Indebtedness could also limit our ability to pursue desirable business opportunities, and may affect our ability to maintain an investment grade rating for our indebtedness.

### ***We may pursue acquisitions in the future.***

We may acquire additional companies if consistent with our strategic plan for growth. The following are some of the potential risks associated with acquisitions that could have a material adverse effect on our business, financial condition and results of operations:

disruption of on-going business operations, distraction of management, diversion of resources and difficulty in maintaining current business standards, controls and procedures;

difficulty in integrating information technology of acquired entity and unanticipated expenses related to such integration;

difficulty in the integration of the new company's accounting, financial reporting, management, information, human resources and other administrative systems and the lack of control if such integration is delayed or not implemented;

difficulty in the implementation of controls, procedures and policies appropriate for filers with the SEC at companies that prior to acquisition lacked such controls, policies and procedures;

potential unknown liabilities associated with the acquired company;

failure of acquired businesses to achieve anticipated revenues, earnings or cash flow;

dilutive issuances of equity securities and incurrence of additional debt to finance acquisitions;

other acquisition-related expenses, including amortization of intangible assets and write-offs; and

competition with other firms, some of which may have greater financial and other resources, to acquire attractive companies.

In addition, we may not successfully realize the intended benefits of any acquisition or investment.

### **Risks Relating to Taxation**

***If the Company is considered to be a controlled foreign corporation under the related person insurance income rules for U.S. federal income tax purposes, U.S. persons that own the Company's shares of Class B common stock could be subject to adverse tax consequences.***

The Company does not expect that it will be considered a controlled foreign corporation under the related person insurance income rules (a RPII CFC) for U.S. federal income tax purposes. However, because RPII CFC status depends in part upon the correlation between an insurance company's shareholders and such company's insurance customers and the extent of such company's insurance business outside its country of incorporation, there can be no

assurance that the Company will not be a RPII CFC in any taxable year. The Company does not intend to monitor whether or not it generates RPII or becomes an RPII CFC. If the Company were a RPII CFC in any taxable year, certain adverse tax consequences could apply to U.S. persons that own the Company's shares of Class B common stock.

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***If the Company is considered to be a passive foreign investment company for U.S. federal income tax purposes, U.S. persons that own the Company's shares of Class B common stock could be subject to adverse tax consequences.***

The Company does not expect that it will be considered a passive foreign investment company (a PFIC) for U.S. federal income tax purposes. However, since PFIC status depends upon the composition of a company's income and assets and the market value of its assets (including, among others, less than 25 percent owned equity investments and the Company's ability to use the proceeds from its initial public offering in a timely fashion) from time to time, there can be no assurance that the Company will not be considered a PFIC for any taxable year. The Company's belief that it is not a PFIC is based, in part, on the fact that the PFIC rules include provisions intended to provide an exception for bona fide insurance companies predominately engaged in an insurance business. However, the scope of this exception is not entirely clear and there are no administrative pronouncements, judicial decisions or Treasury regulations that provide guidance as to the application of the PFIC rules to insurance companies. If the Company were treated as a PFIC for any taxable year, certain adverse consequences could apply to certain U.S. persons that own the Company's shares of Class B common stock.

**Risks Relating to the Regulation of Our Industry**

***Changes in governmental regulations, or the application thereof, may adversely affect our business, financial condition and results of operations.***

Our business is subject to substantial Federal and local, regulation and frequent changes to the applicable legislative and regulatory schemes, including general business regulations and laws relating to taxation, privacy, data protection, pricing, insurance, Medicare, Medicaid (Reform), and health care fraud and abuse laws. Please refer to Item 1. Business **Regulation**. Changes in these laws, enactment of new laws or regulations, changes in interpretation of these laws or changes in enforcement of these laws and regulations may materially impact our business. Such changes include without limitation:

initiatives to provide greater access to coverage for uninsured and under-insured populations without adequate funding to health plan or to be funded through taxes or other negative financial levy on health plans;

payments to health plans that are tied to achievement of certain quality performance measures;

other efforts or specific legislative changes to the Medicare of Reform programs, including changes in the bidding process or other means of materially reducing premiums;

local government regulatory changes;

increased government enforcement of or changes in interpretation or application of fraud and abuse laws; and

regulations that increase the operational burden on health plans or laws that increase a health plan's exposure to liabilities, including efforts to expand the tort liability of health plans.

Since early 2009, President Obama and various members of Congress have proposed varied legislation designed to reform aspects of the health care and insurance system in the United States. The initial health care reform proposal presented by President Obama attempted to address increasing access to health care coverage, reducing the cost of care and improving the quality of care rendered. The health care reform plan proposal was to be financed in large part by reduced expenditures for the Medicare program. Consistent with President Obama's plan proposal, Congress has previously supported financing health care reform by reducing Medicare Advantage funding. Throughout 2009, Congress debated various health reform proposals and held hearings on such proposals. At this time, no health reform proposals have been enacted into law nor does the passage into law of such a proposal appear imminent. Nevertheless, because of the unsettled nature of these proposals, the numerous steps to implement any proposal that may be enacted into law, and the possibility that some amount of the existing reform proposal efforts may be implemented through other means, such as CMS initiatives, that do not require authorizing legislation, we cannot predict the impact, if any, of such proposals on our business provide assurances that if any such proposal were to be enacted whether such

proposal would or would not have a material impact on our business in the future.

Regulations imposed by the Commissioner of Insurance, among other things, influence how our insurance subsidiaries conduct business and solicit subscriptions for shares of capital stock, and place limitations on

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investments and dividends. Possible penalties for violations of such regulations include fines, orders to cease or change practices or behavior and possible suspension or termination of licenses. The regulatory powers of the Commissioner of Insurance are designed to protect policyholders, not shareholders. While we cannot predict the terms of future regulation, the enactment of new legislation could affect the cost or demand of insurance policies, limit our ability to obtain rate increases in those cases where rates are regulated, otherwise restrict our operations, limit the expansion of our business, expose us to expanded liability or impose additional compliance requirements. In addition, we may incur additional operating expenses in order to comply with new legislation and may be required to revise the ways in which we conduct our business.

Future regulatory actions by the Commissioner of Insurance or other governmental agencies could have a material adverse effect on the profitability or marketability of our business, financial condition and results of operations.

***We may be subject to government audits or regulatory proceedings or investigative actions, which may find that our policies, procedures, practices or contracts are not compliant with or found to be in violation of applicable healthcare regulations.***

Federal and Puerto Rico government authorities, including but not limited to the Commissioner of Insurance, ASES, CMS, the OIG, the Office of the Civil Rights of HHS, the U.S. Department of Justice, the U.S. Department of Labor, and the OPM, regularly make inquiries and conduct audits concerning our compliance with applicable insurance and other laws and regulations. We may also become the subject of non-routine regulatory or other investigations or proceedings brought by these or other authorities, and our compliance with and interpretation of applicable laws and regulations may be challenged. In addition, our regulatory compliance may also be challenged by private citizens under the whistleblower provisions of applicable laws. The defense of any such challenge could result in substantial cost, diversion of resources, and a possible material adverse effect on our business.

An adverse action could result in one or more of the following:

recoupment of amounts we have been paid pursuant to our government contracts;

mandated changes in our business practices;

imposition of significant civil or criminal penalties, fines or other sanctions on us and/or our key employees;

loss of our right to participate in Medicare, the Reform or other federal or local programs; damage to our reputation;

increased difficulty in marketing our products and services;

inability to obtain approval for future services or geographic expansions; and

loss of one or more of our licenses to act as an insurance company, preferred provider or managed care organization or other licensed entity or to otherwise provide a service.

Our failure to maintain an effective corporate compliance program may increase our exposure to civil damages and penalties, criminal sanctions and administrative remedies, such as program exclusion, resulting from an adverse review. Any adverse review, audit or investigation could reduce our revenue and profitability and otherwise adversely affect our operating results.

***As a Medicare Advantage program participant, we are subject to complex regulations. If we fail to comply with these regulations, we may be exposed to criminal sanctions and significant civil penalties, and our Medicare Advantage contracts may be terminated or our operations may be required to change in a manner that has a material impact on our business.***

The laws and regulations governing Medicare Advantage program participants are complex, subject to interpretation and can expose us to penalties for non-compliance. If we fail to comply with these laws and regulations, we could be subject to criminal fines, civil penalties or other sanctions, including the termination of our Medicare Advantage contracts.



**Table of Contents*****The revised rate calculation system for Medicare Advantage and the payment system for the Medicare Part D established by the MMA could reduce our profitability.***

Effective January 1, 2006, a revised rate calculation system based on a competitive bidding process was instituted for Medicare Advantage managed care plans, including our *Medicare Selecto* and *Medicare Optimo* plans. The statutory payment rate was relabeled as the benchmark amount, and plans submit competitive bids that reflect the costs they expect to incur in providing the base Medicare benefits. If the accepted bid is less than the benchmark, Medicare pays the plan its bid plus a rebate of 75% of the amount by which the benchmark exceeds the bid. However, these rebates can only be used to enhance benefits or lower premiums and co-pays for plan members. If the bid is greater than the benchmark, the plan will be required to charge a premium to enrollees equal to the difference between the bid and the benchmark, which could affect our ability to attract enrollees. CMS reviews the methodology and assumptions used in bidding with respect to medical and administrative costs, profitability and other factors. CMS could challenge such methodology or assumptions or seek to cap or limit plan profitability.

A number of legislative proposals as well as proposal offered by President Obama includes efforts to save federal funds by implementing significant rate reductions to Medicare Advantage plans by changes in the competitive bidding process, tying the country benchmarks to Medicare fee for service expenditures, or by other means.

In addition, the Medicare Part D prescription drug benefit payments to plans are determined through a competitive bidding process, and enrollee premiums also are tied to plan bids. The bids reflect the plan's expected costs for a Medicare beneficiary of average health; CMS adjusts payments to plans based on enrollees' health and other factors. The program is largely subsidized by the federal government and is additionally supported by risk-sharing between Medicare Part D plans and the federal government through risk corridors designed to limit the profits or losses of the drug plans and reinsurance for catastrophic drug costs. The government payment amount to plans is based on the national weighted average monthly bid for basic Part D coverage, adjusted for member demographics and risk factor payments. The beneficiary will be responsible for the difference between the government payment amount and his or her plan's bid, together with the amount of his or her plan's supplemental premium (before rebate allocations), subject to the co-pays, deductibles and late enrollment penalties, if applicable. Additional subsidies are provided for dual-eligible beneficiaries and specified low-income beneficiaries. Medicare also subsidizes 80% of drug spending above an enrollee's catastrophic threshold.

We face the risk of reduced or insufficient government funding and we may need to terminate our Medicare Advantage and/or Part D contracts with respect to unprofitable markets, which may have a material adverse effect on our financial position, results of operations or cash flows. In addition, as a result of the competitive bidding process, our ability to participate in the Medicare Advantage and/or the Part D programs is affected by the pricing and design of our competitors' bids. Moreover, we may in the future be required to reduce benefits or charge our members an additional premium in order to maintain our current level of profitability, either of which could make our health plans less attractive to members and adversely affect our membership.

***CMS's risk adjustment payment system and budget neutrality factors make our revenue and profitability difficult to predict and could result in material retroactive adjustments to our results of operations.***

CMS has implemented a risk adjustment payment system for Medicare Advantage plans to improve the accuracy of payments and establish incentives for such plans to enroll and treat less healthy Medicare beneficiaries. CMS phased in this payment methodology with a risk adjustment model that bases a portion of the total CMS reimbursement payments on various clinical and demographic factors. CMS requires that all managed care companies capture, collect and submit the necessary diagnosis code information to CMS for reconciliation with CMS's internal database. As a result of this process, it is difficult to predict with certainty our future revenue or profitability. In addition, our own risk scores for any period may result in favorable or unfavorable adjustments to the payments we receive from CMS and our Medicare payment revenue. There can be no assurance that our contracting physicians and hospitals will be successful in improving the accuracy of recording diagnosis code information, which has an impact on our risk scores.

Payments to Medicare Advantage plans are also adjusted by a budget neutrality factor that was implemented in 2003 by Congress and CMS to prevent health plan payments from being reduced overall while, at the same time, directing risk adjusted payments to plans with more chronically ill enrollees. In general, this adjustment has





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favorably impacted payments to all Medicare Advantage plans. However, this adjustment is schedule to be gradually being phased out by 2011. Furthermore, MedPac continues to recommend that Congress enact legislation that reduces Medicare Advantage payment to equalize payments for services made through Medicare Advantage plans and the traditional fee-for-service Medicare program. As of the date of this Annual Report on Form 10-K, Congress has not enacted legislation that contains the MedPac recommendations. However, we cannot provide assurance if, when or to what degree Congress may enact legislation including the MedPac recommendations, but any reduction in Medicare Advantage rates could have a material adverse effect on our revenue, financial position, results of operations or cash flow.

***If during the open enrollment season our Medicare Advantage members enroll in another Medicare Advantage plan, they will be automatically disenrolled from our plan, possibly without our immediate knowledge.***

Pursuant to the MMA, members enrolled in one insurer's Medicare Advantage program will be automatically unenrolled from that program if they enroll in another insurer's Medicare Advantage program. If our members enroll in another insurer's Medicare Advantage program during the open enrollment season, we may not discover that such member has been unenrolled from our program until such time as we fail to receive reimbursement from the CMS in respect of such member, which may occur several months after the end of the open season. As a result, we may discover that a member has unenrolled from our program after we have already provided services to such individual. Our profitability would be reduced as a result of such failure to receive payment from CMS if we had made related payments to providers and were unable to recoup such payments from them.

***If we are deemed to have violated the insurance company change of control statutes in Puerto Rico, we may suffer adverse consequences.***

We are subject to change of control statutes applicable to insurance companies. These statutes regulate, among other things, the acquisition of control of an insurance company or a holding company of an insurance company. Under these statutes, no person may make an offer to acquire or to sell the issued and outstanding voting stock of an insurance company, which constitutes 10% or more of the issued and outstanding stock of an insurance company, or of the total stock issued and outstanding of a holding company of an insurance company, or solicit or receive funds in exchange for the issuance of new shares of our or our insurance subsidiaries' capital stock, without the prior approval of the Commissioner of Insurance. Our amended and restated articles of incorporation (the articles) prohibit any institutional investor from owning 10% or more of our voting power and any person that is not an institutional investor from owning 5% or more of our voting power. We cannot, however, assure you that ownership of our securities will remain below these thresholds. To the extent that a person, including an institutional investor, acquires shares in excess of these limits, our articles provide that we will have the power to take certain actions, including refusing to give effect to a transfer or instituting proceedings to enjoin or rescind a transfer, in order to avoid a violation of the ownership limitation in the articles. If the Commissioner of Insurance determines that a change of control has occurred, we could be subject to fines and penalties, and in some instances the Commissioner of Insurance would have the discretion to revoke our operating licenses.

We are also subject to change of control limitations pursuant to our BCBSA license agreements. The BCBSA ownership limits restrict beneficial ownership of our voting capital stock to less than 10% for an institutional investor and less than 5% for a non-institutional investor, both as defined in our articles. In addition, no person may beneficially own shares of our common stock or other equity securities, or a combination thereof, representing a 20% or more ownership interest, whether voting or non-voting, in our company. This provision in our articles cannot be changed without the prior approval of the BCBSA and the vote of holders of at least 75% of our common stock.

***Our insurance subsidiaries are subject to minimum capital requirements. Our failure to meet these standards could subject us to regulatory actions.***

Puerto Rico insurance laws and the regulations promulgated by the Commissioner of Insurance, among other things, require insurance companies to maintain certain levels of capital, thereby restricting the amount of earnings that can be distributed by our insurance subsidiaries to us. Although we are currently in compliance with these requirements, there can be no assurance that we will continue to comply in the future. Failure to maintain required levels of capital or to otherwise comply with the reporting requirements of the Commissioner of Insurance could subject our insurance subsidiaries to corrective action, including government supervision or liquidation, or require



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us to provide financial assistance, either through subordinated loans or capital infusions, to our subsidiaries to ensure they maintain their minimum statutory capital requirements.

We are also subject to minimum capital requirements pursuant to our BCBSA license agreements. See **Risks Related to Our Business**. The termination or modification of our license agreements to use the BCBS name and mark could have a material adverse effect on our business, financial condition and results of operations.

***We are required to comply with laws governing the transmission, security and privacy of health information.***

Certain implementing regulations of HIPAA require us to comply with standards regarding the formats for electronic transmission, and the privacy and security of certain health information within our company and with third parties, such as managed care providers, business associates and our members. While we have agreements in place with our business associates we have limited control over their operations regarding the privacy and security of protected health information. The HIPAA regulations also provide access rights and other rights for health plan beneficiaries with respect to their health information. These regulations include standards for certain electronic transactions, including encounter and claims information, health plan eligibility and payment information. Compliance with HIPAA is enforced by HHS's Office for Civil Rights for privacy, CMS for security and electronic transactions, and by the U.S. Department of Justice for criminal violations, and by States Attorneys General once the HIPAA amendments under the Stimulus are implemented. Further, the Gramm-Leach-Bliley Act imposes certain privacy and security requirements on insurers that may apply to certain aspects of our business as well.

We continue to implement and revise our health information policies and procedures to monitor and ensure our compliance with these laws and regulations, including the HIPAA amendments under the Stimulus. Furthermore, Puerto Rico's ability to promulgate its own laws and regulations (including those issued in response to the Gramm-Leach-Bliley Act), such as Act No. 194 of August 25, 2000, also known as the Patient's Rights and Responsibilities Act, including those more stringent than HIPAA, and uncertainty regarding many aspects of such state requirements, make compliance with applicable health information laws more difficult. For these reasons, our total compliance costs may increase in the future.

***Puerto Rico insurance laws and regulations and provisions of our articles and bylaws could delay, deter or prevent a takeover attempt that shareholders might consider to be in their best interests and may make it more difficult to replace members of our board of directors and have the effect of entrenching management.***

Puerto Rico insurance laws and the regulations promulgated thereunder, and our articles and bylaws may delay, defer, prevent or render more difficult a takeover attempt that our shareholders might consider to be in their best interests. For instance, they may prevent our shareholders from receiving the benefit from any premium to the market price of our common stock offered by a bidder in a takeover context. Even in the absence of a takeover attempt, the existence of these provisions may adversely affect the prevailing market price of our common stock if they are viewed as discouraging takeover attempts in the future.

Our license agreements with the BCBSA require that our articles contain certain provisions, including ownership limitations. See **Risks Relating to the Regulation of Our Industry**. If we are deemed to have violated the insurance company change of control statutes in Puerto Rico, we may suffer adverse consequences.

Other provisions included in our articles and bylaws may also have anti-takeover effects and may delay, defer or prevent a takeover attempt that our shareholders might consider to be in their best interests. In particular, our articles and bylaws:

permit our board of directors to issue one or more series of preferred stock;

divide our board of directors into three classes serving staggered three-year terms;

limit the ability of shareholders to remove directors;

impose restrictions on shareholders' ability to fill vacancies on our board of directors;

impose advance notice requirements for shareholder proposals and nominations of directors to be considered at meetings of shareholders; and

impose restrictions on shareholders ability to amend our articles and bylaws.

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See also Risks Relating to the Regulation of Our Industry. If we are deemed to have violated the insurance company change of control statutes in Puerto Rico, we may suffer adverse consequences.

Puerto Rico insurance laws and the regulations promulgated by the Commissioner of Insurance may also delay, defer, prevent or render more difficult a takeover attempt that our shareholders might consider to be in their best interests. For instance, the Commissioner of Insurance must review any merger, consolidation or new issue of shares of capital stock of an insurer or its parent company and make a determination as to the fairness of the transaction. Also, a director of an insurer must meet certain requirements imposed by Puerto Rico insurance laws.

These voting and other restrictions may operate to make it more difficult to replace members of our board of directors and may have the effect of entrenching management regardless of their performance.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

We own a seven story (including the basement floor) building located at 1441 F.D. Roosevelt Avenue, in San Juan, Puerto Rico, and two adjacent buildings, as well as the adjoining parking lot. In addition, we own five floors of a fifteen-story building located at 1510 F.D. Roosevelt Avenue, in Guaynabo, Puerto Rico. The properties are subject to liens under our credit facilities. See Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operation Liquidity and Capital Resources.

We also own land in the municipality of Mayagüez, Puerto Rico, in which we plan to build a multi-segment customer service center. In addition to the properties described above, we or our subsidiaries are parties to operating leases that are entered into in the ordinary course of business.

We believe that our facilities are in good condition and that the facilities, together with capital improvements and additions currently underway, are adequate to meet our operating needs for the foreseeable future. The need for expansion, upgrading and refurbishment of facilities is continually evaluated in order to keep facilities aligned with planned business growth and corporate strategy.

**Item 3. Legal Proceedings**

As of December 31, 2009, the Company is a defendant in various lawsuits arising in the ordinary course of business. We are also defendants in various other claims and proceedings, some of which are described below. Furthermore, the Commissioner of Insurance, as well as other Federal and Puerto Rico government authorities, regularly make inquiries and conduct audits concerning the Corporation's compliance with applicable insurance and other laws and regulations.

Management believes that the aggregate liabilities, if any, arising from all such claims, assessments, audits and lawsuits will not have a material adverse effect on the consolidated financial position or results of operations of the Corporation. However, given the inherent unpredictability of these matters, it is possible that an adverse outcome in certain matters could have a material adverse effect on our financial condition, operating results and/or cash flows. Where the Corporation believes that a loss is both probable and estimable, such amounts have been recorded. In other cases, it is at least reasonably possible that the Corporation may incur a loss related to one or more of the mentioned pending lawsuits or investigations, but the Corporation is unable to estimate the range of possible loss which may be ultimately realized, either individually or in the aggregate, upon their resolution.

Additionally, we may face various potential litigation claims that have not to date been asserted, including claims from persons purporting to have contractual rights to acquire shares of the Corporation on favorable terms or to have inherited such shares notwithstanding applicable transfer and ownership restrictions. See Item 1A. Risk Factors Risks Relating to our Capital Stock.

**Hau et al Litigation (formerly known as Jordan et al)**

On April 24, 2002, Octavio Jordán, Agripino Lugo, Ramón Vidal, and others filed a suit against the Corporation, the Corporation's subsidiary TSS and others in the Court of First Instance for San Juan, Superior Section (the Court of First Instance), alleging, among other things, violations by the defendants of provisions of the Puerto Rico

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Insurance Code, antitrust violations, unfair business practices, RICO violations, breach of contract with providers, and damages in the amount of \$12 million. Following years of complaint amendments, motions practice and interim appeals up to the level of the Puerto Rico Supreme Court, the plaintiffs amended their complaint on June 20, 2008 to allege with particularity the same claims initially asserted but on behalf of a more limited group of plaintiffs, and increase their claim for damages to approximately \$207 million. Discovery is expected to conclude by March 2010. The Corporation intends to vigorously defend this claim.

**Dentists Association Litigation**

On February 11, 2009, the Puerto Rico Dentists Association (Colegio de Cirujanos Dentistas de Puerto Rico) filed a complaint in the Court of First Instance against 24 health plans operating in Puerto Rico that offer dental health coverage. The Corporation and two of its subsidiaries, TSS and Triple-C, Inc. ( TCI ), were included as defendants. This litigation purports to be a class action filed on behalf of Puerto Rico dentists who are similarly situated; however, the complaint does not include a single dentist as a class representative nor a definition of the intended class.

The complaint alleges that the defendants, on their own and as part of a common scheme, systematically deny, delay and diminish the payments due to dentists so that they are not paid in a timely and complete manner for the covered medically necessary services they render. The complaint also alleges, among other things, violations to the Puerto Rico Insurance Code, antitrust laws, the Puerto Rico racketeering statute, unfair business practices, breach of contract with providers, and damages in the amount of \$150 million. In addition, the complaint claims that the Puerto Rico Insurance Companies Association is the hub of an alleged conspiracy concocted by the member plans to defraud dentists.

There are numerous available defenses to oppose both the request for class certification and the merits. The Corporation intends to vigorously defend this claim.

Two codefendant plans removed the case to federal court, which the plaintiffs and the other codefendants, including the Corporation, opposed. The federal District Court decided that it lacked jurisdiction under the Class Action Fairness Act ( CAFA ) and remanded the case to state court. The removing defendants petitioned to appeal to the First Circuit Court of Appeals. Having accepted the appeal, the First Circuit Court of Appeals issued an order in late October 2009 which found the lower court's decision premature. The Court of Appeals remanded the case to the federal District Court and allowed limited discovery to determine whether the case should be heard in federal court pursuant to CAFA.

**Colón Litigation**

On October 15, 2007, José L. Colón-Dueño, a former holder of one share of TSS predecessor stock, filed suit against TSS and the Puerto Rico Commissioner of Insurance (the Commissioner ) in the Court of First Instance. The sale of that share to Mr. Colón-Dueño was voided in 1999 pursuant to an order issued by the Commissioner in which the sale of 1,582 shares to a number of TSS shareholders was voided. TSS, however, appealed the Commissioner's order before the Puerto Rico Court of Appeals, which upheld the order on March 31, 2000. Plaintiff requests that the court direct TSS to return his share of stock and compensate him for alleged damages in excess of \$500,000 plus attorney's fees. The Corporation is vigorously contesting this lawsuit because, among other reasons, the Commissioner's order is final and cannot be collaterally attacked in this litigation.

**Puerto Rico Center for Municipal Revenue Collection**

On March 1, 2006 and March 3, 2006, respectively, the Puerto Rico Center for Municipal Revenue Collection (CRIM) imposed a real property tax assessment of approximately \$1.3 million and a personal property tax assessment of approximately \$4.0 million upon TSS for fiscal years 1992-1993 through 2002-2003. During that time, TSS qualified as a tax-exempt entity under Puerto Rico law pursuant to rulings issued by the Puerto Rico tax authorities. In imposing the tax assessments, CRIM revoked the tax rulings retroactively, based on its contention that a for-profit corporation such as TSS is not entitled to such an exemption. On March 28, 2006 and March 29, 2006, respectively, TSS challenged the real and personal property tax assessments in the Court of First Instance. The court granted summary judgment affirming the real property and personal property tax assessments on October 29, 2007 and December 5, 2007, respectively.

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TSS appealed the court's decisions before the Puerto Rico Court of Appeals but on June 30, 2008 the Court of Appeals confirmed the summary judgment issued by the Court of First Instance in both property tax cases. TSS timely filed a certiorari petition, a reconsideration and a second reconsideration with the Puerto Rico Supreme Court and all were denied. The Corporation submitted a petition for certiorari to the U.S. Supreme Court on August 26, 2009, based on its strong belief that CRIM's retroactive revocation of applicable tax rulings and its imposition of a tax liability reaching back over ten years constituted a violation of the Corporation's due process rights. CRIM filed a response on December 8, 2009. On January 11, 2010, the U.S. Supreme Court invited the Solicitor General of the United States to file a brief in this case expressing the views of the United States.

The Corporation recorded an accrual which is included within accounts payable and accrued liabilities in the accompanying consolidated financial statements.

**Claims by Heirs of Former Shareholders**

The Corporation and TSS are defending four individual lawsuits, all filed in state court, from persons who claim to have inherited a total of 90 shares of the Corporation or one of its predecessors or affiliates (before giving effect to the 3,000-for-one stock split). While each case presents unique facts, the lawsuits generally allege that the redemption of the shares by the Corporation pursuant to transfer and ownership restrictions contained in the Corporation's (or its predecessors' or affiliates') articles of incorporation and bylaws was improper. Discovery is underway in each case. Management believes all these claims are time barred under one or more statutes of limitations and other grounds and is vigorously defending them.

***Item 4. Removed and Reserved*****Part II*****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*****Market Information**

Our Class B common stock is listed and began trading on the New York Stock Exchange (the NYSE) on December 7, 2007 under the trading symbol "GTS". Prior to this date our Class B common stock had no established public trading market. There is no established public trading market for our Class A common stock.

The following table presents high and low sales prices of our Class B common stock for the each quarter of the years ended December 31, 2009 and 2008:

|                | <b>High</b> | <b>Low</b> |
|----------------|-------------|------------|
| <b>2008</b>    |             |            |
| First quarter  | \$21.69     | \$16.83    |
| Second quarter | 19.94       | 16.34      |
| Third quarter  | 18.05       | 15.19      |
| Fourth quarter | 16.43       | 6.55       |
| <b>2009</b>    |             |            |
| First quarter  | \$15.00     | \$10.67    |
| Second quarter | 16.23       | 12.06      |
| Third quarter  | 17.84       | 14.50      |
| Fourth quarter | 18.88       | 15.52      |

On February 26, 2010 the closing price of our Class B common stock on the NYSE was \$17.33.

**Holders**

As of February 23, 2010, there were 9,042,809 and 20,110,391 shares of Class A and Class B common Stock outstanding, respectively. The number of our holders of Class A common stock as of February 23, 2010 was 1,965. The number of our holders of Class B common stock as of January 15, 2010 was 2,723.

**Table of Contents****Dividends**

Subject to the limitations under Puerto Rico corporation law and any preferential dividend rights of outstanding preferred stock, of which there is currently none outstanding, holders of common stock are entitled to receive their pro rata share of such dividends or other distributions as may be declared by our board of directors out of funds legally available therefore.

Our ability to pay dividends is dependent on cash dividends from our subsidiaries. Our subsidiaries are subject to regulatory surplus requirements and additional regulatory requirements, which may restrict their ability to declare and pay dividends or distributions to us. In addition, our secured term loan restricts our ability to pay dividends if a default thereunder has occurred and is continuing. Please refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Restriction on Certain Payments by the Corporation's Subsidiaries.

We did not declare any dividends during the two most recent fiscal years and do not expect to pay any cash dividends for the foreseeable future. We currently intend to retain future earnings, if any, to finance operations and expand our business. The ultimate decision to pay a dividend, however, remains within the discretion of our board of directors and may be affected by various factors, including our earnings, financial condition, capital requirements, level of indebtedness, statutory and contractual limitations and other considerations our board of directors deems relevant.

**Securities Authorized for Issuance Under Equity Compensation Plan**

The information required by this Item is incorporated herein by reference from our definitive Proxy Statement for our 2010 Annual Meeting of Shareholders, which will be filed with the SEC pursuant to Regulation 14A within 120 days after the end of our last fiscal year.

**Recent Sales of Unregistered Securities**

Not applicable.

**Purchases of Equity Securities by the Issuer**

The following table presents information related to our repurchases of common stock for the period indicated:

|  | Total<br>Number<br>of Shares<br>Purchased | Average<br>Price Paid<br>per Share | Total<br>Number of<br>Shares<br>Purchased<br>as<br>Part of<br>Publicly<br>Announced<br>Programs <sup>1</sup> | Approximate<br>Dollar<br>Value of<br>Shares<br>that May<br>Yet Be<br>Purchased<br>Under<br>the<br>Programs<br>(in<br>millions) |
|--|---|------------------------------------|--|--|
| <i>(Dollar amounts in millions, except per share data)</i> |   |                                    |  |  |
| November 1, 2009 to November 30, 2009                      | 235,000                                   | \$ 16.30                           | 235,000  | \$ 0.3   |
| December 1, 2009 to December 31, 2009                      | 15,672                                    | 16.27                              | 15,672   | 0.0  |

<sup>1</sup> In October 2008, the Board of Directors authorized a \$40.0 million share repurchase program, which



commenced on  
December 8,  
2008. This  
repurchase  
program was  
completed  
during  
December 2009.

**Performance Graph**

The following graph compares the cumulative total return to shareholders on our Class B common stock for the period from December 7, 2007, the date our Class B common stock began trading on the NYSE, through December 31, 2009, with the cumulative total return over such period of (i) the Standard and Poor's 500 Stock Index (the S&P 500 Index) and (ii) the Morgan Stanley Healthcare Payor Index (the MSHP Index). For illustrative purposes, the graph assumes an investment of \$100 on December 7, 2007 in each of our Class B common stock, the S&P 500 Index and the MSHP Index. The performance graph is not necessarily indicative of future performance.

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The comparisons shown in the graph are based on historical data and the Corporation cautions that the stock price in the graph below is not indicative of, and is not intended to forecast, the potential future performance of our Class B common stock. Information used in the preparation of the graph was obtained from Bloomberg, a source we believe to be reliable, however, the Corporation is not responsible for any errors or omissions in such information.

| <i>Index</i>                          | <b>12/07/07</b> | <b>12/31/07</b> | <i>Period Ending</i> |                 | <b>06/30/09</b> | <b>12/31/09</b> |
|---------------------------------------|-----------------|-----------------|----------------------|-----------------|-----------------|-----------------|
|                                       |                 |                 | <b>06/30/08</b>      | <b>12/31/08</b> |                 |                 |
| Triple-S Management Corporation       | 100.00          | 133.40          | 107.92               | 75.91           | 102.90          | 116.17          |
| S&P 500                               | 100.00          | 97.59           | 85.07                | 60.03           | 61.10           | 74.11           |
| Morgan Stanley Healthcare Payor Index | 100.00          | 100.38          | 58.66                | 45.37           | 52.42           | 69.59           |

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**Table of Contents*****Item 6. Selected Financial Data*****Statement of Earnings Data***(Dollar amounts in millions, except per share data)*

| <i>Years ended December 31,</i>                             | <b>2009</b> | <b>2008</b> | <b>2007</b> | <b>2006 (1)</b> | <b>2005</b> |
|---|-------------|-------------|-------------|-----------------|-------------|
| Premiums earned, net  | \$1,876.1   | \$1,695.5   | \$1,483.6   | \$1,511.6       | \$1,380.2   |
| Administrative service fees                                 | 48.6        | 19.2        | 14.0        | 14.1            | 14.4        |
| Net investment income                                       | 52.1        | 56.2        | 47.2        | 42.7            | 29.1        |
| Total operating revenues                                    | 1,976.8     | 1,770.9     | 1,544.8     | 1,568.4         | 1,423.7     |
| Net realized investments gains (losses)                     | 0.6         | (13.9)      | 5.9         | 0.8             | 7.2         |
| Net unrealized investment gain (loss) on trading securities | 10.5        | (21.1)      | (4.1)       | 7.7             | (4.7)       |
| Other income (expense), net                                 | 1.3         | (2.5)       | 3.2         | 2.3             | 3.7         |
| Total revenues  | 1,989.2     | 1,733.4     | 1,549.8     | 1,579.2         | 1,429.9     |
| Benefits and expenses:                                      |             |             |             |                 |             |
| Claims incurred   | 1,612.8     | 1,434.9     | 1,223.8     | 1,259.0         | 1,208.3     |
| Operating expenses  | 279.4       | 251.9       | 237.5       | 236.1           | 181.7       |
| Total operating costs                                       | 1,892.2     | 1,686.8     | 1,461.3     | 1,495.1         | 1,390.0     |
| Interest expense  | 13.3        | 14.7        | 15.9        | 16.6            | 7.6         |
| Total benefits and expenses                                 | 1,905.5     | 1,701.5     | 1,477.2     | 1,511.7         | 1,397.6     |
| Income before taxes   | 83.7        | 31.9        | 72.6        | 67.5            | 32.3        |
| Income tax expense  | 14.9        | 7.1         | 14.1        | 13.0            | 3.9         |
| Net income  | \$ 68.8     | \$ 24.8     | \$ 58.5     | \$ 54.5         | \$ 28.4     |
| Basic net income per share (2):                             | \$ 2.33     | \$ 0.77     | \$ 2.15     | \$ 2.04         | \$ 1.06     |
| Diluted net income per share:                               | \$ 2.33     | \$ 0.77     | \$ 2.15     | \$ 2.04         | \$ 1.06     |
| Dividend declared per common share (3):                     | \$          | \$          | \$ 0.82     | \$ 0.23         | \$          |

**Balance Sheet Data**

| <i>December 31,</i>       | <b>2009</b> | <b>2008</b> | <b>2007</b> | <b>2006 (1)</b> | <b>2005</b> |
|---------------------------|-------------|-------------|-------------|-----------------|-------------|
| Cash and cash equivalents | \$ 40.4     | \$ 46.1     | \$ 240.2    | \$ 81.6         | \$ 49.0     |
| Total assets              | \$1,648.7   | \$1,559.2   | \$1,659.5   | \$1,345.5       | \$1,137.5   |
| Long-term borrowings      | \$ 167.7    | \$ 169.3    | \$ 170.9    | \$ 183.1        | \$ 150.6    |

|                           |          |          |          |          |          |
|---------------------------|----------|----------|----------|----------|----------|
| Total stockholders equity | \$ 537.8 | \$ 485.9 | \$ 482.5 | \$ 342.6 | \$ 308.7 |
|---------------------------|----------|----------|----------|----------|----------|

**Table of Contents****Additional Managed Care Data (4)**

| <i>Years ended December 31,</i> | <b>2009</b> | <b>2008</b> | <b>2007</b> | <b>2006 (1)</b> | <b>2005</b> |
|---------------------------------|-------------|-------------|-------------|-----------------|-------------|
| Medical loss ratio              | 90.0%       | 88.9%       | 87.0%       | 87.6%           | 90.3%       |
| Operating expense ratio         | 10.6%       | 10.5%       | 11.2%       | 11.5%           | 10.8%       |
| Medical membership (period end) | 1,347,033   | 1,195,450   | 977,190     | 979,506         | 1,252,649   |

(1) On January 31, 2006 we completed the acquisition of GA Life (now TSV). The results of operations and financial condition of GA Life are included in this table for the period following the effective date of the acquisition.

(2) Further details of the calculation of basic earnings per share are set forth in notes 2 and 22 of the audited financial consolidated financial statements for the years ended December 31, 2009, 2008 and 2007.

(3) Shareowners holding qualifying shares were

excluded from dividend payment. See note 19 of the audited financial consolidated financial statements for the years ended December 31, 2009, 2008 and 2007.

- (4) Does not reflect inter-segment eliminations.

***Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations***

This financial discussion contains an analysis of our consolidated financial position and financial performance as of December 31, 2009 and 2008, and consolidated results of operations for 2009, 2008 and 2007. This analysis should be read in its entirety and in conjunction with the consolidated financial statements, notes and tables included elsewhere in this Annual Report on Form 10-K.

**Overview**

We are the largest managed care company in Puerto Rico in terms of membership, with 50 years of experience in the managed care industry. We offer a broad portfolio of managed care and related products in the Commercial, Reform and Medicare (including Medicare Advantage and the Part D stand-alone prescription drug plans ( PDP )) markets. The Reform is a government of Puerto Rico-funded managed care program for the medically indigent, similar to the Medicaid program in the U.S. We have the exclusive right to use the Blue Cross and Blue Shield name and mark throughout Puerto Rico and U.S. Virgin Islands, serve approximately 1.3 million members across all regions of Puerto Rico and hold a leading market position covering approximately 34% of the population. For the years ended December 31, 2009 and 2008 respectively, our managed care segment represented approximately 89.8% and 89.2% of our total consolidated premiums earned, net, and approximately 67.6% and 62.5% of our operating income. We also have significant positions in the life insurance and property and casualty insurance markets. Our life insurance segment had a market share of approximately 12% (in terms of premiums written) as of December 31, 2008. Our property and casualty segment had a market share of approximately 9% (in terms of direct premiums) during the nine-month period ended September 30, 2009.

We participate in the managed care market through our subsidiary, TSS. Our managed care subsidiary is a BCBSA licensee, which provides us with exclusive use of the Blue Cross and Blue Shield brand in Puerto Rico and U.S. Virgin Islands. We offer products to the Commercial, including corporate accounts, federal government employees, local government employees, individual accounts, Medicare Supplement, Reform and Medicare (including Medicare Advantage and PDP) markets.

We participate in the life insurance market through our subsidiary, TSV, and in the property and casualty insurance market through our subsidiary, TSP. TSV and TSP represented approximately 5.3% and 5.1%, respectively, of our consolidated premiums earned, net for the year ended December 31, 2009 and 17.3% and 10.4%, respectively, of our operating income for that period.

The Commissioner of Insurance of the Commonwealth of Puerto Rico recognizes only statutory accounting practices for determining and reporting the financial condition and results of operations of an insurance company, for determining its solvency under the Puerto Rico insurance laws and for determining whether its financial

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condition warrants the payment of a dividend to its stockholders. No consideration is given by the Commissioner of Insurance of the Commonwealth of Puerto Rico to financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) in making such determinations. See note 25 to our audited consolidated financial statements.

Intersegment revenues and expenses are reported on a gross basis in each of the operating segments but eliminated in the consolidated results. Except as otherwise indicated, the numbers presented in this Annual Report on Form 10-K do not reflect intersegment eliminations. These intersegment revenues and expenses affect the amounts reported on the financial statement line items for each segment, but are eliminated in consolidation and do not change net income. The following table shows premiums earned, net and net fee revenue and operating income for each segment, as well as the intersegment premiums earned, service revenues and other intersegment transactions, which are eliminated in the consolidated results:

| <i>(Dollar amounts in millions)</i>      | <b>Years ended December 31,</b> |             |             |
|--|---------------------------------|-------------|-------------|
|  | <b>2009</b>                     | <b>2008</b> | <b>2007</b> |
| <b>Premiums earned, net:</b>             |                                 |             |             |
| Managed care                             | \$1,684.1                       | \$1,513.0   | \$1,301.8   |
| Life insurance                           | 100.1                           | 92.8        | 88.9        |
| Property and casualty insurance          | 96.2                            | 93.8        | 96.9        |
| Intersegment premiums earned             | (4.3)                           | (4.1)       | (4.0)       |
| Consolidated premiums earned, net        | \$1,876.1                       | \$1,695.5   | \$1,483.6   |
| <b>Administrative service fees:</b>      |                                 |             |             |
| Managed care                             | \$ 51.3                         | \$ 22.5     | \$ 17.2     |
| Intersegment administrative service fees | (2.7)                           | (3.3)       | (3.2)       |
| Consolidated administrative service fees | \$ 48.6                         | \$ 19.2     | \$ 14.0     |
| <b>Operating income:</b>                 |                                 |             |             |
| Managed care                             | \$ 57.2                         | \$ 52.6     | \$ 57.4     |
| Life insurance                           | 14.6                            | 12.5        | 10.7        |
| Property and casualty insurance          | 8.8                             | 13.1        | 10.7        |
| Intersegment and other                   | 4.0                             | 5.9         | 4.7         |
| Consolidated operating income            | \$ 84.6                         | \$ 84.1     | \$ 83.5     |

**Results of Operations****Revenue**

*General.* Our revenue consists primarily of (i) premium revenue we generate from our managed care business, (ii) administrative service fees we receive for administrative services provided to self-insured employers (ASO), (iii) premiums we generate from our life insurance and property and casualty insurance businesses and (iv) investment income.

*Managed Care Premium Revenue.* Our revenue primarily consists of premiums earned from the sale of managed care products to the Commercial market sector, including corporate accounts, federal government employees, local government employees, individual accounts and Medicare Supplement, as well as to the Medicare Advantage (including PDP) and Reform sectors. We receive a monthly payment from or on behalf of each member enrolled in

our managed care plans (excluding ASO). We recognize all premium revenue in our managed care business during the month in which we are obligated to provide services to an enrolled member. Premiums we receive in advance of that date are recorded as unearned premiums.

Premiums are generally fixed by contract in advance of the period during which healthcare is covered. Our Commercial premiums are generally fixed for the plan year in the annual renewal process throughout the year. Fully-insured Reform contracts typically have one-year terms, at which time, after a bidding process, premiums are fixed for the plan year. Our Medicare Advantage contracts entitle us to premium payments from CMS on behalf of each Medicare beneficiary enrolled in our plans, generally on a per member per month ( PMPM ) basis. We submit



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rate proposals to CMS in June for each Medicare Advantage product that will be offered beginning January 1 of the subsequent year in accordance with the new competitive bidding process under the MMA. Retroactive rate adjustments are made periodically with respect to our Medicare Advantage plans based on the aggregate health status and risk scores of our plan participants.

Premium payments from CMS in respect of our Medicare Part D prescription drug plans are based on written bids submitted by us which include the estimated costs of providing the prescription drug benefits.

*Administrative Service Fees.* Administrative service fees include amounts paid to us for administrative services provided to self-insured contracts. We provide a range of customer services pursuant to our administrative services only ( ASO ) contracts, including claims administration, billing, access to our provider networks and membership services. Administrative service fees are recognized in the month in which services are provided.

*Other Premium Revenue.* Other premium revenue includes premiums generated from the sale of life insurance and property and casualty insurance products. Premiums on life insurance policies are billed in the month prior to the effective date of the policy, with a one-month grace period, and the related revenue is recorded as earned during the coverage period. If the insured fails to pay within the one-month grace period, we may cancel the policy. We recognize premiums on property and casualty contracts as earned on a pro rata basis over the policy term. Property and casualty policies are subscribed through general agencies, which bill policy premiums to their clients in advance or, in the case of new business, at the inception date and remit collections to us, net of commissions. The portion of premiums related to the period prior to the end of coverage is recorded in the consolidated balance sheet as unearned premiums and is transferred to premium revenue as earned.

*Investment Income and Other Income.* Investment income consists of interest income and other income consists of net realized gains (losses) on investment securities. See note 2 to our audited consolidated financial statements.

***Expenses***

*Claims Incurred.* Our largest expense is medical claims incurred, or the cost of medical services we arrange for our members. Medical claims incurred include the payment of benefits and losses, mostly to physicians, hospitals and other service providers, and to policyholders. We generally pay our providers on one of three bases: (1) fee-for-service contracts based on negotiated fee schedules; (2) capitated arrangements, generally on a fixed PMPM payment basis, whereby the provider generally assumes some of the medical expense risk; and (3) risk-sharing arrangements, whereby we advance a capitated PMPM amount and share the risk of certain medical costs of our members with the provider based on actual experience as measured against pre-determined sharing ratios. Claims incurred also include claims incurred in our life insurance and property and casualty insurance businesses. Each segment's results of operations depend in significant part on our ability to accurately predict and effectively manage claims and losses. A portion of the claims incurred for each period consists of claims reported but not paid during the period, as well as a management and actuarial estimate of claims incurred but not reported during the period.

The medical loss ratio ( MLR ), which is calculated by dividing managed care claims incurred by managed care premiums earned, net is one of our primary management tools for measuring these costs and their impact on our profitability. The medical loss ratio is affected by the cost and utilization of services. The cost of services is affected by many factors, in particular our ability to negotiate competitive rates with our providers. The cost of services is also influenced by inflation and new medical discoveries, including new prescription drugs, therapies and diagnostic procedures. Utilization rates, which reflect the extent to which beneficiaries utilize healthcare services, significantly influence our medical costs. The level of utilization of services depends in large part on the age, health and lifestyle of our members, among other factors. As the medical loss ratio is the ratio of claims incurred to premiums earned, net it is affected not only by our ability to contain cost trends but also by our ability to increase premium rates to levels consistent with or above medical cost trends. We use medical loss ratios both to monitor our management of healthcare costs and to make various business decisions, including what plans or benefits to offer and our selection of healthcare providers.

*Operating Expenses.* Operating expenses include commissions to external brokers, general and administrative expenses, cost containment expenses such as case and disease management programs, and depreciation and amortization. The operating expense ratio is calculated by dividing operating expenses by premiums earned, net and administrative service fees. A significant portion of our operating expenses are fixed



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costs. Accordingly, it is important that we maintain or increase our volume of business in order to distribute our fixed costs over a larger membership base. Significant changes in our volume of business will affect our operating expense ratio and results of operations. We also have variable costs, which vary in proportion to changes in volume of business.

**Membership**

Our results of operation depend in large part on our ability to maintain or grow our membership. In addition to driving revenues, membership growth is necessary to successfully introduce new products, maintain an extensive network of providers and achieve economies of scale. Our ability to maintain or grow our membership is affected principally by the competitive environment and general market conditions.

In July 1, 2009, our subsidiary TSS completed the acquisition of certain managed care assets of La Cruz Azul de Puerto Rico, including members. As of December 31, 2009, the membership attributable to this transaction was 108,502.

The following table sets forth selected membership data as of the dates set forth below:

|                           | <b>2009</b>      | <b>As of December 31,<br/>2008</b> | <b>2007</b>    |
|---------------------------|------------------|------------------------------------|----------------|
| Commercial <sup>(1)</sup> | 737,286          | 592,723                            | 574,251        |
| Reform <sup>(2)</sup>     | 540,142          | 527,447                            | 353,694        |
| Medicare <sup>(3)</sup>   | 69,605           | 75,280                             | 49,245         |
| <b>Total</b>              | <b>1,347,033</b> | <b>1,195,450</b>                   | <b>977,190</b> |

(1) Commercial membership includes corporate accounts, self-funded employers, individual accounts, Medicare Supplement, Federal government employees and local government employees.

(2) Includes rated and self-funded members.

(3) Includes Medicare Advantage as

well as  
stand-alone PDP  
plan  
membership.

**Table of Contents****Consolidated Operating Results**

The following table sets forth our consolidated operating results for the years ended December 31, 2009, 2008 and 2007.

| <i>(Dollar amounts in millions)</i>                         | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|-------------|
| <i>Years ended December 31,</i>                             |             |             |             |
| Revenues:   |             |             |             |
| Premiums earned, net  | \$ 1,876.1  | \$ 1,695.5  | \$ 1,483.6  |
| Administrative service fees                                 | 48.6        | 19.2        | 14.0        |
| Net investment income                                       | 52.1        | 56.2        | 47.2        |
| Total operating revenues                                    | 1,976.8     | 1,770.9     | 1,544.8     |
| Net realized investment gains (losses)                      | 0.6         | (13.9)      | 5.9         |
| Net unrealized investment gain (loss) on trading securities | 10.5        | (21.1)      | (4.1)       |
| Other income (expense), net                                 | 1.3         | (2.5)       | 3.2         |
| Total revenues  | 1,989.2     | 1,733.4     | 1,549.8     |
| Benefits and expenses:                                      |             |             |             |
| Claims incurred   | 1,612.8     | 1,434.9     | 1,223.8     |
| Operating expenses  | 279.4       | 251.9       | 237.5       |
| Total operating costs                                       | 1,892.2     | 1,686.8     | 1,461.3     |
| Interest expense  | 13.3        | 14.7        | 15.9        |
| Total benefits and expenses                                 | 1,905.5     | 1,701.5     | 1,477.2     |
| Income before taxes   | 83.7        | 31.9        | 72.6        |
| Income tax expense  | 14.9        | 7.1         | 14.1        |
| Net income  | \$ 68.8     | \$ 24.8     | \$ 58.5     |

***Year ended December 31, 2009 compared with the year ended December 31, 2008******Operating Revenues***

Consolidated premiums earned, net increased by \$180.6 million, or 10.7%, to \$1.88 billion during the year ended December 31, 2009 compared to the year ended December 31, 2008. The increase was primarily due to an increase in the premiums earned, net in our managed care segment, primarily from growth in Commercial membership, reflecting, in large part, the LCA transaction, as well as higher premium rates across all businesses.

The increase in the administrative service fees of the managed care segment of \$29.4 million in the 2009 period is attributed to a higher self-insured member months enrollment. Increase is mostly due to the fact that TSS was granted the contract for the Reform's Metro-North region, which began on November 2008 on an ASO basis and added approximately 190,000 members to our enrollment, as well as new members enrolled in our Commercial business principally as the result of the aforementioned LCA transaction.

Consolidated net investment income decreased by \$4.1 million, or 7.3%, to \$52.1 million during the year ended December 31, 2009. This decrease is attributed to a lower yield in investments acquired during the period.

***Net Realized Investment Gains***

Consolidated net realized investment gains of \$0.6 million during the year ended December 31, 2009 are the result of net realized gains from the sale of fixed income and equity securities amounting to \$7.7 million. The net realized gains were offset in part by \$7.1 million of other-than-temporary impairments related to fixed income and equity securities.

*Net Unrealized Gains on Trading Securities and Other Income, Net*

The combined balance of our consolidated net unrealized gain on trading securities and other income, net increased by \$35.4 million, to \$11.8 million during the year ended December 31, 2009. This increase is attributable to an increase in the fair value of our trading securities portfolio and in the derivative component of our investment

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in structured notes linked to the Euro Stoxx 50 and Nikkei 225 stock indexes; both fluctuations are due to general market fluctuations. The unrealized gain experienced on our trading portfolio represents a combined increase of 29.0% in the market value of the portfolio, which compares favorably with the changes experienced by the comparable indexes; the Standard and Poor's 500 Index increased by 23.5% and the Russell 1000 Growth increased by 34.8%.

*Claims Incurred*

Consolidated claims incurred during the year ended December 31, 2009 increased by \$177.9 million, or 12.4%, to \$1.61 billion when compared to the claims incurred during the year ended December 31, 2008. This increase is principally due to increased claims in the managed care segment as a result of higher enrollment and MLR. The consolidated loss ratio increased by 1.4 percentage points to 86.0%, primarily due to higher utilization trends in the managed care segment and the effect of reserve developments, offset by the risk score premium adjustment in the Medicare business.

*Operating Expenses*

Consolidated operating expenses during the year ended December 31, 2009 increased by \$27.5 million, or 10.9%, to \$279.4 million as compared to the operating expenses during the year ended December 31, 2008. This increase is primarily attributed to a higher volume of business, particularly in our managed care segment as a result of the Metro-North region which began in November 2008, the LCA transaction and the increased volume in the Medicare and Commercial businesses. In addition, an accrual for litigation expense of approximately \$7.5 million was recorded during the 2009 period, partially offset by the effect in this period of \$3.6 million related to the settlement of an insurance recovery of legal expenses. The consolidated operating expense ratio decreased by 0.2 percentage points to 14.5%.

*Income tax expense*

Consolidated income tax expense during the year ended December 31, 2009 increased by \$7.8 million to \$14.9 million as compared to the income tax expense during the year ended December 31, 2008. The effective tax rate decreased by 4.5 percentage points to 17.8% primarily due to the use of tax credits during the 2009 period, the increase in the weight of exempt income as compared to the taxable income and a higher taxable income in the Life segment, which is taxed at a lower rate.

***Year ended December 31, 2008 compared with the year ended December 31, 2007****Operating Revenues*

Consolidated premiums earned, net increased by \$211.9 million, or 14.3%, to \$1.69 billion during the year ended December 31, 2008 compared to the year ended December 31, 2007. This increase was primarily due to an increase in the premiums earned, net in our managed care segment, principally due to a higher volume in the Medicare Advantage business and general increases in premium rates.

The administrative service fees of the managed care segment increased by \$5.2 million, or 37.1%, to \$19.2 million for the year ended December 31, 2008, mostly as the result of a higher member months enrollment that is mainly attributed to the contract for the Reform's Metro-North region, which we began servicing on November 1, 2008 on an ASO basis.

Consolidated net investment income presented an increase of \$9.0 million, or 19.1%, to \$56.2 million during the year ended December 31, 2008. This increase is attributed to a higher yield in 2008 as well as to a higher balance of invested assets.

*Net Realized Investment Losses*

Consolidated net realized investment losses of \$13.9 million during the year ended December 31, 2008 are primarily the result of other-than-temporary impairments related to equity and fixed income securities amounting to \$16.5 million due to other-than-temporary impairments in three equity mutual funds that replicate the Russell 1000, Standard & Poor's 500 and EAFE indexes, as well as for certain perpetual preferred securities. The other-than-temporary impairments were offset in part by \$2.6 million of net realized gains from the sale of fixed income and equity securities.

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*Net Unrealized Loss on Trading Securities and Other Income (Expense), Net*

The combined balance of our consolidated net unrealized loss on trading securities and other income (expense), net was a loss of \$23.6 million during the year ended December 31, 2008, an increase of \$22.7 million, as compared to the combined loss of \$0.9 million in 2007. This increase is attributable to the net result of the unrealized loss on the trading portfolio, together with a decrease the fair value of the derivative component of our investment in structured notes linked to the Euro Stoxx 50 and Nikkei 225 stock indexes amounting to \$4.7 million due to general market conditions. The unrealized loss experienced on trading securities represents a decrease of 36.7% and 35.8% in TSS and 36.8% in TSP in the fair value of the portfolio, which is lower than the decrease experienced by the comparable indexes of 37.0% in the S&P 500 and 38.44% in the Russell 1000 Growth. The change in the fair value of the derivative component of these structured notes is included within other income (expense), net.

*Claims Incurred*

Consolidated claims incurred during the year ended December 31, 2008 increased by \$211.1 million, or 17.2%, to \$1.43 billion when compared to the claims incurred during the year ended December 31, 2007. This increase is principally due to increased claims in the managed care segment as a result of higher enrollment and utilization trends. The consolidated loss ratio increased by 2.1 percentage points, to 84.6% in the 2008 period, primarily due to higher utilization trends in the managed care segment for the period, particularly in the Medicare Advantage business.

*Operating Expenses*

Consolidated operating expenses during the year ended December 31, 2008 increased by \$14.4 million, or 6.1%, to \$251.9 million as compared to operating expenses during the 2007 period. This increase is primarily attributed to a higher volume of business, particularly in the Medicare business of our Managed Care segment. The consolidated operating expense ratio decreased by 1.2 percentage points, to 14.7%, during the 2008 period mainly due to the aforementioned increase in volume.

*Income tax expense*

The decrease in consolidated income tax expense during the year ended December 31, 2008 is primarily the result of the lower income before tax during the period. The consolidated effective tax rate for the 2008 period reflects an increase of 2.9 percentage points to 22.3% in 2008, mostly due to a lower 2007 deferred tax expense in the property and casualty insurance segment resulting from changes in its effective tax rate.



**Table of Contents****Managed Care Operating Results**

We offer our products in the managed care segment to three distinct market sectors in Puerto Rico: Commercial, Reform and Medicare (including Medicare Advantage and PDP). For the year ended December 31, 2009, the Commercial sector represented 43.8% and 11.2% of our consolidated premiums earned, net and operating income, respectively. During the same period the Reform sector represented 18.6% and 22.5%, of our consolidated premiums earned, net and our operating income, respectively. Premiums earned, net and operating income generated from our Medicare contracts (including PDP) during the year ended December 31, 2009 represented 27.4% and 33.9%, respectively, of our consolidated earned premiums, net and operating income, respectively.

| <i>(Dollar amounts in millions)</i> | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|-------------------------------------|-------------|-------------|-------------|
| Operating revenues:                 |             |             |             |
| Medical premiums earned, net:       |             |             |             |
| Commercial                          | \$ 822.1    | \$ 734.2    | \$ 718.7    |
| Reform                              | 348.1       | 340.1       | 327.5       |
| Medicare                            | 513.9       | 438.7       | 255.6       |
| Medical premiums earned, net        | 1,684.1     | 1,513.0     | 1,301.8     |
| Administrative service fees         | 51.3        | 22.5        | 17.2        |
| Net investment income               | 21.6        | 23.1        | 19.7        |
| Total operating revenues            | 1,757.0     | 1,558.6     | 1,338.7     |
| Medical operating costs:            |             |             |             |
| Medical claims incurred             | 1,515.2     | 1,345.4     | 1,133.2     |
| Medical operating expenses          | 184.6       | 160.6       | 148.1       |
| Total medical operating costs       | 1,699.8     | 1,506.0     | 1,281.3     |
| Medical operating income            | \$ 57.2     | \$ 52.6     | \$ 57.4     |
| Additional data:                    |             |             |             |
| Member months enrollment:           |             |             |             |
| Commercial:                         |             |             |             |
| Fully-insured                       | 5,421,586   | 4,947,854   | 4,983,980   |
| Self-funded                         | 2,726,036   | 2,049,140   | 1,930,850   |
| Total Commercial member months      | 8,147,622   | 6,996,994   | 6,914,830   |
| Reform:                             |             |             |             |
| Fully-insured                       | 4,016,332   | 4,101,905   | 4,262,248   |
| Self-funded                         | 2,321,144   | 376,975     |             |
| Total Reform member months          | 6,337,476   | 4,478,880   | 4,262,248   |
| Medicare:                           |             |             |             |
| Medicare Advantage                  | 742,666     | 727,274     | 416,512     |
| Stand-alone PDP                     | 117,700     | 127,658     | 137,528     |
| Total Medicare member months        | 860,366     | 854,932     | 554,040     |

|                         |            |            |            |
|-------------------------|------------|------------|------------|
| Total member months     | 15,345,464 | 12,330,806 | 11,731,118 |
| Medical loss ratio      | 90.0%      | 88.9%      | 87.0%      |
| Operating expense ratio | 10.6%      | 10.5%      | 11.2%      |

***Year ended December 31, 2009 compared with the year ended December 31, 2008***

***Medical Operating Revenues***

Medical premiums earned for the year ended December 31, 2009 increased by \$171.1 million, or 11.3%, to \$1.68 billion when compared to the medical premiums earned during the year ended December 31, 2008. This increase is principally the result of the following:

Medical premiums generated by the Commercial business increased by \$87.9 million, or 12.0%, to \$822.1 million during the year ended December 31, 2009. This fluctuation is primarily the result of an increase in member months enrollment of 473,732, or 9.6%, and higher average premium rates per member of

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approximately 2.9%. Increase in member months was mainly attributed to new members acquired from LCA effective July 1, 2009, which represented 49.1% of the increase in member months enrollment during this period, and to new groups acquired during the period.

Medical premiums generated by the Medicare business increased during the year ended December 31, 2009 by \$75.2 million, or 17.1%, to \$513.9 million, primarily due to higher average premium rates by approximately 11% and an increase in member months enrollment of 5,434 or 0.6%. The fluctuation in member months is the net result of an increase of 15,392, or 2.1%, in the membership of our Medicare Advantage products and a decrease of 9,958, or 7.8%, in the membership of our PDP product. In addition, the premiums for the year ended December 31, 2009 include the net effect of approximately \$8.7 million in adjustments related to CMS final risk score adjustment for 2008. The premiums for the year ended December 31, 2008 include the net effect of approximately \$1.4 million related to CMS final risk score adjustments for 2007.

Medical premiums earned in the Reform business increased by \$8.0 million, or 2.4%, to \$348.1 million during the year ended December 31, 2009. This fluctuation is due to an increase in premium rates, effective July 1, 2008, of approximately 10%, offset in part by a lower member months enrollment in the Reform's fully-insured membership by 85,573, or 2.1% and premium adjustments of approximately \$8.3 million to provide for unresolved reconciling items with the government of Puerto Rico.

Administrative service fees increased by \$28.8 million, to \$51.3 million during the 2009 period, mainly due to an increase in self-funded member months enrollment of 2,621,065. Such increase is mainly the result of the contract obtained to administer the Reform's Metro-North region, which began on an ASO basis on November 1, 2008, new ASO Commercial contracts effective January 1, 2009, as well as the ASO members from the contracts acquired from LCA. In addition, as the result of the savings achieved in the Metro-North region, during 2009 we recognized a performance incentive of approximately \$6.0 million. Total ASO member months enrollment for the Metro-North region and LCA for the year ended December 31, 2009 totaled 2,321,144 and 469,530, respectively.

*Medical Claims Incurred*

Medical claims incurred during the year ended December 31, 2009 increased by \$169.8 million, or 12.6%, to \$1.52 billion, when compared to the year ended December 31, 2008. The MLR of the segment increased by 1.1 percentage points during the 2009 period, to 90.0%. These fluctuations are primarily attributed to the effect of the following:

The medical claims incurred of the Commercial business increased by \$99.3 million during the 2009 period and its MLR increased by 2.8 percentage points during the year ended December 31, 2009. The increase in claims was partially attributed to the increase in members. The increase in the MLR is primarily due to the effect of prior period reserve developments in the 2009 and 2008 periods and higher utilization trends.

Excluding the effect of prior period reserve developments, the MLR increased by 1.6 percentage points. This variance in the MLR is due to a higher than expected claims experience in the local government employees policy, mainly in the utilization of pharmacy and in-patient benefits, and the effect of the AH1N1 flu of approximately \$4.4 million, or 0.5 percentage points.

The medical claims incurred of the Medicare business increased by \$59.2 million during the 2009 period primarily due to the higher member months enrollment of this business. The MLR for the year ended December 31, 2009 was 88.1%, 1.6 percentage points lower than 2008. The reduction in MLR is attributed to the effect of risk score premium adjustments recorded during this period, as well as premium rate increases and lower utilization trends. Excluding the effect of prior period reserve developments in the 2009 and 2008 periods, as well as premium adjustments, the MLR decreased by 4.7 percentage points, mostly due to the effect of lower medical costs resulting from an improvement in utilization trends and premium rate increases effective January 1, 2009.

The medical claims incurred of the Reform business increased by \$11.3 million and its MLR increased by 1.2 percentage points during the year ended December 31, 2009. The increase in MLR is primarily due to reserve development in the 2009 and 2008 periods and the effect of the premium adjustments to provide for unresolved reconciling items with the government of Puerto Rico. Such increase is also a result of the extension during 2009 of the current Reform contracts to all the participating insurance companies without the re-negotiation of premium rates. In addition, during 2008 we recognized a retroactive adjustment due to a reduction in capitation rates. Excluding the effect of these items in the 2009 and 2008 periods the MLR increased by 1.9 percentage points.

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**Table of Contents***Medical Operating Expenses*

Medical operating expenses for the year ended December 31, 2009 increased by \$24.0 million, or 14.9%, to \$184.6 million when compared to the year ended December 31, 2008. This increase is mainly due to the higher volume of business of the segment, associated to the higher member months enrollment, as well as to the operating costs related to the administration of the Metro-North region and the acquisition and administration of the LCA customers. In addition, an accrual for litigation expense of approximately \$7.5 million was recorded during the 2009 period, partially offset by the effect in this period of \$3.6 million related to the settlement of an insurance recovery of legal expenses. The segment's operating expenses ratio increased by 0.1 percentage points, from 10.5% in 2008 to 10.6% in 2009.

***Year ended December 31, 2008 compared with the year ended December 31, 2007****Medical Operating Revenues*

Medical premiums earned during 2008 increased by \$211.2 million, or 16.2%, to \$1.51 billion when compared to earned premiums during 2007. This increase is principally the result of the following:

Medical premiums generated by the Medicare business increased by \$183.1 million, or 71.6%, to \$438.7 million, primarily due to an increase in member months enrollment of 300,892, or 54.3%, and a change in the mix of products. The increase in member months is the net result of an increase of 310,762, or 74.6%, in the membership of our Medicare Advantage products, mainly in dual eligible members, and a decrease of 9,870, or 7.2%, in the membership of our PDP product.

Medical premiums generated by the Commercial business increased by \$15.5 million, or 2.2%, to \$734.2 million during 2008. This fluctuation is primarily the net result of an increase in the average premium rates of approximately 4.4%, offset in part by a decrease in fully-insured member months enrollment of 36,126 or 0.7%.

Medical premiums earned of the Reform business increased by \$12.6 million, or 3.8%, to \$340.1 million during 2008. This fluctuation is primarily due to the increases in premium rates of approximately 10% effective on July 1, 2008 and of 8.6% during 2007, partially offset by a decrease in member months enrollment of 160,343, or 3.8%.

Administrative service fees increased by \$5.3 million, or 30.8%, to \$22.5 million during the 2008 period. This fluctuation is primarily due to an increase in member months enrollment of self-funded arrangements of 495,265, or 25.7%. The higher member months enrollment is mainly the result of the contract for the Reform's Metro-North region, which began on November 1, 2008. This contract is on an ASO basis and represented an increase in member months of 376,975.

*Medical Claims Incurred*

Medical claims incurred during the year ended December 31, 2008 increased by \$212.2 million, or 18.7%, to \$1.35 billion when compared to the year ended December 31, 2007. The MLR increased 1.9 percentage points during 2008, to 88.9%. These fluctuations are primarily attributed to the effect of the following:

The medical claims incurred of the Medicare business increased by \$190.0 million during the 2008 period mainly as the result of the increase in member months and a higher MLR by 10.0 percentage points. The higher MLR is in part due to the effect of prior period reserve developments and to higher utilization trends. Excluding the effect of prior period reserve developments in the 2007 and 2008 periods, the MLR increased by 7.1 percentage points. The increase in utilization trends is primarily the result of higher utilization in outpatient visits and drug benefits for the dual eligible product. The higher MLR is also the result of a change in enrollment mix between dual and non-dual eligible members within the business. Member months during the year ended December 31, 2008 have a higher concentration of dual eligible members than the prior year. Dual eligible members have higher utilization and MLR than non-dual eligible members.

The medical claims incurred of the Reform business increased by \$16.9 million during the 2008 period and its MLR increased by 1.6 percentage points during the year ended December 31, 2008. The higher MLR is primarily the effect of prior period reserve developments and the retroactive premium rate increase



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received by this business during June 2007 amounting to \$2.8 million corresponding to 2006. Excluding the effect of prior period reserve developments in the 2007 and 2008 periods and considering the effect of this retroactive premium rate increase, the MLR actually decreased by 1.5 percentage points during the 2008 period.

The medical claims incurred of the Commercial business increased by \$5.3 million during the 2008 period and its MLR decreased by 1.2 percentage points during the year ended December 31, 2008. The lower MLR is primarily the result of the re-pricing or termination of less profitable groups, cost containment initiatives and lower utilization trends in drug and medical services.

**Medical Operating Expenses**

Medical operating expenses for the year ended December 31, 2008 increased by \$12.5 million, or 8.4%, to \$160.6 million when compared to 2007. This increase is primarily attributed to the higher volume of the segment, particularly in the Medicare business. The segment's operating expense ratio decreased by 0.7 percentage points during the 2008 period, to 10.5%.

**Life Insurance Operating Results**

(Dollar amounts in millions)

|                                     | 2009     | 2008     | 2007    |
|-------------------------------------|----------|----------|---------|
| <i>Years ended December 31,</i>     |          |          |         |
| Operating revenues:                 |          |          |         |
| Premiums earned, net                |          |          |         |
| Premiums earned, net                | \$ 106.2 | \$ 100.1 | \$ 97.4 |
| Premiums earned ceded               | (6.1)    | (7.6)    | (8.8)   |
| Net premiums earned                 | 100.1    | 92.5     | 88.6    |
| Commission income on reinsurance    |          | 0.3      | 0.3     |
| Premiums earned, net                | 100.1    | 92.8     | 88.9    |
| Net investment income               | 16.8     | 16.5     | 15.0    |
| Total operating revenues            | 116.9    | 109.3    | 103.9   |
| Operating costs:                    |          |          |         |
| Policy benefits and claims incurred | 50.3     | 47.4     | 45.7    |
| Underwriting and other expenses     | 52.0     | 49.4     | 47.5    |
| Total operating costs               | 102.3    | 96.8     | 93.2    |
| Operating income                    | \$ 14.6  | \$ 12.5  | \$ 10.7 |
| Additional data:                    |          |          |         |
| Loss ratio                          | 50.2%    | 51.1%    | 51.4%   |
| Expense ratio                       | 51.9%    | 53.2%    | 53.4%   |

**Year ended December 31, 2009 compared with the year ended December 31, 2008****Operating Revenues**

Premiums earned, net for the segment increased by \$7.3 million, or 7.9%, to \$100.1 million during the year ended December 31, 2009 as compared to the year ended December 31, 2008, primarily as the result of higher sales in the Cancer and Home Service lines of business during the period, offset in part by a lower sales in the Group Life and

Disability business.

*Policy Benefits and Claims Incurred*

Policy benefits and claims incurred during the year ended December 31, 2009 increased by \$2.9 million, or 6.1%, to \$50.3 million during the year ended December 31, 2009. This fluctuation is primarily the result of the segments increased volume in the Cancer and Home Service lines of business and a higher amount of claims incurred in the Ordinary Life business, partially offset by a lower volume and claims experience in the Group Life line of business. The segment also experienced an increase in the change of the liability for future policy benefits. The segment's loss ratio decreased by 0.9 percentage points, to 50.2% during the year ended December 31, 2009.

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**Table of Contents***Underwriting and Other Expenses*

Underwriting and other expenses for the segment increased by \$2.6 million, or 5.3%, to \$52.0 million during the year ended December 31, 2009 primarily the result of the higher volume of business of this segment. The segment's operating expense ratio decreased by 1.3 percentage points, to 51.9% during the 2009 period.

***Year ended December 31, 2008 compared with the year ended December 31, 2007****Operating Revenues*

Premiums earned, net for the segment increased by \$3.9 million, or 4.4%, to \$92.8 million during the year ended December 31, 2008 as compared to the year ended December 31, 2007, primarily as the result of higher sales in the Cancer and Home Service lines of business during 2008.

*Policy Benefits and Claims Incurred*

Policy benefits and claims incurred during the year ended December 31, 2008 increased by \$1.7 million, or 3.7%, to \$47.4 million in 2008. This increase is primarily the result of an increase in claims incurred in the Disability and Cancer lines of business. Despite the higher claim experience, as a result of the increased volume of premiums, the segment experienced a lower loss ratio by 0.3 percentage points, to 51.1%.

*Underwriting and Other Expenses*

Underwriting and other expenses for the segment increased by \$1.9 million, or 4.0%, to \$49.4 million during the year ended December 31, 2008 primarily as a result of higher net commissions attributable to new business. The segment's operating expense ratio decreased by 0.2 percentage points during 2008, from 53.4% in 2007 to 53.2% in 2008.

**Property and Casualty Insurance Operating Results***(Dollar amounts in millions)*

|   | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|-------------|
| <i>Years ended December 31,</i>           |             |             |             |
| Operating revenues:                       |             |             |             |
| Premiums earned, net:                     |             |             |             |
| Premiums written                          | \$ 163.3    | \$ 168.0    | \$ 170.9    |
| Premiums ceded                            | (67.5)      | (72.1)      | (69.1)      |
| Change in unearned premiums               | 0.4         | (2.1)       | (4.9)       |
| Premiums earned, net                      | 96.2        | 93.8        | 96.9        |
| Net investment income                     | 11.7        | 12.5        | 11.8        |
| Total operating revenues                  | 107.9       | 106.3       | 108.7       |
| Operating costs:                          |             |             |             |
| Claims incurred                           | 47.3        | 42.1        | 44.9        |
| Underwriting and other operating expenses | 51.8        | 51.1        | 53.1        |
| Total operating costs                     | 99.1        | 93.2        | 98.0        |
| Operating income                          | \$ 8.8      | \$ 13.1     | \$ 10.7     |
| Additional data:                          |             |             |             |
| Loss ratio                                | 49.2%       | 44.9%       | 46.3%       |
| Expense ratio                             | 53.8%       | 54.5%       | 54.8%       |
| Combined ratio                            | 103.0%      | 99.4%       | 101.1%      |



**Table of Contents*****Year ended December 31, 2009 compared with the year ended December 31, 2008******Operating Revenues***

Total premiums written during the year ended December 31, 2009 decreased by \$4.7 million, or 2.8%, to \$163.3 million. This fluctuation is primarily due to a decrease in premiums written in the Commercial Auto, Dwelling and Property Mono-line, Commercial Multi-peril and Builder's Risk lines of business insurance policies of approximately \$10.0 million, offset in part by increases in the General Liability and Personal Auto lines of business. The commercial business continues under soft market conditions, thus reducing premiums and increasing competition for renewals and new business. Also, the lower activity in auto and mortgage loan originations and in construction, due to the economic slowdown, has affected the volume in the market.

Premiums ceded to reinsurers during the year ended December 31, 2009 decreased by approximately \$4.6 million, or 6.4%, to \$67.5 million. The ratio of premiums ceded to premiums written decreased by 1.6 percentage points, to 41.3% in 2009. This fluctuation was the result of a reduction of reinsurance cessions in quota share contracts for commercial and personal property insurance risks of 5.0% and 7.2%, respectively. This decrease is offset in part by the increase in the cost of non-proportional insurance treaties.

The change in unearned premiums presented an increase of \$2.5 million, to \$0.4 million during the year ended December 31, 2009, primarily as the result of the lower volume of premiums written.

***Claims Incurred***

Claims incurred during the year ended December 31, 2009 increased by \$5.2 million, or 12.4%, to \$47.3 million. The loss ratio increased by 4.3 percentage points, to 49.2% during the year ended December 31, 2009, primarily due to an unfavorable loss experience in the Commercial Multi-peril, Dwelling and Property Mono-line, and Personal Auto insurance.

***Underwriting and Other Expenses***

Underwriting and other operating expenses for the year ended December 31, 2009 increased by \$0.7 million, or 1.4%, to \$51.8 million. This increase is primarily due to an increase in net commissions due to lower reinsurance commissions received during the year. The operating expense ratio decreased by 0.7 percentage points during the same period, to 53.8% in 2009.

***Year ended December 31, 2008 compared with the year ended December 31, 2007******Operating Revenues***

Total premiums written during the year ended December 31, 2008 decreased by \$2.9 million, or 1.7%, to \$168.0 million. This fluctuation is mostly due to the decrease in the premiums written for the Commercial Auto and Inland Marine insurance policies amounting to \$7.3 million. These decreases were partially offset by increases in the Commercial Multi-peril and Dwelling and Property Mono-line insurance policies of \$4.4 million. The commercial products are under soft market conditions reducing premiums and increasing competition for renewals and new business. The auto insurance products have been affected by lower economic activity in sales and auto loan originations.

Premiums ceded to reinsurers increased by \$3.0 million, or 4.3%, to \$72.1 million during the year ended December 31, 2008. The ratio of premiums ceded to premiums written increased by 2.5 percentage points, 42.9% in 2008, primarily due to the effect of non-proportional reinsurance treaties in relation to the level of premiums written as well as to the mix of business. The cost of non-proportional treaties is negotiated for the whole year based on expected premium volume; however, since volume for the year was lower than expected, the cost of reinsurance as a percentage of premiums was higher.

The change in unearned premiums presented an increase of \$2.8 million when compared to the prior year as the result of the lower volume of business written during the period.

***Claims Incurred***

Claims incurred during the year ended December 31, 2008 decreased by \$2.8 million, or 6.2%, to \$42.1 million. The loss ratio decreased by 1.4 percentage points during this period, to 44.9% in 2008, primarily as the result of the segment's underwriting guidelines focus on good selection, disciplined pricing, well diversified business, and with a

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low risk profile. In addition, we have made enhancements to the claims handling process to speed up claims processing. These efforts have resulted in improved loss ratios in the Commercial Multi-peril and Liability coverages.

**Underwriting and Other Operating Expenses**

Underwriting and other operating expenses for the year ended December 31, 2008 decreased by \$2.0 million, or 3.8%, to \$51.1 million. The operating expense ratio decreased by 0.3 percentage points during the same period, to 54.5% in 2008. This decrease is primarily due to a lower net commission expense resulting from the segment's lower volume of business.

**Liquidity and Capital Resources****Cash Flows**

A summary of our major sources and uses of cash for the periods indicated is presented in the following table:

| <i>(dollar amounts in millions)</i>                  | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|-------------|
| <i>Years ended December 31,</i>                      |             |             |             |
| Sources of cash:                                     |             |             |             |
| Net cash provided by operating activities            | \$ 72.6     | \$          | \$ 115.9    |
| Net proceeds from investments sold                   |             |             | 1.0         |
| Proceeds from annuity contracts                      | 4.3         | 8.0         | 6.1         |
| Net proceeds from initial public offering            |             |             | 70.3        |
| Other  |             | 18.3        |             |
| Total sources of cash                                | 76.9        | 26.3        | 193.3       |
| Uses of cash:  |             |             |             |
| Net cash used in operating activities                |             | (3.0)       |             |
| Net purchases of investment securities               | (17.3)      | (178.6)     |             |
| Capital expenditures                                 | (18.7)      | (22.4)      | (9.4)       |
| Dividends  |             |             | (2.4)       |
| Payments of long-term borrowings                     | (1.6)       | (1.6)       | (12.1)      |
| Surrenders of annuity contracts                      | (7.1)       | (7.1)       | (7.4)       |
| Repurchase and retirement of common stock            | (32.3)      | (7.6)       |             |
| Other  | (5.6)       |             | (3.4)       |
| Total uses of cash                                   | (82.6)      | (220.3)     | (34.7)      |
| Net (decrease) increase in cash and cash equivalents | \$ (5.7)    | \$ (194.0)  | \$ 158.6    |

**Year ended December 31, 2009 compared to year ended December 31, 2008**

Cash flows from operating activities increased by \$75.6 million for the year ended December 31, 2009 as compared to the year ended December 31, 2008, principally due to the effect of increase in premiums collections by \$248.8 million, offset in part by increases claims paid and cash paid to suppliers and employees amounting of \$127.8 million and \$43.8 million, respectively. The increase in premiums collected is the result of a higher member months enrollment, mainly in the Medicare and Commercial businesses, particularly after the acquisition by TSS of LCA's membership. Also, the amount of premiums collected last year would have been higher when considering the \$22.8 million of managed care premiums collected in December 2007 but corresponding to January 2008. The fluctuation in claims paid is primarily the result of the higher volume and increased utilization trends in our managed care segment, particularly in the Medicare and Commercial businesses.

Net acquisition of investment securities decreased by \$161.3 million during the year ended December 31, 2009, principally as the result the effect of purchases of investments with trade date in December 2007 and a settlement date

in January 2008, amounting to \$117.5 million and cash used in financing activities.

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The decrease in the other sources (uses) of cash of \$23.9 million is attributed to changes in the amount of outstanding checks over bank balances in the 2009 period.

Capital expenditures increased by \$3.7 million as a result of the capitalization of costs related to the implementation of the new system in our managed care segment.

The net proceeds from policyholder deposits decreased by \$3.7 million during the year ended December 31, 2009 primarily due to the lower deposits received during the period.

On December 8, 2008 we announced the immediate commencement of a \$40.0 million share repurchase program. We paid approximately \$26.1 million under the stock repurchase program during the year ended December 31, 2009. *Year ended December 31, 2008 compared to year ended December 31, 2007*

Cash flows from operating activities decreased by \$118.9 million for the year ended December 31, 2008, principally due to the effect of an increase in the amount of claims paid of \$246.3 million; offset in part by an increase in premiums collected of \$128.2 million. These fluctuations are primarily the result of the higher volume and increased utilization trends in our managed care segment, particularly in the Medicare business. The increase in premiums collected would have been higher when considering the \$22.8 million of managed care premiums collected in December 2007 but corresponding to January 2008. In addition, as of December 31, 2008 the managed care segment experienced a significant increase in its premiums receivable amounting to \$41.1 million, mostly from the government of Puerto Rico and its instrumentalities. A significant amount of these balances has been collected by the managed care segment subsequent to December 31, 2008.

The increase in the other sources of cash of \$18.3 million is attributed to a higher balance in outstanding checks over bank balances in 2008.

Net acquisitions of investment securities increased by \$179.6 million during the year ended December 31, 2008, principally as the result of acquisitions of available for sale securities mainly in our managed care segment and the effect of purchases of investments with trade date in December 2007 and a settlement date in January 2008, amounting to \$117.5 million.

Capital expenditures increased by \$13.0 million as a result of the capitalization of costs related to the new systems initiative in our managed care segment.

On December 8, 2008 we announced the immediate commencement of our \$40.0 million share repurchase program. As of December 31, 2008, we have paid approximately \$7.6 million under our stock repurchase program.

We repaid upon its maturity on August 1, 2007 the outstanding balance of \$10.5 million of one of our secured term loans.

In March 2007, we declared and paid dividends to our stockholders of \$2.4 million.

**Financing and Financing Capacity**

We have several short-term facilities available to address timing differences between cash receipts and disbursements. These short-term facilities are mostly in the form of arrangements to sell securities under repurchase agreements. As of December 31, 2009, we had \$85.0 million of available credit under these facilities. There were no outstanding short-term borrowings under these facilities as of December 31, 2009.

As of December 31, 2009, we had the following senior unsecured notes payable:

On January 31, 2006, we issued and sold \$35.0 million of our 6.7% senior unsecured notes payable due January 2021 (the 6.7% notes). The 6.7% notes were privately placed to various institutional accredited investors. The notes pay interest each month until the principal becomes due and payable. These notes can be redeemed after five years at par, in whole or in part, as determined by us. The proceeds obtained from this issuance were used to finance the acquisition of 100% of the common stock of GA Life effective January 31, 2006.

On December 21, 2005, we issued and sold \$60.0 million of our 6.6% senior unsecured notes due December 2020 (the 6.6% notes). The 6.6% notes were privately placed to various institutional accredited investors. The notes pay interest each month until the principal becomes due and payable. These notes can

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be redeemed after five years at par, in whole or in part, as determined by us. The proceeds obtained from this issuance were used to pay the ceding commission to GA Life on the effective date of the coinsurance funds withheld reinsurance agreement.

On September 30, 2004, TSS issued and sold \$50.0 million of its 6.3% senior unsecured notes due September 2019 (the 6.3% notes). The 6.3% notes are unconditionally guaranteed as to payment of principal and interest by us. The notes were privately placed to various institutional accredited investors. The notes pay interest semiannually until the principal becomes due and payable. These notes can be prepaid after five years at par, in whole or in part, as determined by TSS. Most of the proceeds obtained from this issuance were used to repay \$37.0 million of short-term borrowings. The remaining proceeds were used for general business purposes.

The 6.3% notes, the 6.6% notes and the 6.7% notes contain certain non-financial covenants. At December 31, 2009, we and TSS, as applicable, are in compliance with these covenants.

In addition, as of December 31, 2009 we are a party to a secured term loan with a commercial bank, FirstBank Puerto Rico. This secured loan bears interest at a rate equal to the London Interbank Offered Rate (LIBOR) plus 100 basis points and requires monthly principal repayment of \$0.1 million. As of December 31, 2009, this secured loan had an outstanding balance of \$22.7 million and an average annual interest rate of 1.66%.

This secured loan is guaranteed by a first lien on our land, buildings and substantially all leasehold improvements, as collateral for the term of the agreements under a continuing general security agreement. This secured loan contains certain non-financial covenants which are customary for this type of facility, including, but not limited to, restrictions on the granting of certain liens, limitations on acquisitions and limitations on changes in control. As of December 31, 2009, we are in compliance with these covenants. Failure to meet these non-financial covenants may trigger the accelerated payment of the secured loan's outstanding balances. Principal repayments on this loan are expected to be paid out from our operating and investing cash flows.

We were also a party to another secured loan whose outstanding balance of \$10.5 million was repaid upon its maturity on August 1, 2007.

We anticipate that we will have sufficient liquidity to support our currently expected needs.

***Planned Capital Expenditures***

During 2005, our managed care business began a project to change a significant part of its operations computer system. This project is expected to be carried out in phases until 2012 at a cost of approximately \$64.0 million. Our managed care business expects to incur costs of approximately \$26.6 million during 2010. We estimate that \$14.3 million of the costs expected to be incurred in 2009 will be capitalized over the system's useful life and the remaining amount will be expensed. This amount is expected to be paid out of the operating cash flows of our managed care business.

***Contractual Obligations***

Our contractual obligations impact our short and long-term liquidity and capital resource needs. However, our future cash flow prospects cannot be reasonably assessed based solely on such obligations. Future cash outflows, whether contractual or not, will vary based on our future needs. While some cash outflows are completely fixed (such as commitments to repay principal and interest on borrowings), most are dependent on future events (such as the payout pattern of claim liabilities which have been incurred but not reported).

The table below describes the payments due under our contractual obligations, aggregated by type of contractual obligation, including the maturity profile of our debt, operating leases and other long-term liabilities, and excludes an estimate of the future cash outflows related to the following liabilities:

**Unearned premiums** This amount accounts for the premiums collected prior to the end of coverage period and does not represent a future cash outflow. As of December 31, 2009, we had \$108.3 million in unearned premiums.

**Policyholder deposits** The cash outflows related to these instruments are not included because they do not have defined maturities, such that the timing of payments and withdrawals is uncertain. There are currently





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no significant policyholder deposits in paying status. As of December 31, 2009, our policyholder deposits had a carrying amount of \$47.6 million.

Other long-term liabilities Due to the indeterminate nature of their cash outflows, \$57.3 million of other long-term liabilities are not reflected in the following table, including \$41.0 million of liability for pension benefits and \$13.0 million in liabilities to the Federal Employees Health Benefits Plan Program.

| <i>(Dollar amounts in millions)</i>                 | <b>Total</b> | <b>Contractual obligations by year</b> |             |             |             |             | <b>Thereafter</b> |
|---|--------------|--|-------------|-------------|-------------|-------------|-------------------|
|   |              | <b>2010</b>                            | <b>2011</b> | <b>2012</b> | <b>2013</b> | <b>2014</b> |                   |
| Long-term borrowings (1)                            | \$ 270.0     | \$ 11.4                                | \$ 11.4     | \$ 11.3     | \$ 11.3     | \$ 11.3     | \$ 213.3          |
| Operating leases                                    | 20.1         | 4.6                                    | 3.3         | 2.2         | 1.7         | 1.6         | 6.7               |
| Purchase obligations (2)                            | 148.8        | 146.6                                  | 1.6         | 0.4         | 0.2         |             |                   |
| Claim liabilities (3)                               | 360.4        | 241.4                                  | 68.6        | 14.5        | 13.2        | 6.7         | 16.0              |
| Estimated obligation for future policy benefits (4) | 1,038.3      | 77.3                                   | 67.0        | 62.3        | 58.9        | 55.9        | 716.9             |
|   | \$ 1,837.6   | \$ 481.3                               | \$ 151.9    | \$ 90.7     | \$ 85.3     | \$ 75.5     | \$ 952.9          |

(1) As of December 31, 2009, our long-term borrowings consist of our managed care subsidiary's 6.3% senior unsecured notes payable (which are unconditionally guaranteed as to payment of principal, premium, if any, and interest by us), our 6.6% senior unsecured notes payable, our 6.7% senior unsecured notes payable, and a loan payable to a commercial bank. Total contractual

obligations for long-term borrowings include the current maturities of long term debt. For the 6.3%, 6.6% and 6.7% senior unsecured notes, scheduled interest payments were included in the total contractual obligations for long-term borrowings until the maturity dates of the notes in 2019, 2020, and 2021, respectively. We may redeem the notes starting five years after issuance; however no redemption is considered in this schedule. The interest payments related to our loan payable were estimated using the interest rate applicable as of December 31, 2009. The actual amount of interest payments of the loans payable will differ from the amount included in this schedule due to

the loans  
variable interest  
rate structure.

See the

Financing and  
Financing  
Capacity section  
for additional  
information  
regarding our  
long-term  
borrowings.

- (2) Purchase obligations represent payments required by us under material agreements to purchase goods or services that are enforceable and legally binding and where all significant terms are specified, including: quantities to be purchased, price provisions and the timing of the transaction. Other purchase orders made in the ordinary course of business for which we are not liable are excluded from the table above. Estimated pension plan contributions amounting to \$7.0 million were included within the total purchase

obligations. However, this amount is an estimate which may be subject to change in view of the fact that contribution decisions are affected by various factors such as market performance, regulatory and legal requirements and plan funding policy.

- (3) Claim liabilities represent the amount of our claims processed and incomplete as well as an estimate of the amount of incurred but not reported claims and loss-adjustment expenses. This amount does not include an estimate of claims to be incurred subsequent to December 31, 2009. The expected claims payments are an estimate and may differ materially from the actual claims payments made by us in the future. Also, claim liabilities

are presented gross, and thus do not reflect the effects of reinsurance under which \$30.7 million of reserves had been ceded at December 31, 2009.

- (4) Our life insurance segment establishes, and carries as liabilities, actuarially determined amounts that are calculated to meet its policy obligations when a policy matures or surrenders, an insured dies or becomes disabled or upon the occurrence of other covered events. A significant portion of the estimated obligation for future policy benefits to be paid included in this table considers contracts under which we are currently not making payments and will not make payments until the occurrence of an insurable

event not under our control, such as death, illness, or the surrender of a policy. We have estimated the timing of the cash flows related to these contracts based on historical experience as well as expectations of future payment patterns. The amounts presented in the table above represent the estimated cash payments for benefits under such contracts based on assumptions related to the receipt of future premiums and assumptions related to mortality, morbidity, policy lapses, renewals, retirements, disability incidence and other contingent events as appropriate for the respective product type. All estimated cash payments included in this table are not discounted to present value nor do they



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take into account estimated future premiums on policies in-force as of December 31, 2009 and are gross of any reinsurance recoverable. The \$1,038.3 million total estimated cash flows for all years in the table is different from the liability of future policy benefits of \$222.6 million included in our audited consolidated financial statements principally due to the time value of money. Actual cash payments to policyholders could differ significantly from the estimated cash payments as presented in this table due to differences between actual experience and the assumptions used in the estimation of these payments.

***Off-Balance Sheet Arrangements***

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, revenues and expenses, results of operations, liquidity, capital expenditures or capital resources.

***Restriction on Certain Payments by the Corporation's Subsidiaries***



Our insurance subsidiaries are subject to the regulations of the Commissioner of Insurance of the Commonwealth of Puerto Rico (the Commissioner of Insurance of Puerto Rico). These regulations, among other things, require insurance companies to maintain certain levels of capital, thereby restricting the amount of earnings that can be distributed by the insurance subsidiaries to TSM. As of December 31, 2009, our insurance subsidiaries were in compliance with such minimum capital requirements.

Since 2009, local insurers and health organizations are required by the Insurance Code to submit to the Commissioner of Insurance Puerto Rico RBC reports following the NAIC's RBC Model Act and accordingly are subject to the relevant measures and actions as required based on their capital levels in relation to the determined risk based capital. In February 2010 Insurance Regulation No. 92 entered into effect establishing guidelines to implement the RBC requirements. Rule 92 provides for a gradual compliance and a five-year transition period, including dividend payment restriction and exemption to comply with requirements.

These regulations are not directly applicable to us, as a holding company, since we are not an insurance company.

Our secured term loan restricts the amount of dividends that we and our subsidiaries can declare or pay to shareholders. Under the secured term loan, dividend payments cannot be made in excess of the accumulated retained earnings of the paying entity.

We do not expect that any of the previously described dividend restrictions will have a significant effect on our ability to meet our cash obligations.

#### ***Solvency Regulation***

To monitor the solvency of the operations, the BCBSA requires us and our managed care subsidiary to comply with certain specified levels of RBC. RBC is designed to identify weakly capitalized companies by comparing each company's adjusted surplus to its required surplus (RBC ratio). The RBC ratio reflects the risk profile of insurance companies. At December 31, 2009, both we and our managed care subsidiary's estimated RBC ratio were above the 200% of our RBC required by the BCBSA and the 375% of our RBC level required by the BCBSA to avoid monitoring.

#### ***Other Contingencies***

##### *Legal Proceedings*

Various litigation claims and assessments against us have arisen in the course of our business, including but not limited to, our activities as an insurer and employer. Furthermore, the Commissioner of Insurance, as well as other Federal and Puerto Rico government authorities, regularly make inquiries and conduct audits concerning our compliance with applicable insurance and other laws and regulations.

Based on the information currently known by our management, in its opinion, the outcomes of such pending investigations and legal proceedings are not likely to have a material adverse effect on our financial position, results of operations and cash flows. However, given the inherent unpredictability of these matters, it is possible that an

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adverse outcome in certain matters could, from time to time, have an adverse effect on our operating results and/or cash flows. See Item 3. Legal Proceedings .

***Guarantee Associations***

To operate in Puerto Rico, insurance companies, such as our insurance subsidiaries, are required to participate in guarantee associations, which are organized to pay policyholders contractual benefits on behalf of insurers declared to be insolvent. These associations levy assessments, up to prescribed limits, on a proportional basis, to all member insurers in the line of business in which the insolvent insurer was engaged. During the years ended December 31, 2009, 2008 and 2007, no assessment or payment was made in connection with insurance companies declared insolvent. It is the opinion of management that any possible future guarantee association assessments will not have a material effect on our operating results and/or cash flows, although there is no ceiling on these payment obligations.

Pursuant to the Puerto Rico Insurance Code, our property and casualty insurance subsidiary is a member of Sindicato de Aseguradores para la Suscripción Conjunta de Seguros de Responsabilidad Profesional Médico-Hospitalaria (SIMED) and of the Sindicato de Aseguradores de Responsabilidad Profesional para Médicos. Both syndicates were organized for the purpose of underwriting medical-hospital professional liability insurance. As a member, the property and casualty insurance segment shares risks with other member companies and, accordingly, is contingently liable in the event the previously mentioned syndicates cannot meet their obligations. During 2009, 2008 and 2007, no assessment or payment was made for this contingency. It is the opinion of management that any possible future syndicate assessments will not have a material effect on our operating results and/or cash flows, although there is no ceiling on these payment obligations.

In addition, pursuant to Article 12 of Rule LXIX of the Insurance Code, our property and casualty insurance subsidiary is a member of the Compulsory Vehicle Liability Insurance Joint Underwriting Association (the Association). The Association was organized in 1997 to underwrite insurance coverage of motor vehicle property damage liability risks effective January 1, 1998. As a participant, the segment shares the risk proportionally with other members based on a formula established by the Insurance Code. During the years 2009, 2008 and 2007, the Association distributed the Company a dividend based on the good experience of the business amounting to \$1.2 million, \$1.1 million and \$1.0 million, respectively.

***Critical Accounting Estimates***

Our consolidated financial statements and accompanying notes included in this Annual Report on Form 10-K have been prepared in accordance with GAAP applied on a consistent basis. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We continually evaluate the accounting policies and estimates we use to prepare our consolidated financial statements. In general, management's estimates are based on historical experience and various other assumptions it believes to be reasonable under the circumstances. The following is an explanation of our accounting policies considered most significant by management. These accounting policies require us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information is known. Actual results could differ materially from those estimates.

The policies discussed below are considered by management to be critical to an understanding of our financial statements because their application places the most significant demands on management's judgment, with financial reporting results relying on estimation about the effect of matters that are inherently uncertain. For all these policies, management cautions that future events may not necessarily develop as forecasted, and that the best estimates routinely require adjustment. Management believes that the amounts provided for these critical accounting estimates are adequate.

**Table of Contents****Claim Liabilities**

Claim liabilities by segment as of December 31, 2009 were as follows:

| <i>(Dollar amounts in millions)</i>            | <b>Managed<br/>Care</b> | <b>Life<br/>Insurance</b> | <b>Property<br/>and<br/>Casualty<br/>Insurance</b> | <b>Consolidated</b> |
|--|-------------------------|---------------------------|--|---------------------|
| Claims processed and incomplete <sup>(1)</sup> | \$ 106.0                | \$ 31.6                   | \$ 48.5  | \$ 186.1            |
| Unreported losses <sup>(2)</sup>               | 125.6                   | 8.2                       | 21.2   | 155.0               |
| Unpaid loss-adjustment expenses <sup>(3)</sup> | 4.8                     | 0.3                       | 14.2   | 19.3                |
|  | \$ 236.4                | \$ 40.1                   | \$ 83.9  | \$ 360.4            |

(1) The liability for claims processed and incomplete represents those claims that have been incurred and reported to us that remain unpaid as of the balance sheet date. This amount includes claims that have been investigated and adjusted but have not been paid as well as those reported claims that have not gone through the investigation and adjustment process.

(2) The liability for estimated unreported losses is the amount needed to provide for the estimated ultimate cost of

settling those claims related to insured events that have occurred but have not been reported to us.

- (3) The liability for unpaid loss-adjustment expenses is the amount needed to provide for the estimated ultimate cost required to investigate and adjust claims related to insured events that have occurred as of the balance sheet date, whether or not the claims have been reported to us at that date.

Management continually evaluates the potential for changes in its claim liabilities estimates, both positive and negative, and uses the results of these evaluations to adjust recorded claim liabilities and underwriting criteria. Our profitability depends in large part on our ability to accurately predict and effectively manage the amount of claims incurred, particularly those of the managed care segment and the losses arising from the property and casualty and life insurance segment. Management regularly reviews its premiums and benefits structure to reflect our underlying claims experience and revised actuarial data; however, several factors could adversely affect our underwriting results. Some of these factors are beyond management's control and could adversely affect its ability to accurately predict and effectively control claims incurred. Examples of such factors include changes in health practices, economic conditions, change in utilization trends, healthcare costs, the advent of natural disasters, and malpractice litigation. Costs in excess of those anticipated could have a material adverse effect on our results of operations.

We recognize claim liabilities as follows:

*Managed Care Segment*

At December 31, 2009, claim liabilities for the managed care segment amounted to \$236.4 million and represented 65.6% of our total consolidated claim liabilities and 21.5% of our total consolidated liabilities.

Liabilities for reported but incomplete claims are recorded at the contractual rate. Liabilities for unreported losses are determined employing actuarial methods that are commonly used by managed care actuaries and meet Actuarial Standards of Practice, which require that the claim liabilities be adequate under moderately adverse circumstances. The segment determines the amount of the liability for unreported losses by following a detailed actuarial process that entails using both historical claim payment patterns as well as emerging medical cost trends to project a best estimate of claim liabilities. Under this process, historical claims incurred dates are compared to actual dates of claims payment. This information is analyzed to create completion or development factors that represent the average percentage of total incurred claims that have been paid through a given date after being incurred. Completion factors

are applied to claims paid through the financial statement date to estimate the ultimate claim expense incurred for the current period. Actuarial estimates of claim liabilities are then determined by subtracting the actual paid claims from the estimate of the total expected claims incurred. The majority of unpaid claims, both reported and unreported, for any period, are those claims which are incurred in the final months of the period. Since the percentage of claims paid during the period with respect to claims incurred in those months is generally very low, the above-described completion factor methodology is less reliable for such months. In order to complement the analysis to determine the unpaid claims, historical completion factors and payment patterns are applied to incurred and paid claims for the most recent twelve months and compared to the prior twelve month

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period. Incurred claims for the most recent twelve months also take into account recent claims expense levels and health care trend levels (trend factors). Using all of the above methodologies, our actuaries determine based on the different circumstances the unpaid claims as of the end of period.

Because the reserve methodology is based upon historical information, it must be adjusted for known or suspected operational and environmental changes. These adjustments are made by our actuaries based on their knowledge and their estimate of emerging impacts to benefit costs and payment speed.

Circumstances to be considered in developing our best estimate of reserves include changes in enrollment, utilization levels, unit costs, mix of business, benefit plan designs, provider reimbursement levels, processing system conversions and changes, claim inventory levels, regulatory and legislative requirements, claim processing patterns, and claim submission patterns. A comparison of prior period liabilities to re-estimated claim liabilities based on subsequent claims development is also considered in making the liability determination. In the actuarial process, the methods and assumptions are not changed as reserves are recalculated, but rather the availability of additional paid claims information drives our changes in the re-estimate of the unpaid claim liability. Changes in such development are recorded as a change to current period benefit expense. The re-estimates or recasts are done monthly for the previous four calendar quarters. On average, about 77% of the claims are paid within three months after the last day of the month in which they were incurred and about 13% are within the next three months, for a total of 90% paid within six months after the last day of the month in which they were incurred.

Management regularly reviews its assumptions regarding claim liabilities and makes adjustments to claims incurred when necessary. If management's assumptions regarding cost trends and utilization are significantly different than actual results, our statement of earnings and financial position could be impacted in future periods. Changes to prior year estimates may result in an increase in claims incurred or a reduction of claims incurred in the period the change is made. Further, due to the considerable variability of health care costs, adjustments to claims liabilities are made in each period and are sometimes significant as compared to the net income recorded in that period. Prior year development of claim liabilities is recognized immediately upon the actuary's judgment that a portion of the prior year liability is no longer needed or that an additional liability should have been accrued. Health care trends are monitored in conjunction with the claim reserve analysis. Based on these analyses, rating trends are adjusted to anticipate future changes in health care cost or utilization. Thus, the managed care segment incorporates those trends as part of the development of premium rates in an effort to keep premium rating trends in line with claims trends.

As described above, completion factors and claims trend factors can have a significant impact on determination of our claim liabilities. The following example provides the estimated impact on our December 31, 2009 claim liabilities, assuming the indicated hypothetical changes in completion and trend factors:

*(Dollar amounts in millions)*

| In completion factor | Completion Factor <sup>1</sup><br>(Decrease) Increase |  | In claims trend factor | Claims Trend Factor <sup>2</sup><br>(Decrease) Increase |  |
|----------------------|---|--|------------------------|---|--|
|                      | In unpaid claim liabilities                           |  |                        | In unpaid claim liabilities                             |  |
| (0.6)%               | \$10.5  |  | (0.75)%                | \$10.5  |  |
| (0.4)%               | 7.0   |  | (0.50)%                | 7.0   |  |
| (0.2)%               | 3.5   |  | (0.25)%                | 3.5   |  |
| 0.2%                 | (3.5)   |  | 0.25%                  | (3.5)   |  |
| 0.4%                 | (6.9)   |  | 0.50%                  | (7.0)   |  |
| 0.6%                 | (10.4)  |  | 0.75%                  | (10.5)  |  |

(1) Assumes  
(decrease) increase  
in the completion  
factors for the most

recent twelve  
months.

- (2) Assumes  
(decrease) increase  
in the claims trend  
factors for the most  
recent twelve  
months.

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The segments' reserving practice is to consistently recognize the actuarial best estimate as the ultimate liability for claims within a level of confidence required by actuarial standards. Management believes that the methodology for determining the best estimate for claim liabilities at each reporting date has been consistently applied.

Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately settled. Liabilities at any year-end are continually reviewed and re-estimated as information regarding actual claims payments, or run-out becomes known. This information is compared to the originally established year-end liability. Negative amounts reported for incurred claims related to prior years result from claims being settled for amounts less than originally estimated. The reverse is true of reserve shortfalls. Medical claim liabilities are usually described as having a short tail: which means that they are generally paid within several months of the member receiving service from the provider. Accordingly, the majority, or approximately 95%, of any redundancy or shortfall relates to claims incurred in the previous calendar year-end, with the remaining 5% related to claims incurred prior to the previous calendar year-end. Management has not noted any significant emerging trends in claim frequency and severity and the normal fluctuations in enrollment and utilization trends from year to year.

The following table shows the variance between the segment's incurred claims for current period insured events and the incurred claims for such years had they been determined retrospectively (the Incurred claims related to current period insured events for the year shown plus or minus the Incurred claims related to prior period insured events for the following year as included in note 10 to the audited consolidated financial statements). This table shows that the segments' estimates of this liability have approximated the actual development.

| <i>(Dollar amounts in millions)</i>           | <b>2008</b> | <b>2007</b> | <b>2006</b> |
|---|-------------|-------------|-------------|
| Years ended December 31,                      |             |             |             |
| Total incurred claims:                        |             |             |             |
| As reported <sup>(1)</sup>                    | \$ 1,348.9  | \$ 1,156.8  | \$ 1,184.3  |
| On a retrospective basis                      | 1,352.0     | 1,149.2     | 1,160.7     |
| Variance                                      | \$ (3.1)    | \$ 7.6      | \$ 23.6     |
| Variance to total incurred claims as reported | -0.2%       | 0.7%        | 2.0%        |

(1) Includes total claims incurred less adjustments for prior year reserve development.

Management expects that substantially all of the development of the 2009 estimate of medical claims payable will be known during 2010 and that the variance of the total incurred claims on a retrospective basis when compared to reported incurred claims will be similar to the prior years.

In the event this segment experiences an unexpected increase in health care cost or utilization trends, we have the following options to cover claim payments:

Through the management of our cash flows and investment portfolio.

We have the ability to increase the premium rates throughout the year in the monthly renewal process, when renegotiating the premiums for the following contract year of each group as they become due. We consider the actual claims trend of each group when determining the premium rates for the following contract year.



We have available short-term borrowing facilities that from time to time address differences between cash receipts and disbursements.

For additional information on our credit facilities, see section Financing and Financing Capacity of this Item.

*Life Insurance Segment*

At December 31, 2009, claim liabilities for the life insurance segment amounted to \$40.1 million and represented 11.1% of total consolidated claim liabilities and 3.6% of our total consolidated liabilities.

The claim liabilities related to the life insurance segment are based on methods and underlying assumptions in accordance with GAAP and applicable actuarial standards. The estimate of claim liabilities for this segment is based on the amount of benefits contractually determined and on actuarial estimates of the amount of loss inherent

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in that period's claims, including losses for which claims have not been reported. This estimate relies on actuarial observations of ultimate loss experience for similar historical events. Principal assumptions used in the establishment of claim liabilities for this segment are mortality, morbidity and claim submission patterns, among others.

Claim reserve reviews are generally conducted on a monthly basis, in light of continually updated information. These reviews incorporate a variety of actuarial methods, judgments and analysis. We review reserves using current inventory of policies and claims data. These reviews incorporate a variety of actuarial methods, judgments and analysis.

The key assumption with regard to claim liabilities for our life insurance segment is related to claims incurred prior to the end of the year, but not yet reported to our subsidiary. A liability for these claims is estimated based upon experience with regards to amounts reported subsequent to the close of business in prior years. There are uncertainties in the development of these estimates; however, in recent years our estimates have resulted in immaterial redundancies or deficiencies.

*Property and Casualty Insurance Segment*

At December 31, 2009, claim liabilities for the property and casualty insurance segment amounted to \$83.9 million and represented 23.3% of the total consolidated claim liabilities and 7.6% of our total consolidated liabilities.

Estimates of the ultimate cost of claims and loss-adjustment expenses of this segment are based largely on the assumption that past developments, with appropriate adjustments due to known or unexpected changes, are a reasonable basis on which to predict future events and trends, and involve a variety of actuarial techniques that analyze current experience, trends and other relevant factors. Property and casualty insurance claim liabilities are categorized and tracked by line of business. Medical malpractice policies are written on a claims-made basis. Policies written on a claims-made basis require that claims be reported during the policy period. Other lines of business are written on an occurrence basis.

Individual case estimates for reported claims are established by a claims adjuster and are changed as new information becomes available during the course of handling the claim. Our property and casualty business, other than medical malpractice, is primarily short-tailed business, where losses (e.g. paid losses and case reserves) are generally reported quickly.

Claim reserve reviews are generally conducted on a quarterly basis, in light of continually updated information. Our actuary certifies reserves for both current and prior accident years using current claims data. These reviews incorporate a variety of actuarial methods, judgments, and analysis. For each line of business, a variety of actuarial methods are used, with the final selections of ultimate losses that are appropriate for each line of business selected based on the current circumstances affecting that line of business. These selections incorporate input from management, particularly from the claims, underwriting and operations divisions, about reported loss cost trends and other factors that could affect the reserve estimates.

Key assumptions are based on the consideration that past emergence of paid losses and case reserves is credible and likely indicative of future emergence and ultimate losses. A key assumption is the expected loss ratio for the current accident year. This expected loss ratio is generally determined through a review of the loss ratios of prior accident years and expected changes to earned pricing, loss costs, mix of business, and other factors that are expected to impact the loss ratio for the current accident year. Another key assumption is the development patterns for paid and reported losses (also referred to as the loss emergence and settlement patterns). The reserves for unreported claims for each year are determined after reviewing the indications produced by each actuarial projection method, which, in turn, rely on the expected paid and reported development patterns and the expected loss ratio for that year.

At December 31, 2009, the actuarial reserve range determined by the actuaries was from \$82 million to \$92 million. Management reviews the results of the reserve estimates in order to determine any appropriate adjustments in the recording of reserves. Adjustments to reserve estimates are made after management's consideration of numerous factors, including but not limited to the magnitude of the difference between the actuarial indication and the recorded reserves, improvement or deterioration of actuarial indications in the period, the maturity of the accident year, trends observed over the recent past and the level of volatility within a particular line of business. In general, changes are made more quickly to more mature accident years and less volatile lines of



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business. Varying the net expected loss ratio by +/-1% in all lines of business for the six most recent accident years would increase/decrease the claims incurred by approximately \$5.5 million.

***Liability for Future Policy Benefits***

Our life insurance segment establishes, and carries as liabilities, actuarially determined amounts that are calculated to meet its policy obligations when a policy matures or surrenders, an insured dies or becomes disabled or upon the occurrence of other covered events. We compute the amounts for actuarial liabilities in conformity with GAAP.

Liabilities for future policy benefits for whole life and term insurance products and active life reserves for accident and health products are computed by the net level premium method, using interest assumptions ranging from 5.0% to 5.4% and withdrawal, mortality, morbidity and maintenance expense assumptions appropriate at the time the policies were issued (or when a block of business was purchased, as applicable). Accident and health unpaid claim reserves are stated at amounts determined by estimates on individual claims and estimates of unreported claims based on past experience. Liabilities for universal life policies are stated at policyholder account values before surrender charges. Deferred annuity reserves are carried at the account value.

The liabilities for all products, except for universal life and deferred annuities, are based upon a variety of actuarial assumptions that are uncertain. The most significant of these assumptions is the level of anticipated death and health claims. Other assumptions that are less significant to the appropriate level of the liability for future policy benefits are anticipated policy persistency rates, investment yields, and operating expense levels. These are reviewed frequently by our subsidiary's external actuaries, to assure that the current level of liabilities for future policy benefits is sufficient, in combination with anticipated future cash flows, to provide for all contractual obligations. For all products, except for universal life and deferred annuities, the basis for the liability for future policy benefits is established at the time of issuance of each contract and would only change if our experience deteriorates to the point that the level of the liability is not adequate to provide for future policy benefits. We do not currently expect that level of deterioration to occur.

***Deferred Policy Acquisition Costs and Value of Business Acquired***

Certain costs for acquiring life and property and casualty insurance business are deferred. Acquisition costs related to the managed care business are expensed as incurred.

The costs of acquiring new life business, principally commissions, and certain variable underwriting, agency and policy issue expenses of our life insurance segment, have been deferred. These costs, including value of business acquired (VOBA) recorded upon our acquisition of GA Life (now TSV), are amortized to income over the premium-paying period of the related whole life and term insurance policies in proportion to the ratio of the expected annual premium revenue to the expected total premium revenue, and over the anticipated lives of universal life policies in proportion to the ratio of the expected annual gross profits to the expected total gross profits. The expected premiums revenue and gross profits are based upon the same mortality and withdrawal assumptions used in determining the liability for future policy benefits. For universal life and deferred annuity policies, changes in the amount or timing of expected gross profits result in adjustments to the cumulative amortization of these costs. The effect on the amortization of deferred policy acquisition costs of revisions to estimated gross profits is reported in earnings in the period such estimated gross profits are revised.

The schedules of amortization of life insurance deferred policy acquisition costs (DPAC) and VOBA are based upon actuarial assumptions regarding future events that are uncertain. For all products, other than universal life and deferred annuities, the most significant of these assumptions is the level of contract persistency and investment yield rates. For these products the basis for the amortization of DPAC and VOBA is established at the issue of each contract and would only change if our segment's experience deteriorates to the point that the level of the liability is not adequate. We do not currently expect that level of deterioration to occur. For the universal life and deferred annuity products, amortization schedules are based upon the level of historic and anticipated gross profit margins, from the date of each contract's issued (or purchase, in the case of VOBA). These schedules are based upon several actuarial assumptions that are uncertain, are reviewed annually and are modified if necessary. The most significant of these assumptions are anticipated universal life claims, investment yield rates and contract persistency. Based upon the most recent actuarial reviews of all of the assumptions, we do not currently anticipate material changes to the level of these amortization schedules.



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The property and casualty business acquisition costs consist of commissions incurred during the production of business and are deferred and amortized ratably over the terms of the policies.

***Impairment of Investments***

Impairment of an investment exists if a decline in the estimated fair value is below the amortized cost of the security. Management regularly monitors and evaluates the difference between the cost and estimated fair value of investments. For investments with a fair value below cost, the process includes evaluating: (1) the length of time and the extent to which the estimated fair value has been less than amortized cost for fixed maturity security securities, or cost for equity securities, (2) the financial condition, near-term and long-term prospects for the issuer, including relevant industry conditions and trends, and implications of rating agency actions, (3) the Company's intent sell or the likelihood of a required sale prior to recovery, (4) the recoverability of principal and interest for fixed maturity securities, or cost for equity securities, and (5) other factors, as applicable. This process is not exact and further requires consideration of risks such as credit and interest rate risks. Consequently, if an investment's cost exceeds its estimated fair value solely due to changes in interest rates, other-than temporary impairment may not be appropriate. Due to the subjective nature of our analysis, along with the judgment that must be applied in the analysis, it is possible that we could reach a different conclusion whether or not to impair a security if it had access to additional information about the investee. Additionally, it is possible that the investee's ability to meet future contractual obligations may be different than what we determined during its analysis, which may lead to a different impairment conclusion in future periods. If after monitoring and analyzing impaired securities, management determines that a decline in the estimated fair value of any available-for-sale or held-to-maturity security below cost is other than temporary, the carrying amount of the security is reduced to its fair value by the credit component of the other-than-temporary impairment. The new cost basis of an impaired security is not adjusted for subsequent increases in estimated fair value. In periods subsequent to the recognition of an other-than-temporary impairment, the impaired security is accounted for as if it had been purchased on the measurement date of the impairment. For debt securities, the discount (or reduced premium) based on the new cost basis may be accreted into net investment income in future periods based on prospective changes in cash flow estimates, to reflect adjustments to the effective yield.

Our process for identifying and reviewing invested assets for other-than temporary impairments during any quarter includes the following:

Identification and evaluation of securities that have possible indications of other-than-temporary impairment, which includes an analysis of all investments with gross unrealized investments losses that represent 20% or more of cost.

Review and evaluation of any other security based on the investee's current financial condition, liquidity, near-term recovery prospects, implications of rating agency actions, the outlook for the business sectors in which the investee operates and other factors. This evaluation is in addition to the evaluation of those securities with a gross unrealized investment loss representing 20% or more of cost.

Consideration of evidential matter, including an evaluation of factors or triggers that may or may not cause individual investments to qualify as having other-than-temporary impairments; and

Determination of the status of each analyzed security as other-than-temporary or not, with documentation of the rationale for the decision.

Management continues to review the investment portfolios under our impairment review policy. Given the current market conditions and the significant judgments involved, there is a continuing risk that further declines in fair value may occur and additional material other-than-temporary impairments may be recorded in future periods.

During the years ended December 31, 2009, 2008 and 2007 we recognized other-than-temporary impairments amounting to \$7.1 million, \$16.5 million and \$1.1 million, respectively, on fixed income, equity securities and perpetual preferred stocks classified as available for sale. As of December 31, 2009, of the total amount of investments in securities of \$1,043.4 million, \$43.9 million, or 4.2%, are classified as trading securities, and thus are recorded at fair value with changes in estimated fair value recognized in the statement of operations. The remaining

\$999.5 million is classified as either available-for-sale or held-to-maturity and consists of high-quality investments. Of this amount, \$819.6 million, or 78.6%, are securities in obligations of U.S. government-sponsored enterprises, U.S. Treasury securities, obligations of the Commonwealth of Puerto Rico, municipal securities, obligations of U.S. states and its political subdivisions, mortgage backed and collateralized mortgage obligations that are U.S. agency-backed. The remaining \$115.2 million, or 11.0%, are from corporate fixed, equity securities and mutual funds. The

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net unrealized gain as of December 31, 2009 of the available-for-sale and held-to-maturity portfolios amounted to \$11.5 million.

The impairment analysis as of December 31, 2009 and 2008 indicated that, other than those securities for which an other-than-temporary impairment was recognized, none of the securities whose carrying amount exceeded its estimated fair value was considered other-than-temporarily impaired as of that date; however, several factors are beyond management's control, such as the following: financial condition of the issuer, movement of interest rates, specific situations within corporations, among others. Over time, the economic and market environment may provide additional insight regarding the estimated fair value of certain securities, which could change management's judgment regarding impairment. This could result in realized losses related to other-than-temporary declines being charged against future income.

Our fixed maturity securities are sensitive to interest rate and credit risk fluctuations, which impact the fair value of individual securities. Our equity securities are sensitive to equity price risks, for which potential losses could arise from adverse changes in the value of equity securities. For additional information on the sensitivity of our investments, see Item 7A. Quantitative and Qualitative Disclosures About Market Risk in this Annual Report on Form 10-K.

A detail of the gross unrealized losses on investment securities and the estimated fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized gain position as of December 31, 2009 and 2008 is included in note 3 to the audited consolidated financial statements.

***Allowance for Doubtful Receivables***

We estimate the amount of uncollectible receivables in each period and establish an allowance for doubtful receivables. The allowance for doubtful receivables amounted to \$25.2 million and \$14.7 million as of December 31, 2009 and 2008, respectively. The amount of the allowance is based on the age of unpaid accounts, information about the customer's creditworthiness and other relevant information. The estimates of uncollectible accounts are revised each period, and changes are recorded in the period they become known. In determining the allowance, we use predetermined percentages applied to aged account balances, as well as individual analysis of large accounts. These percentages are based on our collection experience and are periodically evaluated. A significant change in the level of uncollectible accounts would have a material effect on our results of operations.

In addition to premium-related receivables, we evaluate the risk in the realization of other accounts receivable, including balances due from third parties related to overpayment of medical claims and rebates, among others. These amounts are individually analyzed and the allowance determined based on the specific collectivity assessment and circumstances of each individual case.

We consider this allowance adequate to cover potential losses that may result from our inability to subsequently collect the amounts reported as accounts receivable. However, such estimates may change significantly in the event that unforeseen economic conditions adversely impact the ability of third parties to repay the amounts due to us.

***Other Significant Accounting Policies***

We have other accounting policies that are important to an understanding of the financial statements. See note 2 to the audited consolidated financial statements.

***Recently Issued Accounting Standards***

In April 2009, the Financial Accounting Standards Board (FASB) issued guidance to address application issues raised by preparers, auditors, and members of the legal profession on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. This guidance is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of the new guidance did not have impact on the Corporation's consolidated financial statements.

In April 2009, the FASB issued guidance to amend the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of



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other-than-temporary impairments on debt and equity securities in the financial statements. This guidance does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The guidance is effective for interim and annual periods ending after June 15, 2009. The adoption of this new guidance did not have a material impact on the consolidated financial position and results of operations. See note 3 to our audited consolidated financial statements included in this Annual Report on Form 10-K for the required new disclosures as the result of the adoption of this guidance.

In April 2009, the FASB issued guidance to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This guidance also requires those disclosures in summarized financial information at interim reporting periods. The guidance is effective for interim and annual periods ending after June 15, 2009. The adoption of this guidance did not have an impact on the consolidated financial position and results of operations. See note 7 to our audited consolidated financial statements included in this Annual Report on Form 10-K for the required new disclosure as the result of the adoption of this guidance.

In April 2009, the FASB issued guidance to provide additional assistance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. This guidance also includes assistance on identifying circumstances that indicate a transaction is not orderly. The guidance is effective for interim and annual periods ending after June 15, 2009. The adoption of this guidance had no impact on the consolidated financial position and results of operations.

In May 2009, the FASB issued guidance to establish the general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This guidance requires disclosure of the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. In February 2010, the FASB issued new guidance to amend these standards. Under this new guidance, we are not required to disclose the date through which subsequent events have been evaluated. This guidance is effective upon issuance. The adoption of this guidance did not have an impact in our consolidated financial statements.

In August 2009, the FASB issued additional guidance for the fair value measurement of liabilities. The Corporation had chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with GAAP. This guidance is effective for the first reporting period, including interim periods, beginning after issuance. The adoption of this guidance did not have an impact on our consolidated financial statements.

In September 2009, the FASB issued guidance for the fair value measurement of investments in certain entities that calculate net asset value per share (or its equivalent). The amendments in this guidance improve financial reporting by permitting use of a practical expedient, with appropriate disclosures, when measuring the fair value of an alternative investment that does not have a readily determinable fair value. The amendments in this guidance also improve transparency by requiring additional disclosures about investments in the scope of the amendments in this guidance to enable users of financial statements to understand the nature and risks of investments and whether the investments are probable of being sold at amounts different from net asset value per share. The adoption of this guidance did not have an impact on our consolidated financial statements.

In January 2010, the FASB issued guidance for the fair value measurement and disclosure; improving disclosures about fair value measurements. This guidance requires new disclosures as follows: (1) Disclose separately the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and describe the reasons for the transfers; (2) In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), present separately information about purchases, sales, issuances, and settlements (that is on a gross basis rather than as one net number). This guidance also provides amendments that clarify existing disclosure as follows: (1) Level of disaggregation provide fair value measurement disclosures for each class of assets and liabilities; (2) Disclosures about inputs and valuation techniques provide disclosures about the input and valuation techniques used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. This guidance is effective for annual or interim reporting periods beginning after December 15, 2009, except for the requirement to provide the Level 3 activity for purchases, sales, issuances, and settlements on a gross basis. That requirement will be effective for fiscal years beginning after



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require any new fair value measurements. We do not expect the adoption of this guidance to have an impact on our financial position or results of operations.

There were no other new accounting pronouncements issued that had or are expected to have a material impact on our financial position, operating results or disclosures.

***Item 7A. Quantitative and Qualitative Disclosures About Market Risk***

We are exposed to certain market risks that are inherent in our financial instruments, which arise from transactions entered into in the normal course of business. We are also subject to additional market risk with respect to certain of our financial instruments. We must effectively manage, measure, and monitor the market risk associated with our invested assets and interest rate sensitive liabilities. We have established and implemented comprehensive policies and procedures to minimize the effects of potential market volatility.

**Market Risk Exposure**

We have exposure to market risk mostly in our investment activities. For purposes of this disclosure, market risk is defined as the risk of loss resulting from changes in interest rates and equity prices. Analytical tools and monitoring systems are in place to assess each one of the elements of market risks.

As in other insurance companies, investment activities are an integral part of our business. Insurance statutes regulate the type of investments that the insurance segments are permitted to make and limit the amount of funds that may be invested in some types of securities. We have a diversified investment portfolio with a large portion invested in investment-grade, fixed income securities.

Our investment philosophy is to maintain a largely investment-grade fixed income portfolio, provide adequate liquidity for expected liability durations and other requirements, and maximize total return through active investment management.

We evaluate the interest rate risk of our assets and liabilities regularly, as well as the appropriateness of investments relative to our internal investment guidelines. We operate within these guidelines by maintaining a diversified portfolio, both across and within asset classes.

The board of directors monitors and approves investment policies and procedures. Investment decisions are centrally managed by investment professionals based on the guidelines established in our investment policies and procedures. The investment portfolio is managed following those policies and procedures.

Our investment portfolio is predominantly comprised of obligations of U.S. government-sponsored enterprises, U.S. Treasury securities, obligations of state and political subdivisions, obligations of the Commonwealth of Puerto Rico, municipal securities and obligations of U.S. states and its political subdivisions and obligations from U.S. and Puerto Rican government instrumentalities. These investments comprised approximately 78.6% of the total portfolio value as of December 31, 2009, of which 30.4% consisted of U. S. agency-backed mortgage backed securities and collateralized mortgage obligations. The remaining balance of the investment portfolio consists of an equity securities portfolio that seeks to replicate the S&P 500 Index, a large-cap growth index, a large-cap value index, mutual funds, investments in local stocks from well-known financial institutions and investments in corporate bonds.

We use a sensitivity analysis to measure the market risk related to our holdings of invested assets and other financial instruments. This analysis estimates the potential changes in fair value of the instruments subject to market risk. The sensitivity analysis was performed separately for each of our market risk exposures related to our trading and other than trading portfolios. This sensitivity analysis is an estimate and should not be viewed as predictive of our future financial performance. Our actual losses in any particular year could exceed the amounts indicated in the following paragraphs. Limitations related to this sensitivity analysis include:

the market risk information is limited by the assumptions and parameters established in creating the related sensitivity analysis, including the impact of prepayment rates on mortgages; and

the model assumes that the composition of assets and liabilities remains unchanged throughout the year.

Accordingly, we use such models as tools and not as a substitute for the experience and judgment of our management.

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**Interest Rate Risk**

Our exposure to interest rate changes results from our significant holdings of fixed maturity securities. Investments subject to interest rate risk are held in our other-than-trading portfolios. We are also exposed to interest rate risk from our variable interest secured term loan and from our policyholder deposits.

**Equity Price Risk**

Our investments in equity securities expose us to equity price risks, for which potential losses could arise from adverse changes in the value of equity securities. Financial instruments subject to equity prices risk are held in our trading and other-than-trading portfolios.

**Risk Measurement**

**Trading Portfolio**

Our trading securities are a source of market risk. As of December 31, 2009, our trading portfolio was comprised of investments in publicly-traded common stocks. The securities in the trading portfolio are believed by management to be high quality and are diversified across industries and readily marketable. Trading securities are recorded at fair value, and changes in fair value are included in operations. The fair value of the investments in trading securities is exposed to equity price risk. Assuming an immediate decrease of 10% in the market value of these securities as of December 31, 2009 and 2008, the hypothetical loss in the fair value of these investments would have been approximately \$4.4 million and \$3.2 million, respectively.

**Other than Trading Portfolio**

Our available-for-sale and held-to-maturity securities are also a source of market risk. As of December 31, 2009 approximately 93.6% and 100.0% of our investments in available-for-sale and held-to-maturity securities, respectively, consisted of fixed income securities. The remaining balance of the available-for-sale portfolio is comprised of equity securities. Available-for-sale securities are recorded at fair value and changes in the fair value of these securities, net of the related tax effect, are excluded from operations and are reported as a separate component of other comprehensive income (loss) until realized. Held-to-maturity securities are recorded at amortized cost and adjusted for the amortization or accretion of premiums or discounts. The fair value of the investments in the other-than-trading portfolio is exposed to both interest rate risk and equity price risk.

**Interest Rate Risk**

We have evaluated the net impact to the fair value of our fixed income investments of a significant one-time change in interest rate risk using a combination of both statistical and fundamental methodologies. From these shocked values a resultant market price appreciation/depreciation can be determined after portfolio cash flows are modeled and evaluated over instantaneous 100, 200 and 300 basis point rate shifts. Techniques used in the evaluation of cash flows include Monte Carlo simulation through a series of probability distributions over 200 interest rate paths. Necessary prepayment speeds are compiled using Salomon Brothers Yield Book, which sources numerous factors in deriving speeds, including but not limited to: historical speeds, economic indicators, street consensus speeds, etc. Securities evaluated by us under these scenarios include mortgage pass-through certificates and collateralized mortgage obligations of U.S. agencies, and private label structures, provided that cash flows information is available. The following table sets forth the result of this analysis for the years ended December 31, 2009 and 2008.

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| <b>Change in Interest Rates</b> | <b>Expected<br/>Fair Value</b> | <b>Amount of<br/>Decrease</b> | <b>%<br/>Change</b> |
|---------------------------------|--------------------------------|-------------------------------|---------------------|
| <b>December 31, 2009:</b>       |                                |                               |                     |
| Base Scenario                   | \$935.5                        |                               |                     |
| +100 bp                         | 885.4                          | (50.1)                        | (5.4)%              |
| +200 bp                         | 836.2                          | (99.3)                        | (10.6)%             |
| +300 bp                         | 786.7                          | (148.8)                       | (15.9)%             |
| <b>December 31, 2008:</b>       |                                |                               |                     |
| Base Scenario                   | \$910.7                        |                               |                     |
| +100 bp                         | 891.0                          | (19.7)                        | (2.2)%              |
| +200 bp                         | 844.9                          | (65.8)                        | (7.2)%              |
| +300 bp                         | 787.7                          | (123.0)                       | (13.5)%             |

We believe that an interest rate shift in a 12-month period of 100 basis points represents a moderately adverse outcome, while a 200 basis point shift is significantly adverse and a 300 basis point shift is unlikely given historical precedents. Although we classify 98.2% of our fixed income securities as available-for-sale, our cash flows and the intermediate duration of our investment portfolio should allow us to hold securities until maturity, thereby avoiding the recognition of losses, should interest rates rise significantly.

**Equity Price Risk**

Our equity securities in the available-for-sale portfolio are comprised primarily of stock of several Puerto Rican financial institutions and mutual funds. Assuming an immediate decrease of 10% in the market value of these securities as of December 31, 2009 and 2008, the hypothetical loss in the fair value of these investments would have been approximately \$6.5 million and \$6.9 million, respectively.

**Other Risk Measurement**

We are subject to interest rate risk on our variable interest secured term loan and our policyholder deposits. Shifting interest rates do not have a material effect on the fair value of these instruments. The secured term loan has a variable interest rate structure, which reduces the potential exposure to interest rate risk. The policyholder deposits have short-term interest rate guarantees, which also reduce the accounts' exposure to interest rate risk.

We have invested in a hybrid instrument, including a derivative component, with a market value of approximately \$11.2 million and \$11.1 million as of December 31, 2009 and 2008 in order to diversify our investment in securities and participate in foreign stock markets.

In 2005, we invested in \$5.0 million in each of two structured note agreements, under which the interest income received is linked to the performance of the Dow Jones Euro STOXX 50 and Nikkei 225 Equity Indices (the Indices). Under these agreements the principal invested by us is protected, the only amount that varies according to the performance of the Indices is the interest to be received upon the maturity of the instruments. Should the Indices experience a negative performance during the holding period of the structured notes, no interest will be received and no amount will be paid to the issuer of the structured notes. The contingent interest payment component within the structured note agreements meets the definition of an embedded derivative. In accordance with current accounting

guidance the embedded derivative component of the structured note is separated from the structured notes and accounted for separately as a derivative instrument. The derivative component of the structured notes exposes us to credit risk and market risk. We minimize credit risk by entering into transactions with counterparties that we believe to be high-quality based on their credit ratings. The market risk is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. As of December 31, 2009 and 2008, the fair value of the derivative component of the structured notes amounted to \$1.6 million and \$1.7 million, respectively, and is included within other assets in the consolidated balance sheets. Assuming an immediate decrease of 10% in the period-end Indices as of December 31, 2009 and 2008, the hypothetical loss in the estimated fair value of the derivative component of the structured notes would have been approximately \$0.2 million each year.

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The investment component of the structured notes, which had a fair value of \$9.6 million and \$9.4 million as of December 31, 2009 and 2008, respectively, is accounted for as a held-to-maturity debt security and is included within investment in securities in the consolidated balance sheet and its risk measurement is evaluated along the other investments in Other Than Trading Portfolio above.

***Item 8. Financial Statements and Supplementary Data***

**Financial Statements**

For our audited consolidated financial statements as of December 31, 2009 and 2008 and for the three years ended December 31, 2009 see Index to financial statements in Item 15. Exhibits and Financial Statements Schedules to this Annual Report on Form 10-K.

**Selected Quarterly Financial Data**

For the selected unaudited quarterly financial data corresponding to the years 2009 and 2008, see note 22 of the audited consolidated financial statements as of December 31, 2009 and 2008 and for the three years ended December 31, 2009.

***Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures***

There have been no changes in or disagreements with our independent registered public accounting firm on accounting or financial disclosures.

***Item 9A. Controls and Procedures***

**Evaluation of Disclosure Controls and Procedures**

In connection with the preparation of this Annual Report on Form 10-K, management, under the supervision and with the participation of the chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as such term is defined under Exchange Act Rule 13a-15(e)). Disclosure controls and procedures are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and that such information is accumulated and communicated to management, including the chief executive officer and chief financial officer, to allow timely decisions regarding required disclosures. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility that judgments in decision-making can be faulty, and breakdowns as a result of simple errors or mistake. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on this evaluation, our chief executive officer and chief financial officer have concluded that as of December 31, 2009, which is the end of the period covered by this Annual Report on Form 10-K, our disclosure controls and procedures are effective to a reasonable level of assurance.

**Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting, as defined under Exchange Act Rule 13a-15(f). The Company's internal control over financial reporting is a process designed by, or under the supervision of, the Company's chief executive officer and chief financial officer, and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the

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reliability of financial reporting and the preparation of the Company's consolidated financial statements for external purposes in accordance with GAAP, and includes those policies and procedures that:

pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the consolidated financial statements.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management, under the supervision and with the participation of the chief executive officer and chief financial officer, assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2009 based on criteria described in the Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). Based on that assessment and those criteria, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2009 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's consolidated financial statements for external reporting purposes in accordance with GAAP.

PricewaterhouseCoopers LLP, the Company's independent registered public accounting firm, has audited the consolidated financial statements of the Company as of and for the year ended December 31, 2009, and has also issued an opinion dated March 5, 2010, on the effectiveness of the Company's internal control over financial reporting as of December 31, 2009, which is included in this Annual Report on Form 10-K.

### **Changes in Internal Control Over Financial Reporting**

No changes in our internal control over financial reporting (as such term is defined in the Exchange Act Rule 13a-15(f)) occurred during the fiscal quarter ended December 31, 2009 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### **Report of Independent Registered Public Accounting Firm**

The effectiveness of our internal control over financial reporting as of December 31, 2009 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included in this Annual Report on Form 10-K.

### ***Item 9B. Other Information***

None.

## **Part III**

### ***Item 10. Directors, Executive Officers and Corporate Governance***

The Board has established a code of business conduct and ethics that applies to our employees, agents, independent contractors, consultants, officers and directors. The complete text of the Code of Business Conduct and Ethics is available at the Corporation's website at [www.triplesmanagement.com](http://www.triplesmanagement.com).



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The information required by this Item is incorporated herein by reference from our definitive Proxy Statement for our 2010 Annual Meeting of Shareholders, which will be filed with the SEC pursuant to Regulation 14A within 120 days after the end of our last fiscal year.

***Item 11. Executive Compensation***

The information required by this Item is incorporated herein by reference from our definitive Proxy Statement for our 2010 Annual Meeting of Shareholders, which will be filed with the SEC pursuant to Regulation 14A within 120 days after the end of our last fiscal year.

***Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required by this Item is incorporated herein by reference from our definitive Proxy Statement for our 2010 Annual Meeting of Shareholders, which will be filed with the SEC pursuant to Regulation 14A within 120 days after the end of our last fiscal year.

***Item 13. Certain Relationships and Related Transactions, and Director Independence***

The information required by this Item is incorporated herein by reference from our definitive Proxy Statement for our 2010 Annual Meeting of Shareholders, which will be filed with the SEC pursuant to Regulation 14A within 120 days after the end of our last fiscal year.

***Item 14. Principal Accountant Fees and Services***

The information required by this Item is incorporated herein by reference from our definitive Proxy Statement for our 2010 Annual Meeting of Shareholders, which will be filed with the SEC pursuant to Regulation 14A within 120 days after the end of our last fiscal year.

***Item 15. Exhibits and Financial Statements Schedules*****Financial Statements and Schedules**

| <b><i>Financial Statements</i></b>           | <b><i>Description</i></b>   |
|--|---|
| F-1  | Reports of Independent Registered Public Accounting Firms   |
| F-2  | Consolidated Balance Sheets as of December 31, 2009 and 2008  |
| F-3  | Consolidated Statements of Earnings for the years ended December 31, 2009, 2008 and 2007                                      |
| F-4  | Consolidated Statements of Stockholders' Equity and Comprehensive Income for the years ended December 31, 2009, 2008 and 2007 |
| F-5  | Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2008 and 2007                                    |
| F-7  | Notes to Consolidated Financial Statements December 31, 2009, 2008 and 2007   |
| <b><i>Financial Statements Schedules</i></b> | <b><i>Description</i></b>   |
| S-1  | Schedule II Condensed Financial Information of the Registrant   |
| S-2  | Schedule III Supplementary Insurance Information  |

**Table of Contents*****Financial Statements***      ***Description******Schedules***

S-3                      Schedule IV    Reinsurance

S-4                      Schedule V    Valuation and Qualifying Accounts

Schedule I    Summary of Investments was omitted because the information is disclosed in the notes to the audited consolidated financial statements. Schedule VI    Supplemental Information Concerning Property Casualty Insurance Operations was omitted because the schedule is not applicable to the Corporation.

**Exhibits*****Exhibits******Description***

|         |  |
|---------|--|
| 3(i)(a) | Amended and Restated Articles of Incorporation (incorporated herein by reference to Exhibit 3(i)(d) to TSM's Annual Report on Form 10-K for the Year Ended December 31, 2007 (File No. 001-33865).   |
| 3(i)(b) | Amendment to Article Tenth of the Amended and Restated Articles of Incorporation of Triple-S Management Corporation, incorporated by reference to Exhibit 3(i)(b) to TSM's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 (File No. 001-33865).  |
| 3(i)(c) | Articles of Incorporation of Triple-S Management Corporation, as currently in effect, incorporated by reference to Exhibit 3(i)(c) to TSM's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 (File No. 001-33865).   |
| 3(ii)   | Amended and Restated Bylaws (incorporated herein by reference to Exhibit 3.1 to TSM's Current Report on Form 8-K filed on October 23, 2007 (File No. 001-33865)).  |
| 10.1    | Agreement between the Puerto Rico Health Insurance Administration and TSS for the provision of health insurance coverage to eligible population in the North and South-West Regions (incorporated herein by reference to Exhibit 10.1 to TSM's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2008 (File No. 001-33865)).             |
| 10.2    | Extension to the agreement between the Puerto Rico Health Insurance Administration and TSS for the provision of health insurance coverage to eligible population in the North and South-West regions (incorporated herein by reference to Exhibit 10.3 of TSM's Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2009 (File No. 001-33865)). |
| 10.3*   | Extension to the agreement between the Puerto Rico Health Insurance Administration and TSS for the provision of health insurance coverage to eligible population in the North and South-West.  |
| 10.4    | Agreement between the Puerto Rico Health Insurance Administration and TSS to act as Third Party Administrator in the Metro-North Region (incorporated herein by reference to Exhibit 10.17 to TSM's Annual Report on Form 10-K for the year ended December 31, 2008 (File No. 001-33865)).   |

- 10.5\*            Extension to the agreement between the Puerto Rico Health Insurance Administration and TSS. to act as Third Party Administrator in the Metro-North Region.
- 10.6            Extension to the agreement between the Puerto Rico Health Insurance Administration and TSS for the provision of the wraparound coverage for the Government health insurance dual eligible population (incorporated herein by reference to Exhibit 10.4 of TSM's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2009 (File No. 001-33865)).

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| <i><b>Exhibits</b></i> | <i><b>Description</b></i>  |
|------------------------|--|
| 10.7                   | Federal Employees Health Benefits Contract (incorporated herein by reference to Exhibit 10.5 to TSM's General Form of Registration of Securities on Form 10 (File No. 001-33865)).   |
| 10.8                   | Credit Agreement with FirstBank Puerto Rico in the amount of \$41,000,000 (incorporated herein by reference to Exhibit 10.6 to TSM's General Form of Registration of Securities on Form 10 (File No. 001-33865)).  |
| 10.9                   | Credit Agreement with FirstBank Puerto Rico in the amount of \$20,000,000 (incorporated herein by reference to Exhibit 10.7 to TSM's General Form of Registration of Securities on Form 10 (File No. 001-33865)).  |
| 10.10                  | Non-Contributory Retirement Program (incorporated herein by reference to Exhibit 10.8 to TSM's General Form of Registration of Securities on Form 10 (File No. 001-33865)).  |
| 10.11*                 | Blue Shield License Agreement by and between BCBSA and TSM, including revisions, if any, adopted by Member Plans through the November 19, 2009 meeting.  |
| 10.12*                 | Blue Shield Controlled Affiliate License Agreement by and among BCBSA, TSS and TSM, including revisions, if any, adopted by Member Plans through the November 19, 2009 meeting.  |
| 10.13*                 | Blue Cross License Agreements by and between BCBSA and TSM, including revisions, if any, adopted by Member Plans through the November 19, 2009 meeting.  |
| 10.14*                 | Blue Cross Controlled Affiliate License Agreement by and among BCBSA, TSS and TSM, including revisions, if any, adopted by Member Plans through the November 19, 2009 meeting.   |
| 10.15                  | 6.30% Senior Unsecured Notes Due September 2019 Note Purchase Agreement, dated September 30, 2004, between Triple-S Management Corporation, Triple-S, Inc. and various institutional accredited investors (incorporated herein by reference to Exhibit 10.15 to TSM's Annual Report on Form 10-K for the year ended December 31, 2005 (File No. 001-33865)). |
| 10.16                  | 6.60% Senior Unsecured Notes Due December 2020 Note Purchase Agreement, dated December 15, 2005, between Triple-S Management Corporation and various institutional accredited investors (incorporated herein by reference to Exhibit 10.16 to TSM's Annual Report on Form 10-K for the year ended December 31, 2005 (File No. 001-33865)).                   |
| 10.17                  | 6.70% Senior Unsecured Notes Due December 2021 Note Purchase Agreement, dated January 23, 2006, between Triple-S Management Corporation and various institutional accredited investors (incorporated herein by reference to Exhibit 10.1 to TSM's Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2006 (File No. 001-33865)).                  |

- 10.18 TSM 2007 Incentive Plan, dated October 16, 2007 (incorporated herein by reference to Exhibit C to TSM's 2007 Proxy Statement (File No. 001-33865)).
- 10.19 Software License and Maintenance Agreement between Quality Care Solutions, Inc, and TSS dated August 16, 2007 (incorporated herein by reference to Exhibit 10.15 to TSM's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 001-33865)).
- 10.20 Addendum Number One to the Software License and Maintenance Agreement between Quality Care Solutions, Inc, and TSS (incorporated herein by reference to Exhibit 10.15(a) to TSM's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 001-33865)).

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| <i><b>Exhibits</b></i> | <i><b>Description</b></i>  |
|------------------------|--|
| 10.21                  | Addendum Number Two to the Software License and Maintenance Agreement between Quality Care Solutions, Inc, and TSS (incorporated herein by reference to Exhibit 10.15(b) to TSM's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 001-33865)).   |
| 10.22                  | Addendum Number Three to the Software License and Maintenance Agreement between Quality Care Solutions, Inc, and TSS (incorporated herein by reference to Exhibit 10.15(c) to TSM's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 001-33865)).   |
| 10.23                  | Work Order Agreement between Quality Care Solutions, Inc. and TSS (incorporated herein by reference to Exhibit 10.16 to TSM's Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 001-33865)).   |
| 10.24*                 | Employment Contract between Ramón M. Ruiz Comas and TSM.   |
| 11.1                   | Statement re computation of per share earnings; an exhibit describing the computation of the earnings per share has been omitted as the detail necessary to determine the computation of earnings per share can be clearly determined from the material contained in Part II of this Annual Report on Form 10-K.   |
| 12.1                   | Statement re computation of ratios; an exhibit describing the computation of the loss ratio, expense ratio and combined ratio has been omitted as the detail necessary to determine the computation of the loss ratio, operating expense ratio and combined ratio can be clearly determined from the material contained in Part II of this Annual Report on Form 10-K. |
| 21*                    | List of Subsidiaries of TSM.   |
| 23.1*                  | Consent of Independent Registered Public Accounting Firm (PricewaterhouseCoopers LLP).   |
| 23.2*                  | Consent of Independent Registered Public Accounting Firm (KPMG LLP).   |
| 31.1*                  | Certification of the President and Chief Executive Officer required by Rule 13a-14(a)/15d-14(a).   |
| 31.2*                  | Certification of the Vice President of Finance and Chief Financial Officer required by Rule 13a-14(a)/15d-14(a).   |
| 32.1*                  | Certification of the President and Chief Executive Officer required pursuant to 18 U.S. Section 1350.  |

32.2\*

Certification of the Vice President of Finance and Chief Financial Officer required pursuant to 18 U.S. Section 1350.

All other exhibits for which provision is made in the applicable accounting regulation of the SEC are not required under the related instructions or are inapplicable, and therefore have been omitted.

\* Filed herein.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**Triple-S Management Corporation**

Registrant

By: /s/ Ramón M. Ruiz-Comas Date: March 5, 2010

Ramón M. Ruiz-Comas  
President and Chief Executive Officer

By: /s/ Juan J. Román Date: March 5, 2010

Juan J. Román  
Vice President of Finance and Chief  
Financial Officer, Principal  
Accounting Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Luis A. Clavell-Rodríguez, MD Date: March 5, 2010

Luis A. Clavell-Rodríguez, MD  
Director and Chairman of the Board

By: /s/ Vicente J. León-Irizarry, CPA Date: March 5, 2010

Vicente J. León-Irizarry, CPA  
Director and Vice-Chairman of the  
Board

By: /s/ Jesús R. Sánchez-Colón, DMD Date: March 5, 2010

Jesús R. Sánchez-Colón, DMD  
Director and Secretary of the Board

By: /s/ Adamina Soto-Martínez, CPA Date: March 5, 2010

Adamina Soto-Martínez, CPA  
Director

By: /s/ Ms. Carmen Ana Date: March 5, 2010  
Culpeper-Ramírez

Ms. Carmen Ana Culpeper-Ramírez  
Director



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By: /s/ Jorge L. Fuentes-Benejam, PE Date: March 5, 2010

Jorge L. Fuentes-Benejam, PE  
Director

By: /s/ Mr. Antonio F. Faría-Soto Date: March 5, 2010

Mr. Antonio F. Faría-Soto  
Director

By: /s/ Manuel Figueroa-Collazo, PE, Ph.D. Date: March 5, 2010

Manuel Figueroa-Collazo, PE, Ph.D.  
Director

By: /s/ José Hawayek-Alemañy, MD Date: March 5, 2010

José Hawayek-Alemañy, MD  
Director

By: /s/ Jaime Morgan-Stubbe, Esq. Date: March 5, 2010

Jaime Morgan-Stubbe, Esq.  
Director

By: /s/ Roberto Muñoz-Zayas, MD Date: March 5, 2010

Roberto Muñoz-Zayas, MD  
Director

By: /s/ Juan E. Rodríguez-Díaz, Esq. Date: March 5, 2010

Juan E. Rodríguez-Díaz, Esq.  
Director

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**Triple-S Management Corporation  
Consolidated Financial Statements  
December 31, 2009, 2008, and 2007**

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| <b><u>Consolidated Financial Statements</u></b>                                 |                |
| <u>Consolidated Balance Sheets</u>  | 3              |
| <u>Consolidated Statements of Earnings</u>                                      | 4              |
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| <u>Notes to Consolidated Financial Statements</u>                               | 5 65           |

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of Triple-S Management Corporation

In our opinion, the accompanying consolidated balance sheet as of December 31, 2009 and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for the year ended December 31, 2009 present fairly, in all material respects, the financial position of Triple-S Management Corporation and its subsidiaries (the Company) at December 31, 2009, and the results of their operations and their cash flows for the year ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules as of and for the year ended December 31, 2009 listed in the accompanying index present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedules, and on the Company's internal control over financial reporting based on our integrated audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

**San Juan, Puerto Rico**

**March 5, 2010**

CERTIFIED PUBLIC ACCOUNTANTS  
(OF PUERTO RICO)

License No. 216 Expires December 1, 2010

Stamp 2389700 of the P.R. Society of  
Certified Public Accountants has been  
affixed to the file copy of this report

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

Triple-S Management Corporation:

We have audited the accompanying consolidated balance sheet of Triple-S Management Corporation and Subsidiaries (the Company) as of December 31, 2008, and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for each of the years in the two-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Triple-S Management Corporation and Subsidiaries at December 31, 2008, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

March 5, 2010

Stamp No. 2446615 of the Puerto Rico

Society of Certified Public Accountants

was affixed to the record copy of this report.

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**Triple-S Management Corporation**  
**Consolidated Balance Sheets**  
**December 31, 2009 and 2008**

| <i>(dollar amounts in thousands, except per share data)</i>  | <b>2009</b>      | <b>2008</b>      |
|--|------------------|------------------|
| <b>Assets</b>  |                  |                  |
| Investments and cash   |                  |                  |
| Equity securities held for trading, at fair value (cost of \$42,075 in 2009 and \$40,847 in 2008)                                  | \$ 43,909        | \$ 32,184        |
| Securities available for sale, at fair value:  |                  |                  |
| Fixed maturities (amortized cost of \$911,362 in 2009 and \$879,663 in 2008)   | 918,977          | 887,684          |
| Equity securities (cost of \$61,531 in 2009 and \$70,054 in 2008)  | 64,689           | 68,629           |
| Securities held to maturity, at amortized cost:  |                  |                  |
| Fixed maturities (fair value of \$16,490 in 2009 and \$23,063 in 2008)   | 15,794           | 21,753           |
| Policy loans   | 5,940            | 5,451            |
| Cash and cash equivalents  | 40,376           | 46,095           |
| <br>Total investments and cash   | <br>1,089,685    | <br>1,061,796    |
| <br>Premium and other receivables, net   | <br>272,932      | <br>237,158      |
| Deferred policy acquisition costs and value of business acquired   | 139,917          | 126,347          |
| Property and equipment, net  | 68,803           | 58,448           |
| Deferred tax asset   | 37,551           | 35,926           |
| Other assets   | 39,816           | 39,515           |
| <br>Total assets   | <br>\$ 1,648,704 | <br>\$ 1,559,190 |
| <br><b>Liabilities and Stockholders Equity</b>   |                  |                  |
| Claim liabilities  | 360,446          | 323,710          |
| Liability for future policy benefits   | 222,619          | 207,545          |
| Unearned premiums  | 108,342          | 110,141          |
| Policyholder deposits  | 47,563           | 48,684           |
| Liability to Federal Employees Health Benefits Program   | 13,002           | 11,157           |
| <br>Accounts payable and accrued liabilities   | <br>139,161      | <br>148,713      |
| Deferred tax liability   | 11,088           | 10,731           |
| Borrowings   | 167,667          | 169,307          |
| Liability for pension benefits   | 41,044           | 44,103           |
| <br>Total liabilities  | <br>1,110,932    | <br>1,074,091    |
| <br>Commitments and contingencies  |                  |                  |
| <br>Stockholders equity  |                  |                  |
| Common stock Class A, \$1 par value. Authorized 100,000,000 shares; issued and outstanding 9,042,809 at December 31, 2009 and 2008 | 9,043            | 9,043            |
|  | 20,110           | 22,105           |

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Common stock Class B, \$1 par value. Authorized 100,000,000 shares; issued and outstanding 20,110,391 and 22,104,989 shares at December 31, 2009 and 2008, respectively

|  |              |              |
|--|--------------|--------------|
| Additional paid-in capital                 | 159,303      | 179,504      |
| Retained earnings                          | 360,892      | 292,112      |
| Accumulated other comprehensive loss, net  | (11,576)     | (17,665)     |
| Total stockholders' equity                 | 537,772      | 485,099      |
| Total liabilities and stockholders' equity | \$ 1,648,704 | \$ 1,559,190 |

The accompanying notes are an integral part of these financial statements.

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**Triple-S Management Corporation**  
**Consolidated Statements of Earnings**  
**Years Ended December 31, 2009, 2008 and 2007**

| <i>(dollar amounts in thousands, except per share data)</i>                        | <b>2009</b>  | <b>2008</b>  | <b>2007</b>  |
|--|--------------|--------------|--------------|
| <b>Revenues</b>  |              |              |              |
| Premiums earned, net   | \$ 1,876,072 | \$ 1,695,457 | \$ 1,483,548 |
| Administrative service fees  | 48,643       | 19,187       | 14,018       |
| Net investment income  | 52,136       | 56,253       | 47,194       |
| Total operating revenues   | 1,976,851    | 1,770,897    | 1,544,760    |
| Net realized investment gains (losses):  |              |              |              |
| Total other-than-temporary impairment losses on securities                         | (7,118)      | (16,494)     | (1,087)      |
| Net realized gains, excluding other-than-temporary impairment losses on securities | 7,732        | 2,554        | 7,018        |
| Total net realized investment gains (losses)                                       | 614          | (13,940)     | 5,931        |
| Net unrealized investment gain (loss) on trading securities                        | 10,497       | (21,064)     | (4,116)      |
| Other income (loss), net   | 1,237        | (2,467)      | 3,217        |
| Total revenues   | 1,989,199    | 1,733,426    | 1,549,792    |
| <b>Benefits and expenses</b>   |              |              |              |
| Claims incurred  | 1,612,860    | 1,434,914    | 1,223,775    |
| Operating expenses   | 279,418      | 251,887      | 237,533      |
| Total operating costs  | 1,892,278    | 1,686,801    | 1,461,308    |
| Interest expense   | 13,270       | 14,681       | 15,839       |
| Total benefits and expenses  | 1,905,548    | 1,701,482    | 1,477,147    |
| Income before taxes  | 83,651       | 31,944       | 72,645       |
| Income tax expense (benefit)   |              |              |              |
| Current  | 19,197       | 11,542       | 15,906       |
| Deferred   | (4,326)      | (4,388)      | (1,779)      |
| Total income taxes   | 14,871       | 7,154        | 14,127       |
| Net income   | \$ 68,780    | \$ 24,790    | \$ 58,518    |
| Basic net income per share   | \$ 2.33      | \$ 0.77      | \$ 2.15      |
| Diluted net income per share   | \$ 2.33      | \$ 0.77      | \$ 2.15      |

The accompanying notes are an integral part of these financial statements.

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**Triple-S Management Corporation**  
**Consolidated Statements of Stockholders Equity and Comprehensive Income**  
**December 31, 2009, 2008 and 2007**  
(dollar amounts in thousands, except per share data)

|  | <b>Class A<br/>Common<br/>Stock</b> | <b>Class B<br/>Common<br/>Stock</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Retained<br/>Earnings</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income<br/>(Loss)</b> | <b>Total<br/>Stockholders<br/>Equity</b> |
|--|-------------------------------------|-------------------------------------|---|------------------------------|--|--|
| <b>Balance, December 31,<br/>2006</b>                                | \$ 26,733                           | \$                                  | \$ 124,031                                | \$ 211,266                   | \$ (19,431)  | \$ 342,599                               |
| Dividends declared   |                                     |                                     |   | (2,448)                      |  | (2,448)                                  |
| Sale of stock in public offering                                     | (10,813)                            | 16,100                              | 64,992                                    |                              |  | 70,279                                   |
| Grant of restricted Class B common stock                             |                                     | 166                                 |   |                              |  | 166                                      |
| Share-based compensation   |                                     |                                     | 34  |                              |  | 34                                       |
| Other  | 123                                 |                                     | (122)                                     |                              |  | 1  |
| Comprehensive income   |                                     |                                     |   |                              |  |  |
| Net income   |                                     |                                     |   | 58,518                       |  | 58,518                                   |
| Net unrealized change in fair value of available for sale securities |                                     |                                     |   |                              | 9,549  | 9,549                                    |
| Defined benefit pension plan   |                                     |                                     |   |                              |  |  |
| Prior service cost, net  |                                     |                                     |   |                              | 3,935  | 3,935                                    |
| Actuarial loss   |                                     |                                     |   |                              | 155  | 155                                      |
| Net change in fair value of cash flow hedges                         |                                     |                                     |   |                              | (250)  | (250)                                    |
| Total comprehensive income   |                                     |                                     |   |                              |  | 71,907                                   |
| <b>Balance, December 31,<br/>2007</b>                                | 16,043                              | 16,266                              | 188,935                                   | 267,336                      | (6,042)  | 482,538                                  |
| Conversion of Class A common stock to Class B common stock           | (7,000)                             | 7,000                               |   |                              |  |  |
| Share-based compensation   |                                     |                                     | 3,268                                     |                              |  | 3,268                                    |
| Grant of restricted Class B common stock                             |                                     | 20                                  |   |                              |  | 20                                       |
| Repurchase and retirement of common stock                            |                                     | (1,181)                             | (12,699)                                  |                              |  | (13,880)                                 |

|  |          |           |            |            |             |            |
|--|----------|-----------|------------|------------|-------------|------------|
| Other  |          |           |            | (14)       |             | (14)       |
| Comprehensive income   |          |           |            |            |             |            |
| Net income   |          |           |            | 24,790     |             | 24,790     |
| Net unrealized change in fair value of available for sale securities |          |           |            |            | (3,952)     | (3,952)    |
| Defined benefit pension plan   |          |           |            |            |             |            |
| Prior service credit, net  |          |           |            |            | (266)       | (266)      |
| Actuarial loss   |          |           |            |            | (7,349)     | (7,349)    |
| Net change in fair value of cash flow hedges                         |          |           |            |            | (56)        | (56)       |
| Total comprehensive income   |          |           |            |            |             | 13,167     |
| <b>Balance, December 31, 2008</b>                                    | 9,043    | 22,105    | 179,504    | 292,112    | (17,665)    | 485,099    |
| Share-based compensation   |          |           | 3,897      |            |             | 3,897      |
| Grant of restricted Class B common stock                             |          | 27        |            |            |             | 27         |
| Repurchase and retirement of common stock                            |          | (2,022)   | (24,098)   |            |             | (26,120)   |
| Comprehensive income   |          |           |            |            |             |            |
| Net income   |          |           |            | 68,780     |             | 68,780     |
| Net unrealized change in fair value of available for sale securities |          |           |            |            | 3,539       | 3,539      |
| Defined benefit pension plan   |          |           |            |            |             |            |
| Prior service credit, net  |          |           |            |            | (273)       | (273)      |
| Actuarial gain   |          |           |            |            | 2,823       | 2,823      |
| Total comprehensive income   |          |           |            |            |             | 74,869     |
| <b>Balance, December 31, 2009</b>                                    | \$ 9,043 | \$ 20,110 | \$ 159,303 | \$ 360,892 | \$ (11,576) | \$ 537,772 |

The accompanying notes are an integral part of these financial statements.

**Table of Contents****Triple-S Management Corporation****Statements of Cash Flows****December 31, 2009, 2008 and 2007****(dollar amounts in thousands, except per share data)**

|  | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|-------------|
| <b>Cash flows from operating activities</b>  |             |             |             |
| Net income   | \$ 68,780   | \$ 24,790   | \$ 58,518   |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities |             |             |             |
| Depreciation and amortization  | 9,643       | 7,367       | 7,562       |
| Net amortization of investments  | 744         | 952         | 354         |
| Provision (reversal of provision) for doubtful receivables                                 | 10,489      | (1,180)     | (2,305)     |
| Deferred tax benefit   | (4,326)     | (4,388)     | (1,779)     |
| Net realized investment gains (losses)   | (614)       | 13,940      | (5,931)     |
| Net unrealized (gain) loss on trading securities   | (10,497)    | 21,064      | 4,116       |
| Share-based compensation   | 3,924       | 3,268       | 200         |
| Proceeds from trading securities sold  |             |             |             |
| Equity securities  | 4,240       | 24,640      | 43,614      |
| Acquisition of securities in trading portfolio   |             |             |             |
| Equity securities  | (6,132)     | (10,737)    | (23,921)    |
| Gain on sale of property and equipment   |             | 11          | 28          |
| (Increase) decrease in assets  |             |             |             |
| Premium and other receivables, net   | (46,263)    | (32,210)    | (34,337)    |
| Deferred policy acquisition costs and value of business acquired                           | (13,570)    | (9,108)     | (5,822)     |
| Other deferred taxes   | 900         | (8,337)     |             |
| Other assets   | (1,593)     | (933)       | (13,213)    |
| Increase (decrease) in liabilities   |             |             |             |
| Claim liabilities  | 36,736      | (30,120)    | 39,148      |
| Liability for future policy benefits   | 15,074      | 13,414      | 13,711      |
| Unearned premiums  | (1,799)     | (22,458)    | 19,017      |
| Policyholder deposits  | 1,665       | 1,902       | 1,800       |
| Liability to FEHBP   | 1,845       | (10,181)    | 7,775       |
| Accounts payable and accrued liabilities   | 3,339       | 15,322      | 7,359       |
| Net cash provided by (used in) operating activities  | 72,585      | (2,982)     | 115,894     |

The accompanying notes are an integral part of these financial statements.

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**Triple-S Management Corporation**  
**Consolidated Statements of Cash Flows**  
**December 31, 2009, 2008 and 2007**  
**(dollar amounts in thousands, except per share data)**

|   | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|-------------|
| <b>Cash flows from investing activities</b>             |             |             |             |
| Proceeds from investments sold or matured               |             |             |             |
| Securities available for sale                           |             |             |             |
| Fixed maturities sold                                   | \$ 241,368  | \$ 228,436  | \$ 299,561  |
| Fixed maturities matured                                | 189,144     | 91,732      | 41,248      |
| Equity securities sold                                  | 9,877       | 4,450       | 1,000       |
| Securities held to maturity                             |             |             |             |
| Fixed maturities matured                                | 7,819       | 22,875      | 13,246      |
| Acquisition of investments                              |             |             |             |
| Securities available for sale                           |             |             |             |
| Fixed maturities  | (459,705)   | (505,896)   | (327,409)   |
| Equity securities                                       | (3,684)     | (19,636)    | (18,379)    |
| Securities held to maturity                             |             |             |             |
| Fixed maturities  | (1,502)     | (554)       | (8,244)     |
| Net (disbursements) repayment for policy loans          | (489)       | 30          | (287)       |
| Capital expenditures                                    | (18,706)    | (22,411)    | (9,390)     |
| Net cash used in investing activities                   | (35,878)    | (200,974)   | (8,654)     |
| <b>Cash flows from financing activities</b>             |             |             |             |
| Repurchase and retirement of common stock               | (32,355)    | (7,645)     |             |
| Change in outstanding checks in excess of bank balances | (5,645)     | 18,353      | (3,076)     |
| Repayments of borrowings                                | (1,640)     | (1,639)     | (12,141)    |
| Proceeds from annuity contracts                         | 4,307       | 8,018       | 6,150       |
| Surrenders of annuity contracts                         | (7,093)     | (7,195)     | (7,416)     |
| Net proceeds from initial public offering               |             |             | 70,279      |
| Dividends   |             |             | (2,448)     |
| Other   |             | 6           | 1           |
| Net cash (used in) provided by financing activities     | (42,426)    | 9,898       | 51,349      |
| Net (decrease) increase in cash and cash equivalents    | (5,719)     | (194,058)   | 158,589     |
| <b>Cash and cash equivalents</b>                        |             |             |             |
| Beginning of year                                       | 46,095      | 240,153     | 81,564      |
| End of year   | \$ 40,376   | \$ 46,095   | \$ 240,153  |

The accompanying notes are an integral part of these financial statements.

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**Triple-S Management Corporation  
Notes to Consolidated Financial Statements  
December 31, 2009, 2008 and 2007**

**(dollar amounts in thousands, except per share data)**

**1. Nature of Business**

Triple-S Management Corporation (the Company or TSM) was incorporated under the laws of the Commonwealth of Puerto Rico on January 17, 1997 to engage, among other things, as the holding company of entities primarily involved in the insurance industry.

The Company has the following wholly owned subsidiaries that are subject to the regulations of the Commissioner of Insurance of the Commonwealth of Puerto Rico (the Commissioner of Insurance): (1) Triple-S Salud, Inc. (TSS) a managed care organization that provides health benefits services to subscribers through contracts with hospitals, physicians, dentists, laboratories, and other organizations; (2) Triple-S Vida, Inc. (TSV), which is engaged in the underwriting of life and accident and health insurance policies and the administration of annuity contracts; and (3) Triple-S Propiedad, Inc. (TSP), which is engaged in the underwriting of property and casualty insurance policies. The Company and TSS are members of the Blue Cross and Blue Shield Association (BCBSA).

The Company also has two other wholly owned subsidiaries, Interactive Systems, Inc. (ISI) and Triple-C, Inc. (TC). ISI is mainly engaged in providing data processing services to the Company and its subsidiaries. TC is mainly engaged as a third-party administrator for TSS in the administration of the Commonwealth of Puerto Rico Health Care Reform's (the Reform) business. Also, TC provides healthcare advisory services to TSS and other health insurance-related services to the health insurance industry.

A substantial majority of the Company's business activity is with insurers located throughout Puerto Rico, and as such, the Company is subject to the risks associated with the Puerto Rico economy.

**2. Significant Accounting Policies**

The following are the significant accounting policies followed by the Company and its subsidiaries:

***Basis of Presentation***

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP).

The consolidated financial statements include the financial statements of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

***Use of Estimates***

The preparation of the consolidated financial statements in conformity with GAAP requires the Company to make a number of estimates and assumptions relating to 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 period. Actual results could differ from those estimates. The most significant items on the consolidated balance sheets that involve a greater degree of accounting estimates and actuarial determinations subject to changes in the near future are the assessment of other-than-temporary impairments, allowance for doubtful receivables, deferred policy acquisition costs and value of business acquired, claim liabilities, the liability for future policy benefits, and liability for pension benefits. As additional information becomes available (or actual amounts are determinable), the recorded estimates are revised and reflected in operating results of the period they are determined.





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**Triple-S Management Corporation**  
**Notes to Consolidated Financial Statements**  
**December 31, 2009, 2008 and 2007**

**(dollar amounts in thousands, except per share data)**

Although some variability is inherent in these estimates, the Company believes the amounts provided are adequate.

***Reclassifications***

Certain amounts in the 2008 and 2007 consolidated financial statements were reclassified to conform to the 2009 presentation.

***Cash Equivalents***

The Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. Cash equivalents of \$920 and \$2,564 at December 31, 2009 and 2008, respectively, consist principally of obligations of government-sponsored enterprises and certificates of deposit with an initial term of less than three months.

***Investments***

Investment in securities at December 31, 2009 and 2008 consists mainly of obligations of government-sponsored enterprises, U.S. Treasury securities and obligations of U.S. government instrumentalities, obligations of the Commonwealth of Puerto Rico and its instrumentalities, municipal securities, obligations of states of the United States and political subdivisions of the states, corporate bonds, mortgage-backed securities, collateralized mortgage obligations, and equity securities. The Company classifies its debt and equity securities in one of three categories: trading, available for sale, or held to maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Securities classified as held to maturity are those securities in which the Company has the ability and intent to hold the security until maturity. All other securities not included in trading or held to maturity are classified as available for sale.

Trading and available-for-sale securities are recorded at fair value. The fair values of debt securities (both available for sale and held to maturity investments) and equity securities are based on quoted market prices for those or similar investments at the reporting date. Held-to-maturity debt securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums and discounts, respectively. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of other comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities are included in earnings and are determined on a specific-identification basis.

Transfers of securities between categories are recorded at fair value at the date of transfer. Unrealized holding gains and losses are recognized in earnings for transfers into trading securities. Unrealized holding gains or losses associated with transfers of securities from held to maturity to available for sale are recorded as a separate component of other comprehensive income. The unrealized holding gains or losses included in the separate component of other comprehensive income for securities transferred from available for sale to held to maturity, are maintained and amortized into earnings over the remaining life of the security as an adjustment to yield in a manner consistent with the amortization or accretion of premium or discount on the associated security.

If a fixed maturity security is in an unrealized loss position and the Company has the intent to sell the fixed maturity security, or it is more likely than not that the Company will have to sell the fixed maturity security before recovery

of its amortized cost basis, the decline in value is deemed to be other-than-temporary and is recorded to other-than-temporary impairment losses recognized in earnings in the Company's consolidated statements of earnings. For impaired fixed maturity

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**Triple-S Management Corporation**  
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**December 31, 2009, 2008 and 2007**

**(dollar amounts in thousands, except per share data)**

securities that the Company does not intend to sell or it is more likely than not that such securities will not have to be sold, but the Company expects not to fully recover the amortized cost basis, the credit component of the other-than temporary impairment is recognized in other-than-temporary impairment losses recognized in earnings in the Company's consolidated income statements and the non-credit component of the other-than-temporary impairment is recognized in other comprehensive income. Furthermore, unrealized losses entirely caused by non-credit related factors related to fixed maturity securities for which the Company expects to fully recover the amortized cost basis continue to be recognized in accumulated other comprehensive income.

The credit component of an other-than-temporary impairment is determined by comparing the net present value of projected future cash flows with the amortized cost basis of the fixed maturity security. The net present value is calculated by discounting the Company's best estimate of projected future cash flows at the effective interest rate implicit in the fixed maturity security at the date of acquisition.

The unrealized gains or losses on the Company's equity securities classified as available-for-sale are included in accumulated other comprehensive income as a separate component of stockholders' equity, unless the decline in value is deemed to be other-than-temporary and the Company does not have the intent and ability to hold such equity securities until their full cost can be recovered, in which case such equity securities are written down to fair value and the loss is charged to other-than-temporary impairment losses recognized in earnings

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. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is other-than-temporary, the Company considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, market conditions, 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.

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. Dividend and interest income are recognized when earned.

The Company regularly invests in mortgaged-backed securities and other securities subject to prepayment and call risk. Significant changes in prevailing interest rates may adversely affect the timing and amount of cash flows on such securities. In addition, the amortization of market premium and accretion of market discount for mortgaged-backed securities is based on historical experience and estimates of future payment speeds on the underlying mortgage loans. Actual prepayment speeds will differ from original estimates and may result in material adjustments to amortization or accretion recorded in future periods.

***Revenue Recognition***

**a. Managed Care**

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Notes to Consolidated Financial Statements  
December 31, 2009, 2008 and 2007****(dollar amounts in thousands, except per share data)**

Subscriber premiums on the managed care business are billed in advance of their respective coverage period and the related revenue is recorded as earned during the coverage period. Managed care premiums are billed in the month prior to the effective date of the policy with a grace period of up to two months. If the insured fails to pay, the policy can be canceled at the end of the grace period at the option of the Company. Managed care premiums are reported as earned when due.

Premiums for the Medicare Advantage (MA) business are based on a bid contract with the Centers for Medicare and Medicaid Services (CMS) and billed in advance of the coverage period. MA contracts provide for a risk factor to adjust premiums paid for members that represent a higher or lower risk to the Company. Retroactive rate adjustments are made periodically based on the aggregate health status and risk scores of the Company's MA membership. These risk adjustments are evaluated quarterly based on actuarial estimates. Actual results could differ from these estimates. As additional information becomes available, the recorded estimate is revised and reflected in operating results.

TSS offers prescription drug coverage to Medicare eligible beneficiaries as part of its MA plans (MA-PD) and on a stand-alone basis (stand-alone PDP). Premiums are based on a bid contract with CMS that considers the estimated costs of providing prescription drug benefits to enrolled participants. MA-PD and stand-alone PDP premiums are subject to adjustment, positive or negative, based upon the application of risk corridors that compare the estimated prescription drug costs included in the bids to CMS to actual prescription drug costs. Variances exceeding certain thresholds may result in CMS making additional payments to the TSS or in TSS refunding CMS a portion of the premiums collected. TSS estimates and records adjustments to earned premiums related to estimated risk corridor payments based upon actual prescription drug costs for each reporting period as if the annual contract were to end at the end of each reporting period.

Administrative service fees include revenue from certain groups, including the Reform Metro-North Region contract, which has managed care contracts that provide for the group to be at risk for all or a portion of their claims experience. For these groups, the Company is not at risk and only handles the administration of the insurance coverage for an administrative service fee. The Company pays claims under self-funded arrangements from its own funds, and subsequently receives reimbursement from these groups. Claims paid under self-funded arrangements are excluded from the claims incurred in the accompanying consolidated financial statements. Administrative service fees under the self-funded arrangements are recognized based on the group's membership or incurred claims for the period multiplied by an administrative fee rate plus other fees. In addition, some of these self-funded groups purchase aggregate and/or specific stop-loss coverage. In exchange for a premium, the group's aggregate liability or the group's liability on any one episode of care is capped for the year. Premiums for the stop-loss coverage are actuarially determined based on experience and other factors and are recorded as earned over the period of the contract in proportion to the coverage provided. This fully insured portion of premiums is included within the premiums earned, net in the accompanying consolidated statements of earnings. The contract for the Metro-North Region contains a savings-sharing provision whereby the Commonwealth of Puerto Rico shares with TSS a portion of the medical cost savings obtained with the administration of the contract. Any savings-sharing amount is recorded when earned as administrative service fees in the accompanying consolidated statements of earnings.

**b. Life and Accident and Health Insurance**

Premiums on life insurance policies are billed in advance of their respective coverage period and the related revenue is recorded as earned when due. Premiums on accident and health and other short-term policies are recognized as earned primarily on a pro rata basis over the

**Table of Contents****Triple-S Management Corporation  
Notes to Consolidated Financial Statements  
December 31, 2009, 2008 and 2007****(dollar amounts in thousands, except per share data)**

contract period. Premiums on credit life policies are recognized as earned in proportion to the amounts of insurance in-force. Revenues from universal life and interest sensitive policies represent amounts assessed against policyholders, including mortality charges, surrender charges actually paid, and earned policy service fees. The revenues for limited payment contracts are recognized over the period that benefits are provided rather than on collection of premiums.

**c. Property and Casualty Insurance**

Premiums on property and casualty contracts are billed in advance of their respective coverage period and they are recognized as earned on a pro rata basis over the policy term. The portion of premiums related to the period prior to the end of coverage is recorded in the consolidated balance sheets as unearned premiums and is transferred to premium revenue as earned.

***Allowance for Doubtful Receivables***

The allowance for doubtful receivables is based on management's evaluation of the aging of accounts and such other factors, which deserve current recognition. Actual results could differ from these estimates. Receivables are charged against their respective allowance accounts when deemed to be uncollectible.

***Deferred Policy Acquisition Costs and Value of Business Acquired***

Certain direct costs for acquiring life and accident and health, and property and casualty insurance business are deferred by the Company. Substantially all acquisition costs related to the managed care business are expensed as incurred.

In the life and accident and health business deferred acquisition costs consist of commissions and certain expenses related to the production of life, annuity, accident and health, and credit business. In the event that future premiums, in combination with policyholder reserves and anticipated investment income, could not provide for all future maintenance and settlement expenses, the amount of deferred policy acquisition costs would be reduced to provide for such amount. The related amortization is provided over the anticipated premium-paying period of the related policies in proportion to the ratio of annual premium revenue to expected total premium revenue to be received over the life of the policies. Interest is considered in the amortization of deferred policy acquisition cost and value of business acquired. For these contracts interest is considered at a level rate, at the time of issue of each contract, currently 5.4%, and, in the case of the value of business acquired, at the time of any acquisition. For certain other long-duration contracts, deferred amounts are amortized at historical and forecasted credited interest rates. Expected premium revenue is estimated by using the same mortality and withdrawal assumptions used in computing liabilities for future policy benefits. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated net realizable value. In determining estimated net realizable value, the computations give effect to the premiums to be earned, related investment income, losses and loss-adjustment expenses, and certain other costs expected to be incurred as the premium is earned. Costs deferred on universal life and interest sensitive products are amortized as a level percentage of the present value of anticipated gross profits from investment yields, mortality, expenses and surrender charges. Estimates used are based on the Company's experience as adjusted to provide for possible adverse deviations. These estimates are periodically reviewed and compared with actual experience. When it is determined that future expected experience differs significantly from that assumed, the estimates are revised for current and future issues.

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The value assigned to the insurance in-force of TSV at the date of the acquisition is amortized using methods similar to those used to amortize the deferred policy acquisition costs of the life and accident and health business. In the property and casualty business, acquisition costs consist of commissions incurred during the production of business and are deferred and amortized ratably over the terms of the policies.

**Property and Equipment**

Property and equipment are stated at cost. Maintenance and repairs are expensed as incurred. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets. Costs of computer equipment, programs, systems, installations, and enhancements are capitalized and amortized straight-line over their estimated useful lives. The following is a summary of the estimated useful lives of the Company's property and equipment:

| <b>Asset Category</b>                          | <b>Estimated Useful Life</b>                   |
|--|--|
| Buildings                                      | 20 to 50 years                                 |
| Building improvements                          | 3 to 5 years                                   |
| Leasehold improvements                         | Shorter of estimated useful life or lease term |
| Office furniture                               | 5 years  |
| Computer software                              | 3 to 10 years                                  |
| Computer equipment, equipment, and automobiles | 3 years  |

**Software Development Costs**

Costs related to software developed or obtained for internal use that is incurred in the preliminary project stage are expensed as incurred. Once capitalization criteria are met, directly attributable development costs are capitalized and amortized over the expected useful life of the software. Upgrade and maintenance costs are expensed as incurred. During the year ended December 31, 2009 and 2008 the Company capitalized approximately \$10,993 and \$16,408 associated with the implementation of new software. No software development costs were capitalized during the year ended December 31, 2007.

**Long-Lived Assets**

Long-lived assets, such as property and equipment, 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. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheets and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held for sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheets. Goodwill and intangible assets that have indefinite useful lives are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset

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might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. For goodwill, the impairment determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of a reporting unit and compares it to its carrying amount. Second, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

**Claim Liabilities**

Claim liabilities for managed care policies represent the estimated amounts to be paid to providers based on experience and accumulated statistical data. Loss-adjustment expenses related to such claims are currently accrued based on estimated future expenses necessary to process such claims.

TSS contracts with various independent practice associations (IPAs) for certain medical care services provided to some policies subscribers. The IPAs are compensated on a capitation basis. In the Reform business and one of the MA policies, TSS retains a portion of the capitation payments to provide for incurred but not reported losses. At December 31, 2009 and 2008, total withholdings and capitation payable amounted to \$25,568 and \$24,462, respectively, which are recorded as part of the claim liabilities in the accompanying consolidated balance sheets. Claim liabilities include unpaid claims and loss-adjustment expenses of the life and accident and health business based on a case-basis estimate for reported claims, and on estimates, based on experience, for unreported claims and loss-adjustment expenses. The liability for policy and contract claims and claims expenses has been established to cover the estimated net cost of insured claims.

Also included within the claim liabilities is the liability for losses and loss-adjustment expenses for the property and casualty business represents individual case estimates for reported claims and estimates for unreported losses, net of any salvage and subrogation based on past experience modified for current trends and estimates of expenses for investigating and settling claims.

The above 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, and any adjustments are reflected in the consolidated statements of earnings in the period determined.

**Future Policy Benefits**

The liability for future policy benefits has been computed using the level-premium method based on estimated future investment yield, mortality, morbidity and withdrawal experience. The interest rate assumption ranges between 5.0% and 5.40% for all years in issue. Mortality has been calculated principally on select and ultimate tables in common usage in the industry. Withdrawals have been determined principally based on industry tables, modified by Company's experience.

**Policyholder Deposits**

Amounts received for annuity contracts are considered deposits and recorded as a liability along with the accrued interest and reduced for charges and withdrawals. Interest incurred on such



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deposits, which amounted to \$1,665, \$1,902, and \$1,800, during the years ended December 31, 2009, 2008, and 2007, respectively, is recorded as interest expense in the accompanying consolidated statements of earnings.

**Reinsurance**

In the normal course of business, the insurance-related subsidiaries seek to limit their exposure that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers.

Reinsurance premiums, commissions, and expense reimbursements, related to reinsured business are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Accordingly, reinsurance premiums are reported as prepaid reinsurance premiums and amortized over the remaining contract period in proportion to the amount of insurance protection provided.

Premiums ceded and recoveries of losses and loss-adjustment expenses have been reported as a reduction of premiums earned and losses and loss-adjustment expenses incurred, respectively. Commission and expense allowances received by TSP in connection with reinsurance ceded have been accounted for as a reduction of the related policy acquisition costs and are deferred and amortized accordingly. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy.

**Derivative Instruments and Hedging Activities**

The Company recognizes all derivative instruments, including certain derivative instruments embedded in other contracts, whether or not designated in hedging relationships, as either assets or liabilities in the balance sheet at their respective fair values. Changes in the fair value of derivative instruments are recorded in earnings, unless specific hedge accounting criteria are met in which case the change in fair value of the instrument is recorded within other comprehensive income for cash flow hedges.

On the date the derivative contract designated as a hedging instrument is entered into, the Company designates the instrument as either a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair-value hedge), a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (cash-flow hedge), a foreign currency fair-value or cash-flow hedge (foreign-currency hedge), or a hedge of a net investment in a foreign operation. For all hedging relationships the Company formally documents the hedging relationship and its risk-management objective and strategy for undertaking the hedge, the hedging instrument, the hedged item, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed, and a description of the method of measuring ineffectiveness. This process includes linking all derivatives that are designated as fair-value, cash-flow, or foreign-currency hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a fair-value hedge, along with the loss or gain on the hedged asset or liability or unrecognized firm commitment of the hedged item that is attributable to the hedged risk, are recorded in earnings. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash-flow

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hedge are recorded in other comprehensive income to the extent that the derivative is effective as hedge, until earnings are affected by the variability in cash flows of the designated hedged item. Changes in the fair value of derivatives that are highly effective as hedges and that are designated and qualify as foreign-currency hedges are recorded in either earnings or other comprehensive income, depending on whether the hedge transaction is a fair-value hedge or a cash-flow hedge. However, if a derivative is used as a hedge of a net investment in a foreign operation, its changes in fair value, to the extent effective as a hedge, are recorded in the cumulative translation adjustments account within other comprehensive income. The ineffective portion of the change in fair value of a derivative instrument that qualifies as either a fair-value hedge or a cash-flow hedge is reported in earnings. Changes in the fair value of derivative trading instruments are reported in current period earnings.

The Company discontinues hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative expires or is sold, terminated, or exercised, the derivative is de-designated as a hedging instrument, because it is unlikely that a forecasted transaction will occur, a hedged firm commitment no longer meets the definition of a firm commitment, or management determines that designation of the derivative as a hedging instrument is no longer appropriate.

In all situations in which hedge accounting is discontinued and the derivative is retained, the Company continues to carry the derivative at its fair value on the balance sheet and recognizes any subsequent changes in its fair value in earnings. When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair-value hedge, the Company no longer adjusts the hedged asset or liability for changes in fair value. The adjustment of the carrying amount of the hedged asset or liability is accounted for in the same manner as other components of the carrying amount of that asset or liability. When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, the Company removes any asset or liability that was recorded pursuant to recognition of the firm commitment from the balance sheet, and recognizes any gain or loss in earnings. When it is probable that a forecasted transaction will not occur, the Company discontinues hedge accounting if not already done and recognizes immediately in earnings gains and losses that were accumulated in other comprehensive income.

**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 bases 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 earnings 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 any interest and penalties related to unrecognized tax benefits within the operating expenses in the consolidated statement of earnings.

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**Insurance-Related Assessments**

The Company records a liability 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 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 financial statements; and (3) the amount of the assessment can be reasonably estimated. A related asset is recognized when the paid or accrued assessment is recoverable through either premium taxes or policy surcharges.

**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 of the assessment and/or remediation can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred. Recoveries of costs from third parties, which are probable of realization, are separately recorded as assets, and are not offset against the related liability.

**Share-Based Compensation**

Share-based compensation is measured at the fair value of the award and recognized as an expense in the financial statements over the vesting period. The Company recognizes compensation expense based on estimated grant date fair value using the Black-Scholes option-pricing model.

**Earnings Per Share**

Basic earnings per share excludes dilution and is computed by dividing net income available to all classes of common stockholders by the weighted average number of all classes of common shares outstanding for the period, excluding non-vested restricted stocks. Diluted earnings per share is computed in the same manner as basic earnings per share except that the number of shares is increased to include the number of additional common shares that would have been outstanding if the potentially dilutive common shares had been issued. Dilutive common shares are included in the diluted earnings per share calculation using the treasury stock method.

**Fair Value**

The fair value information of financial instruments in the accompanying consolidated financial statements was determined as follows:

**a. Cash and Cash Equivalents**

The carrying amount approximates fair value because of the short-term nature of such instruments.

**b. Investment in Securities**

The fair value of investment securities is estimated based on quoted market prices for those or similar investments. Additional information pertinent to the estimated fair value of investment in securities is included in note 3 and note 9.

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**c. Policy Loans**

Policy loans have no stated maturity dates and are part of the related insurance contract. The carrying amount of policy loans approximates fair value because their interest rate is reset periodically in accordance with current market rates.

**d. Receivables, Accounts Payable, and Accrued Liabilities**

The carrying amount of receivables, accounts payable, and accrued liabilities approximates fair value because they mature and should be collected or paid within 12 months after December 31.

**e. Policyholder Deposits**

The fair value of policyholder deposits is the amount payable on demand at the reporting date, and accordingly, the carrying value amount approximates fair value.

**f. Borrowings**

The carrying amounts and fair value of the Company's borrowings are as follows:

|                                     | 2009               |               | 2008               |               |
|-------------------------------------|--------------------|---------------|--------------------|---------------|
|                                     | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
| Loans payable to bank               | 22,667             | 22,667        | \$ 24,307          | \$ 24,307     |
| 6.3% senior unsecured notes payable | 50,000             | 48,000        | 50,000             | 46,250        |
| 6.6% senior unsecured notes payable | 60,000             | 57,420        | 60,000             | 55,800        |
| 6.7% senior unsecured notes payable | 35,000             | 33,320        | 35,000             | 34,059        |
|                                     | \$ 167,667         | \$ 161,407    | \$ 169,307         | \$ 160,416    |

The carrying amount of the loans payable to bank approximates fair value due to its floating interest-rate structure. The fair value of the senior unsecured notes payable was determined using market quotations. Additional information pertinent to borrowings is included in Note 12.

**g. Derivative Instruments**

Current market pricing models were used to estimate fair value of structured notes agreements. Fair values were determined using market quotations provided by outside securities consultants or prices provided by market makers. Additional information pertinent to the estimated fair value of derivative instruments is included in note 12.

**Recently Issued Accounting Standards**

In April 2009, the Financial Accounting Standards Board (FASB) issued guidance to address application issues raised by preparers, auditors, and members of the legal profession on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. This guidance is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of the new guidance did not have impact on the Company's consolidated financial statements.

In April 2009, the FASB issued guidance to amend the other-than-temporary impairment guidance in GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This guidance does

not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The guidance is effective for

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interim and annual periods ending after June 15, 2009. The adoption of this new guidance did not have a material impact on the consolidated financial position and results of operations. See note 3, Investment in Securities, for the required disclosures.

In April 2009, the FASB issued guidance to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This guidance also requires those disclosures in summarized financial information at interim reporting periods. The guidance is effective for interim and annual periods ending after June 15, 2009. The adoption of this guidance did not have an impact on the consolidated financial position and results of operations.

In April 2009, the FASB issued guidance to provide additional assistance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. This guidance also includes assistance on identifying circumstances that indicate a transaction is not orderly. The guidance is effective for interim and annual periods ending after June 15, 2009. The adoption of this guidance had no impact on the consolidated financial position and results of operations.

In May 2009, the FASB issued guidance to establish the general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This guidance requires disclosure of the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. In February 2010, the FASB issued new guidance to amend these standards. Under this new guidance, the Company is not required to disclose the date through which subsequent events have been evaluated. This guidance is effective upon issuance. The adoption of this guidance did not have impact on the Company's consolidated financial statements.

In August 2009, the FASB issued additional guidance for the fair value measurement of liabilities. The Company had chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with GAAP. This guidance is effective for the first reporting period, including interim periods, beginning after issuance. The adoption of this guidance did not have an impact on our consolidated financial statements.

In September 2009, the FASB issued guidance for the fair value measurement of investments in certain entities that calculate net asset value per share (or its equivalent). The amendments in this guidance improve financial reporting by permitting use of a practical expedient, with appropriate disclosures, when measuring the fair value of an alternative investment that does not have a readily determinable fair value. The amendments in this guidance also improve transparency by requiring additional disclosures about investments in the scope of the amendments in this guidance to enable users of financial statements to understand the nature and risks of investments and whether the investments are probable of being sold at amounts different from net asset value per share. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In January 2010, the FASB issued guidance for the fair value measurement and disclosure; improving disclosures about fair value measurements. This guidance requires new disclosures as follows: (1) Disclose separately the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and describe the reasons for the transfers; (2) In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), present separately information about purchases, sales, issuances, and

settlements (that is on a gross basis rather than as one net number). This guidance also provides amendments that clarify existing disclosure as follows: (1) Level of disaggregation provide fair value measurement disclosures for each class of assets and liabilities; (2) Disclosures about inputs and valuation techniques provide disclosures about the input and valuation techniques used to measure fair value for both recurring and nonrecurring fair

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value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. This guidance is effective for annual or interim reporting periods beginning after December 15, 2009, except for the requirement to provide the Level 3 activity for purchases, sales, issuances, and settlements on a gross basis. That requirement will be effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. This guidance does not require any new fair value measurements. The Company does not expect the adoption of this guidance to have an impact on our financial position or results of operations.

There were no other new accounting pronouncements issued that had or are expected to have a material impact on our financial position, operating results or disclosures.

**3. Investment in Securities**

The amortized cost for debt and equity securities, gross unrealized gains, gross unrealized losses, and estimated fair value for trading, available-for-sale, and held-to-maturity securities by major security type and class of security at December 31, 2009 and 2008 were as follows:

|                    |             | <b>2009</b>                           |  |                                     |
|--------------------|-------------|---------------------------------------|--|-------------------------------------|
|                    | <b>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Estimated<br/>Fair<br/>Value</b> |
| Trading securities |             |                                       |  |                                     |
| Equity securities  | \$ 42,075   | \$ 7,064                              | \$ (5,230)                             | \$ 43,909                           |
|                    |             |                                       |  |                                     |
|                    |             | <b>2008</b>                           |  |                                     |
|                    | <b>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Estimated<br/>Fair<br/>Value</b> |
| Trading securities |             |                                       |  |                                     |
| Equity securities  | \$ 40,847   | \$ 2,781                              | \$ (11,444)                            | \$ 32,184                           |

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|   | <b>2009</b>      |                   |                   |                  |
|---|------------------|-------------------|-------------------|------------------|
|   | <b>Amortized</b> | <b>Gross</b>      | <b>Gross</b>      | <b>Estimated</b> |
|   | <b>Cost</b>      | <b>Unrealized</b> | <b>Unrealized</b> | <b>Fair</b>      |
|   |                  | <b>Gains</b>      | <b>Losses</b>     | <b>Value</b>     |
| Securities available for sale   |                  |                   |                   |                  |
| Fixed maturities  |                  |                   |                   |                  |
| Obligations of government- sponsored enterprises                              | \$ 252,513       | \$ 2,240          | \$ (3,325)        | \$ 251,428       |
| U.S. Treasury securities and obligations of U.S. government instrumentalities | 48,190           | 3,148             |                   | 51,338           |
| Obligations of the Commonwealth of Puerto Rico and its instrumentalities      | 154,754          | 3,113             | (1,919)           | 155,948          |
| Municipal securities  | 107,441          | 1,117             | (1,851)           | 106,707          |
| Corporate bonds   | 102,547          | 3,546             | (728)             | 105,365          |
| Residential mortgage-backed securities  | 16,605           | 677               | (1)               | 17,281           |
| Collateralized mortgage obligations   | 229,312          | 4,237             | (2,639)           | 230,910          |
| Total fixed maturities  | 911,362          | 18,078            | (10,463)          | \$ 918,977       |
| Equity securities   |                  |                   |                   |                  |
| Common stocks   | 4,074            | 3,435             |                   | 7,509            |
| Preferred stocks  | 4,000            |                   | (1,325)           | 2,675            |
| Perpetual preferred stocks  | 2,849            |                   | (270)             | 2,579            |
| Mutual funds  | 50,608           | 4,150             | (2,832)           | 51,926           |
| Total equity securities   | 61,531           | 7,585             | (4,427)           | 64,689           |
| Total   | \$ 972,893       | \$ 25,663         | \$ (14,890)       | \$ 983,666       |

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|   | <b>2008</b>      |                   |                   |                  |
|---|------------------|-------------------|-------------------|------------------|
|   | <b>Amortized</b> | <b>Gross</b>      | <b>Gross</b>      | <b>Estimated</b> |
|   | <b>Cost</b>      | <b>Unrealized</b> | <b>Unrealized</b> | <b>Fair</b>      |
|   |                  | <b>Gains</b>      | <b>Losses</b>     | <b>Value</b>     |
| Securities available for sale   |                  |                   |                   |                  |
| Fixed maturities  |                  |                   |                   |                  |
| Obligations of government- sponsored enterprises                              | \$ 422,038       | \$ 7,991          | \$ (220)          | \$ 429,809       |
| U.S. Treasury securities and obligations of U.S. government instrumentalities | 78,024           | 11,961            |                   | 89,985           |
| Obligations of the Commonwealth of Puerto Rico and its instrumentalities      | 121,934          | 448               | (6,077)           | 116,305          |
| Municipal securities  | 35,611           | 426               | (116)             | 35,921           |
| Corporate bonds   | 100,745          | 1,625             | (7,399)           | 94,971           |
| Residential mortgage-backed securities  | 17,420           | 425               | (3)               | 17,842           |
| Collateralized mortgage obligations   | 103,891          | 1,287             | (2,327)           | 102,851          |
| Total fixed maturities  | 879,663          | 24,163            | (16,142)          | 887,684          |
| Equity securities   |                  |                   |                   |                  |
| Common stocks   | 6,651            | 1,541             | (1,185)           | 7,007            |
| Preferred stocks  | 8,746            |                   | (406)             | 8,340            |
| Perpetual preferred stocks  | 3,617            |                   | (335)             | 3,282            |
| Mutual funds  | 51,040           | 217               | (1,257)           | 50,000           |
| Total equity securities   | 70,054           | 1,758             | (3,183)           | 68,629           |
| Total   | \$ 949,717       | \$ 25,921         | \$ (19,325)       | \$ 956,313       |

|   | <b>2009</b>      |                   |                   |                  |
|---|------------------|-------------------|-------------------|------------------|
|   | <b>Amortized</b> | <b>Gross</b>      | <b>Gross</b>      | <b>Estimated</b> |
|   | <b>Cost</b>      | <b>Unrealized</b> | <b>Unrealized</b> | <b>Fair</b>      |
|   |                  | <b>Gains</b>      | <b>Losses</b>     | <b>Value</b>     |
| Securities held to maturity   |                  |                   |                   |                  |
| Obligations of government- sponsored enterprises                              | \$ 925           | \$ 6              |                   | \$ 931           |
| U.S. Treasury securities and obligations of U.S. government instrumentalities | 3,786            | 132               |                   | 3,918            |
| Corporate bonds   | 9,063            | 534               |                   | 9,597            |
| Residential mortgage-backed securities  | 1,256            | 25                | (1)               | 1,280            |
| Certificates of deposits  | 764              |                   |                   | 764              |
|   | \$ 15,794        | \$ 697            | \$ (1)            | 16,490           |

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|   | <b>2008</b>      |                   |                        |                        |
|---|------------------|-------------------|------------------------|------------------------|
|   | <b>Amortized</b> | <b>Unrealized</b> | <b>Gross Estimated</b> | <b>Unrealized Fair</b> |
|   | <b>Cost</b>      | <b>Gains</b>      | <b>Losses</b>          | <b>Value</b>           |
| Securities held to maturity   |                  |                   |                        |                        |
| Obligations of government- sponsored enterprises                              | \$ 9,082         | \$ 240            | \$                     | \$ 9,322               |
| U.S. Treasury securities and obligations of U.S. government instrumentalities | 1,488            | 379               |                        | 1,867                  |
| Corporate bonds   | 8,698            | 698               |                        | 9,396                  |
| Residential mortgage-backed securities  | 1,749            |                   | (7)                    | 1,742                  |
| Certificates of deposits  | 736              |                   |                        | 736                    |
|   | \$ 21,753        | \$ 1,317          | \$ (7)                 | 23,063                 |

Gross unrealized losses on investment securities and the estimated fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2009 and 2008 were as follows:

|  | <b>2009</b>                |                   |                   |                            |                   |                   |                  |                   |                   |
|--|----------------------------|-------------------|-------------------|----------------------------|-------------------|-------------------|------------------|-------------------|-------------------|
|  | <b>Less than 12 months</b> |                   |                   | <b>12 months or longer</b> |                   |                   | <b>Total</b>     |                   |                   |
|  | <b>Gross</b>               |                   |                   | <b>Gross</b>               |                   |                   | <b>Gross</b>     |                   |                   |
|  | <b>Number</b>              |                   |                   | <b>Number</b>              |                   |                   | <b>Number</b>    |                   |                   |
|  | <b>Estimated</b>           | <b>Unrealized</b> | <b>of</b>         | <b>Estimated</b>           | <b>Unrealized</b> | <b>of</b>         | <b>Estimated</b> | <b>Unrealized</b> | <b>of</b>         |
|  | <b>Fair</b>                | <b>Loss</b>       | <b>Securities</b> | <b>Fair</b>                | <b>Loss</b>       | <b>Securities</b> | <b>Fair</b>      | <b>Loss</b>       | <b>Securities</b> |
|  | <b>Value</b>               | <b>Value</b>      | <b>Value</b>      | <b>Value</b>               | <b>Value</b>      | <b>Value</b>      | <b>Value</b>     | <b>Value</b>      | <b>Value</b>      |
| Securities available for sale  |                            |                   |                   |                            |                   |                   |                  |                   |                   |
| Fixed maturities   |                            |                   |                   |                            |                   |                   |                  |                   |                   |
| Obligations of government- sponsored enterprises                         | \$ 110,602                 | \$ (2,264)        | 21                | \$ 25,468                  | \$ (1,061)        | 5                 | \$ 136,070       | \$ (3,325)        | 26                |
| Obligations of the Commonwealth of Puerto Rico and its instrumentalities | 12,944                     | (201)             | 10                | 58,866                     | (1,718)           | 22                | 71,810           | (1,919)           | 32                |
| Municipal securities   | 62,292                     | (1,841)           | 39                | 173                        | (10)              | 1                 | 62,465           | (1,851)           | 40                |
| Corporate bonds  | 10,997                     | (215)             | 4                 | 7,975                      | (513)             | 6                 | 18,972           | (728)             | 10                |
| Residential mortgage-backed securities                                   |                            |                   |                   | 36                         | (1)               | 1                 | 36               | (1)               | 1                 |
| Collateralized mortgage obligations                                      | 101,265                    | (1,732)           | 21                | 7,171                      | (907)             | 10                | 108,436          | (2,639)           | 31                |
| Total fixed maturities   | 298,100                    | (6,253)           | 95                | 99,689                     | (4,210)           | 45                | 397,789          | (10,463)          | 140               |
| Equity securities  |                            |                   |                   |                            |                   |                   |                  |                   |                   |
| Preferred stocks   |                            |                   |                   | 2,675                      | (1,325)           | 1                 | 2,675            | (1,325)           | 1                 |
| Perpetual preferred stocks   |                            |                   |                   | 730                        | (270)             | 1                 | 730              | (270)             | 1                 |
| Mutual funds   | 9,994                      | (907)             | 4                 | 21,667                     | (1,925)           | 15                | 31,661           | (2,832)           | 19                |

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|   |            |            |    |            |            |    |            |             |     |
|---|------------|------------|----|------------|------------|----|------------|-------------|-----|
| Total equity securities                 | 9,994      | (907)      | 4  | 25,072     | (3,520)    | 17 | 35,066     | (4,427)     | 21  |
| Total for securities available for sale | \$ 308,094 | \$ (7,160) | 99 | \$ 124,761 | \$ (7,730) | 62 | \$ 432,855 | \$ (14,890) | 161 |
| Securities held to maturity             |            |            |    |            |            |    |            |             |     |
| Residential mortgage-backed securities  |            |            |    | \$ 55      | \$ (1)     | 1  | \$ 55      | \$ (1)      | 1   |

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|  | Less than 12 months        |                    |                         | 2008<br>12 months or longer |                    |                         | Total                      |                    |                         |
|--|----------------------------|--------------------|-------------------------|-----------------------------|--------------------|-------------------------|----------------------------|--------------------|-------------------------|
|  | Gross                      |                    |                         | Gross                       |                    |                         | Gross                      |                    |                         |
|  | Estimated<br>Fair<br>Value | Unrealized<br>Loss | Number<br>of Securities | Estimated<br>Fair<br>Value  | Unrealized<br>Loss | Number<br>of Securities | Estimated<br>Fair<br>Value | Unrealized<br>Loss | Number<br>of Securities |
| Securities available for sale  |                            |                    |                         |                             |                    |                         |                            |                    |                         |
| Fixed maturities   |                            |                    |                         |                             |                    |                         |                            |                    |                         |
| Obligations of government-sponsored enterprises                          | \$ 16,550                  | \$ (191)           | 5                       | \$ 2,956                    | \$ (29)            | 1                       | \$ 19,506                  | \$ (220)           | 6                       |
| Obligations of the Commonwealth of Puerto Rico and its instrumentalities | 79,045                     | (5,230)            | 30                      | 8,932                       | (847)              | 9                       | 87,977                     | (6,077)            | 39                      |
| Municipal securities   | 2,223                      | (75)               | 2                       | 1,459                       | (41)               | 3                       | 3,682                      | (116)              | 5                       |
| Corporate bonds  | 31,324                     | (2,688)            | 22                      | 29,044                      | (4,711)            | 14                      | 60,368                     | (7,399)            | 36                      |
| Residential mortgage-backed securities                                   | 1,374                      | (2)                | 1                       | 36                          | (1)                | 1                       | 1,410                      | (3)                | 2                       |
| Collateralized mortgage obligations                                      | 5,797                      | (2,327)            | 10                      |                             |                    | 0                       | 5,797                      | (2,327)            | 10                      |
| Total fixed maturities   | 136,313                    | (10,513)           | 70                      | 42,427                      | (5,629)            | 28                      | 178,740                    | (16,142)           | 98                      |
| Equity securities  |                            |                    |                         |                             |                    |                         |                            |                    |                         |
| Common stocks  | 3,917                      | (1,106)            | 6                       | 416                         | (79)               | 1                       | 4,333                      | (1,185)            | 7                       |
| Preferred stocks   | 3,594                      | (406)              | 1                       |                             |                    | 0                       | 3,594                      | (406)              | 1                       |
| Perpetual preferred stocks   | 1,033                      | (335)              | 2                       |                             |                    | 0                       | 1,033                      | (335)              | 2                       |
| Mutual funds   | 10,027                     | (343)              | 6                       | 9,235                       | (914)              | 8                       | 19,262                     | (1,257)            | 14                      |
| Total equity securities  | 18,571                     | (2,190)            | 15                      | 9,651                       | (993)              | 9                       | 28,222                     | (3,183)            | 24                      |
| Total for securities available for sale                                  | \$ 154,884                 | \$ (12,703)        | 85                      | \$ 52,078                   | \$ (6,622)         | 37                      | \$ 206,962                 | \$ (19,325)        | 122                     |
| Securities held to maturity  |                            |                    |                         |                             |                    |                         |                            |                    |                         |
| Residential mortgage-backed securities                                   | \$                         | \$                 |                         | \$ 1,741                    | \$ (7)             | 3                       | \$ 1,741                   | \$ (7)             | 3                       |

The Company regularly monitors and evaluates the difference between the cost and estimated fair value of investments. For investments with a fair value below cost, the process includes evaluating: (1) the length of time and the extent to which the estimated fair value has been less than amortized cost for fixed maturity securities, or cost for equity securities, (2) the financial condition, near-term and long-term prospects for the issuer, including relevant industry conditions and trends, and implications of rating agency actions, (3) the Company's intent to sell or the likelihood of a required sale prior to recovery, (4) the recoverability of principal

and interest for fixed maturity securities, or cost for equity securities, and (5) other factors, as applicable. This process is not exact and further requires consideration of risks such as credit and interest rate risks. Consequently, if an investment's cost exceeds its estimated fair value solely due to changes in interest rates, other-than-temporary impairment may not be appropriate. Due to the subjective nature of the Company's analysis, along with the judgment that must be applied in the analysis, it is possible that the Company could reach a different conclusion whether or not to impair a security if it had access to additional information about the investee. Additionally, it is possible that the investee's ability to meet future contractual obligations may be different than what the Company determined during its analysis, which may lead to a different impairment conclusion in future periods. If after monitoring and analyzing impaired securities, the Company determines that a decline in the estimated fair value of any available-for-sale or held-to-maturity security below cost is other-than-temporary, the carrying amount of the security is reduced to its fair value by the credit component of the other-than-temporary impairment. The new cost basis of an impaired security is not adjusted for subsequent increases in estimated fair value. In periods subsequent to the recognition of an other-than-temporary impairment, the impaired security is accounted for as if it had been purchased on the measurement date of the impairment. For debt securities, the discount (or reduced premium) based on the new cost basis may be accreted into

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net investment income in future periods based on prospective changes in cash flow estimates, to reflect adjustments to the effective yield.

The Company's process for identifying and reviewing invested assets for other-than temporary impairments during any quarter includes the following:

Identification and evaluation of securities that have possible indications of other-than-temporary impairment, which includes an analysis of all investments with gross unrealized investments losses that represent 20% or more of cost.

Review and evaluation of any other security based on the investee's current financial condition, liquidity, near-term recovery prospects, implications of rating agency actions, the outlook for the business sectors in which the investee operates and other factors. This evaluation is in addition to the evaluation of those securities with a gross unrealized investment loss representing 20% or more of cost.

Consideration of evidential matter, including an evaluation of factors or triggers that may or may not cause individual investments to qualify as having other-than-temporary impairments; and

Determination of the status of each analyzed security as other-than-temporary or not, with documentation of the rationale for the decision.

The Company continues to review the investment portfolios under the Company's impairment review policy. Given the current market conditions and the significant judgments involved, there is a continuing risk that further declines in fair value may occur and additional material other-than-temporary impairments may be recorded in future periods.

*Obligations of Government-sponsored Enterprises, U.S. Treasury Securities and Obligations of U.S. Government Instrumentalities, Obligations of States of the United States and Political Subdivisions of the States, and Obligations of the Commonwealth of Puerto Rico and its Instrumentalities:* The unrealized losses on the Company's investments in obligations of government-sponsored enterprises, U.S. Treasury securities and obligations of U.S. government instrumentalities, obligations of states of the United States and political subdivisions of the states, and in obligations of the Commonwealth of Puerto Rico and its instrumentalities were mainly caused by fluctuations in interest rate and general market conditions. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the par value of the investment. In addition, most of these investments have investment grade ratings. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does to intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, and because the Company expects to collect all contractual cash flows, these investments are not considered other-than-temporarily impaired.

*Corporate Bonds:* The unrealized losses of these bonds were principally caused by fluctuations in interest rates and general market conditions. The estimated fair value of these corporate bonds has improved during 2009. In addition, except for one position, these corporate bonds have investment grade ratings. Because the decline in estimated fair value is principally attributable to changes in interest rate, the Company does not intend to sell the investments and it is not more likely than not that he Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, and because the Company expects to collect all contractual cash flows, these investments are not considered other-than-temporarily impaired.

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*Residential Mortgage-Backed Securities and Collateralized Mortgage Obligations:* The unrealized losses on investments in residential mortgage-backed securities and collateralized mortgage obligations were caused by fluctuations in interest rates. The contractual cash flows of these securities, other than private CMOs, are guaranteed by a U.S. government-sponsored enterprise. The Company also has investments in private CMOs. Any loss in these securities is determined according to the seniority level of each tranche, with the least senior (or most junior), typically the unrated residual tranche, taking any initial loss. The investment grade credit rating of our securities reflects the seniority of the securities that the Company owns. Because the decline in fair value is attributable to changes in interest rates and not credit quality, the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, and because the Company expects to collect all contractual cash flows, these investments are not considered other-than-temporarily impaired.

*Preferred Stocks:* Because the estimated fair value of this investment has experienced a significant improvement in market value during the past year, the issuer's capital ratios are above regulatory levels, this particular instrument has a specified maturity, the issuer has continued dividend payments on this instrument and in all of its outstanding debt instruments, the issuer does not have the ability to call the security at a price lower than its stated value, the Company expects to collect all contractual cash flows, the Company does not have the intent to sell the investment, and it is not more likely than not that the Company will be required to sell the investment before market price recovery or maturity, this investments is not considered other-than-temporarily impaired.

*Perpetual Preferred Stocks:* Because this security has experienced a significant improvement during the past year, the issuers' capital ratios are above regulatory levels, analyst target price is above market price and book value as of December 31, 2009, the Company does not have the intent to sell the investment, and the Company has the intent and ability to hold the investments until a market price recovery, these investments are not considered other-than-temporarily impaired.

*Mutual Funds:* The unrealized losses in the Company's investment in mutual funds are in several mutual funds that in turn invested in fixed income securities. The unrealized loss of each position represents between 4% and 14% of its book value. To better understand the funds, the Company evaluated the invested assets that compose the funds, which are mostly fixed income obligations of the Puerto Rico and U.S. government or its agencies. As these mutual funds are invested in fixed income securities, they are susceptible to fluctuations in interest rates as well as supply and demand. In recent months there has been a very strong recovery in Puerto Rico obligations. However, the mutual funds did not follow this performance because there have been many sellers and few buyers, combined with poor liquidity. This relative underperformance versus Puerto Rico obligations has brought the market price of the funds closer to their net asset value, rather than trading at a premium. However, given the quality of the securities within the funds, the market value is expected to improve in line with an increase in demand for fixed income securities. Because the current valuations are close to the funds' underlying assets, the funds' underlying assets are mostly on investment grade fixed income securities (mostly U.S. and Puerto Rico government and its agencies, which have been affected by general market conditions), the Company does not have the intent to sell the investment, and the Company has the ability to hold the investments until a market price recovery, these investments are not considered other-than-temporarily impaired.



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Maturities of investment securities classified as available for sale and held to maturity were as follows at December 31, 2009:

|  | <b>Amortized<br/>Cost</b> | <b>Estimated<br/>Fair Value</b> |
|--|---------------------------|---------------------------------|
| <b>Securities available for sale</b>   |                           |                                 |
| Due in one year or less                | \$ 13,800                 | \$ 14,172                       |
| Due after one year through five years  | 122,706                   | 126,690                         |
| Due after five years through ten years | 190,032                   | 193,183                         |
| Due after ten years                    | 338,907                   | 336,741                         |
| Residential mortgage-backed securities | 16,605                    | 17,281                          |
| Collateralized mortgage obligations    | 229,312                   | 230,910                         |
|  | <b>\$ 911,362</b>         | <b>\$ 918,977</b>               |
| <b>Securities held to maturity</b>     |                           |                                 |
| Due in one year or less                | \$ 10,752                 | \$ 11,291                       |
| Due after one year through five years  | 510                       | 524                             |
| Due after five years through ten years | 1,793                     | 1,800                           |
| Due after ten years                    | 1,483                     | 1,595                           |
| Residential mortgage-backed securities | 1,256                     | 1,280                           |
|  | <b>\$ 15,794</b>          | <b>\$ 16,490</b>                |

Expected maturities may differ from contractual maturities because some issuers have the right to call or prepay obligations with or without call or prepayment penalties.

Investments with an amortized cost of \$4,642 and \$5,356 (fair value of \$4,758 and \$5,602) at December 31, 2009 and 2008, respectively, were deposited with the Commissioner of Insurance to comply with the deposit requirements of the Insurance Code of the Commonwealth of Puerto Rico (the Insurance Code). Investment with an amortized cost of \$577 and \$554 (fair value of \$577 and \$554) at December 31, 2009 and 2008, respectively, were deposited with the Commissioner of Insurance of the Government of the U.S. Virgin Islands.

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Information regarding realized and unrealized gains and losses from investments for the years ended December 31, 2009, 2008, and 2007 is as follows:

|  | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|-------------|
| <b>Realized gains (losses)</b>                     |             |             |             |
| Fixed maturity securities                          |             |             |             |
| Securities available for sale                      |             |             |             |
| Gross gains from sales                             | \$ 5,323    | \$ 1,876    | \$ 1,208    |
| Gross losses from sales                            | (3)         | (225)       | (1,797)     |
| Gross losses from other-than-temporary impairments | (1,712)     | (3,872)     |             |
| Total debt securities                              | 3,608       | (2,221)     | (589)       |
| Equity securities                                  |             |             |             |
| Trading securities:                                |             |             |             |
| Gross gains from sales                             | 717         | 3,358       | 8,873       |
| Gross losses from sales                            | (1,381)     | (3,160)     | (1,558)     |
|  | (664)       | 198         | 7,315       |
| Securities available for sale                      |             |             |             |
| Gross gains from sales                             | 3,468       | 881         | 292         |
| Gross losses from sales                            | (391)       | (176)       |             |
| Gross losses from other-than-temporary impairments | (5,407)     | (12,622)    | (1,087)     |
|  | (2,330)     | (11,917)    | (795)       |
| Total equity securities                            | (2,994)     | (11,719)    | 6,520       |
| Net realized gains (losses) on securities          | \$ 614      | \$ (13,940) | \$ 5,931    |

The other-than-temporary impairments on fixed maturity securities are attributable to credit losses.

|  | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|-------------|
| <b>Changes in unrealized gains (losses)</b>        |             |             |             |
| Recognized in income                               |             |             |             |
| Equity securities trading                          | \$ 10,497   | \$ (21,064) | \$ (4,116)  |
| Recognized in accumulated other comprehensive loss |             |             |             |
| Fixed maturities available for sale                | (406)       | 928         | 18,640      |
| Equity securities available for sale               | 4,583       | (5,734)     | (7,251)     |
|  | \$ 4,177    | \$ (4,806)  | \$ 11,389   |

Not recognized in the consolidated financial statements

|                  |                  |    |          |          |          |
|------------------|------------------|----|----------|----------|----------|
| Fixed maturities | held to maturity |    | \$ (614) | \$ 1,152 | \$ 1,266 |
|                  |                  | 28 |          |          |          |

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The deferred tax liability (asset) on unrealized gains and (losses) recognized in accumulated other comprehensive income during the years 2009, 2008, and 2007 aggregated \$(638), \$854 and \$1,840, respectively.

As of December 31, 2009 and 2008, no individual investment in securities exceeded 10% of stockholders' equity.

**4. Net Investment Income**

Components of net investment income were as follows:

|  | <b>Years ended December 31</b> |                  |                  |
|--|--------------------------------|------------------|------------------|
|  | <b>2009</b>                    | <b>2008</b>      | <b>2007</b>      |
| Fixed maturities                               | \$ 46,285                      | \$ 48,197        | \$ 37,205        |
| Equity securities                              | 4,077                          | 5,451            | 5,271            |
| Policy loans                                   | 411                            | 387              | 394              |
| Cash equivalents and interest-bearing deposits | 577                            | 1,003            | 2,187            |
| Other  | 786                            | 1,215            | 2,137            |
| <b>Total</b>                                   | <b>\$ 52,136</b>               | <b>\$ 56,253</b> | <b>\$ 47,194</b> |

**5. Premium and Other Receivables, Net**

Premium and other receivables, net as of December 31 were as follows:

|   | <b>2009</b>       | <b>2008</b>       |
|---|-------------------|-------------------|
| Premium                                   | \$ 98,429         | \$ 90,315         |
| Self-funded group receivables             | 70,315            | 35,749            |
| FEHBP                                     | 10,297            | 9,600             |
| Agent balances                            | 37,888            | 38,491            |
| Accrued interest                          | 9,287             | 11,802            |
| Reinsurance recoverable                   | 43,951            | 42,181            |
| Other                                     | 27,999            | 23,765            |
|   | <b>298,166</b>    | <b>251,903</b>    |
| Less allowance for doubtful receivables:  |                   |                   |
| Premium                                   | 20,280            | 10,467            |
| Other                                     | 4,954             | 4,278             |
|   | <b>25,234</b>     | <b>14,745</b>     |
| <b>Premium and other receivables, net</b> | <b>\$ 272,932</b> | <b>\$ 237,158</b> |

**6. Deferred Policy Acquisition Costs and Value of Business Acquired**

The movement of deferred policy acquisition costs (DPAC) and value of business acquired (VOBA) for the years ended December 31, 2009, 2008, and 2007 is summarized as follows:

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|   | <b>DPAC</b> | <b>VOBA</b> | <b>Total</b> |
|---|-------------|-------------|--------------|
| <b>Balance, December 31, 2006</b>         | \$ 38,825   | \$ 72,592   | \$ 111,417   |
| Additions                                 | 46,898      |             | 46,898       |
| VOBA interest at an average rate of 5.27% |             | 3,874       | 3,874        |
| Amortization                              | (32,508)    | (12,442)    | (44,950)     |
| Net change                                | 14,390      | (8,568)     | 5,822        |
| <b>Balance, December 31, 2007</b>         | 53,215      | 64,024      | 117,239      |
| Additions                                 | 49,470      |             | 49,470       |
| VOBA interest at an average rate of 5.40% |             | 3,425       | 3,425        |
| Amortization                              | (33,442)    | (10,345)    | (43,787)     |
| Net change                                | 16,028      | (6,920)     | 9,108        |
| <b>Balance, December 31, 2008</b>         | 69,243      | 57,104      | 126,347      |
| Additions                                 | 55,632      |             | 55,632       |
| VOBA interest at an average rate of 5.29% |             | 3,066       | 3,066        |
| Amortization                              | (35,923)    | (9,205)     | (45,128)     |
| Net change                                | 19,709      | (6,139)     | 13,570       |
| <b>Balance, December 31, 2009</b>         | \$ 88,952   | \$ 50,965   | \$ 139,917   |

The amortization expense of the deferred policy acquisition costs and value of business acquired is included within the operating expenses in the accompanying consolidated statement of earnings.

The estimated amount of the year-end VOBA balance expected to be amortized during the next five years is as follows:

Year ending December 31:

|      |          |
|------|----------|
| 2010 | \$ 8,239 |
| 2011 | 7,397    |
| 2012 | 6,607    |
| 2013 | 5,808    |
| 2014 | 5,159    |

**7. Property and Equipment, Net**

Property and equipment, net as of December 31 are composed of the following:

|                                      | <b>2009</b> | <b>2008</b> |
|--------------------------------------|-------------|-------------|
| Land                                 | \$ 7,309    | \$ 6,531    |
| Buildings and leasehold improvements | 45,034      | 44,791      |

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|  |           |           |
|--|-----------|-----------|
| Office furniture and equipment                 | 16,821    | 16,208    |
| Computer equipment and software                | 69,652    | 56,482    |
| Automobiles                                    | 513       | 461       |
|  | 139,329   | 124,473   |
| Less accumulated depreciation and amortization | 70,526    | 66,025    |
| Property and equipment, net                    | \$ 68,803 | \$ 58,448 |

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**8. Acquired Intangible Asset**

On July 1, 2009, the Company, through TSS, closed an Asset Purchase Agreement (the Agreement) to acquire certain managed care assets of La Cruz Azúl de Puerto Rico, Inc. (LCA) in Puerto Rico and the U.S. Virgin Islands on such date, generating an intangible asset. Such intangible asset, net as of December 31, 2009 amounted to \$5.6 million and is included within other assets in the accompanying consolidated balance sheets. The estimated weighted average useful life is 4 years. Amortization expense recorded during 2009 amounted to \$1.3 million. The Company may be required to make additional payments depending upon certain conditions as defined in the Agreement, which would have the effect of increasing the intangible asset.

**9. Fair Value Measurements**

Assets recorded at fair value in the consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Level inputs are as follows:

**Level Input: Input Definition:**

Level 1 Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.

Level 2 Inputs other than quoted prices included in Level 1 that are observable for the asset or liability through corroboration with market data at the measurement date.

Level 3 Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The Company uses observable inputs when available. Fair value is based upon quoted market prices when available. If market prices are not available, the Company employs internally-developed models that primarily use market-based inputs including yield curves, interest rates, volatilities, and credit curves, among others. The Company limits valuation adjustments to those deemed necessary to ensure that the security or derivative's fair value adequately represents the price that would be received or paid in the marketplace. Valuation adjustments may include consideration of counterparty credit quality and liquidity as well as other criteria. The estimated fair value amounts are subjective in nature and may involve uncertainties and matters of significant judgment for certain financial instruments. Changes in the underlying assumptions used in estimating fair value could affect the results. The fair value measurement levels are not indicative of risk of investment.

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The following table summarizes fair value measurements by level at December 31, 2009 and 2008 for assets measured at fair value on a recurring basis:

|   | <b>2009</b>    |                |                |              |
|---|----------------|----------------|----------------|--------------|
|   | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
| Equity securities held for trading  | \$ 43,909      | \$             | \$             | \$ 43,909    |
| Securities available for sale   |                |                |                |              |
| Fixed maturity securities   | 51,339         | 867,638        |                | 918,977      |
| Equity securities   | 19,724         | 44,190         | 775            | 64,689       |
| Derivatives (reported within other assets in the consolidated balance sheets) |                | 1,608          |                | 1,608        |
|   | \$ 114,972     | \$ 913,436     | \$ 775         | \$ 1,029,183 |
|   |                |                |                |              |
|   | <b>2008</b>    |                |                |              |
|   | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
| Equity securities held for trading  | \$ 32,184      | \$             | \$             | \$ 32,184    |
| Securities available for sale   |                |                |                |              |
| Fixed maturity securities   | 89,985         | 796,418        | 1,281          | 887,684      |
| Equity securities   | 18,953         | 48,590         | 1,086          | 68,629       |
| Derivatives (reported within other assets in the consolidated balance sheets) |                | 1,674          |                | 1,674        |
|   | \$ 141,122     | \$ 846,682     | \$ 2,367       | \$ 990,171   |

A reconciliation of the beginning and ending balances of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2009 and 2008 is as follows:

|  | <b>Fixed<br/>Maturity<br/>Securities</b> | <b>Equity<br/>Securities</b> | <b>Total</b> |
|--|--|------------------------------|--------------|
| <b>Beginning balance December 31, 2007</b>           | \$ 4,280                                 | \$ 989                       | \$ 5,269     |
| Total gains or (losses)                              |  |                              |              |
| Realized in earnings                                 | (3,883)                                  |                              | (3,883)      |
| Unrealized in other accumulated comprehensive income | 884                                      | 97                           | 981          |
| <b>Ending balance December 31, 2008</b>              | \$ 1,281                                 | \$ 1,086                     | \$ 2,367     |
| Total losses realized in earnings                    | (1,281)                                  |                              | (1,281)      |
| Sales  |  | (1,086)                      | (1,086)      |
| Transfers in to Level 3                              |  | 775                          | 775          |
| <b>Ending balance December 31, 2009</b>              | \$                                       | \$ 775                       | \$ 775       |



Realized gains or losses on Level 3 investments are included within net realized gains, excluding other-than-temporary impairment losses on securities in the consolidated statements of earnings.

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**10. Claim Liabilities**

The activity in claim liabilities during 2009, 2008, and 2007 is as follows:

|   | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|-------------|
| Claim liabilities at beginning of year          | \$ 323,710  | \$ 353,830  | \$ 314,682  |
| Reinsurance recoverable on claim liabilities    | (30,432)    | (54,834)    | (32,066)    |
| Net claim liabilities at beginning of year      | 293,278     | 298,996     | 282,616     |
| Claims incurred                                 |             |             |             |
| Current period insured events                   | 1,601,802   | 1,432,843   | 1,241,866   |
| Prior period insured events                     | (1,887)     | (9,918)     | (31,007)    |
| Total   | 1,599,915   | 1,422,925   | 1,210,859   |
| Payments of losses and loss-adjustment expenses |             |             |             |
| Current period insured events                   | 1,316,292   | 1,195,414   | 1,004,346   |
| Prior period insured events                     | 247,167     | 233,229     | 190,133     |
| Total   | 1,563,459   | 1,428,643   | 1,194,479   |
| Net claim liabilities at end of year            | 329,734     | 293,278     | 298,996     |
| Reinsurance recoverable on claim liabilities    | 30,712      | 30,432      | 54,834      |
| Claim liabilities at end of year                | \$ 360,446  | \$ 323,710  | \$ 353,830  |

As a result of differences between actual amounts and estimates of insured events in prior years, the amounts included as incurred claims for prior period insured events differ from anticipated claims incurred.

The credits in the claims incurred and loss-adjustment expenses for prior period insured events for 2009, 2008 and 2007 are due primarily to better than expected utilization trends. Reinsurance recoverable on unpaid claims is reported as premium and other receivables, net in the accompanying consolidated financial statements.

The claims incurred disclosed in this table exclude the change in the liability for future policy benefits amounting to \$12,945, \$11,989 and \$12,916 during the years ended December 31, 2009, 2008 and 2007, respectively.

**11. Federal Employees Health Benefits Program (FEHBP)**

TSS entered into a contract, renewable annually, with the Office of Personnel Management (OPM) as authorized by the Federal Employees Health Benefits Act of 1959, as amended, to provide health benefits under the FEHBP. The FEHBP covers postal and federal employees residing in the Commonwealth of Puerto Rico and the United States Virgin Islands as well as retirees and eligible dependents. The FEHBP is financed through a negotiated contribution made by the federal government and employees payroll deductions.

The accounting policies for the FEHBP are the same as those described in the Company's summary of significant accounting policies. Premium rates are determined annually by TSS and approved by the federal government. Claims are paid to providers based on the guidelines determined by the federal government. Operating expenses are allocated from TSS's operations

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to the FEHBP based on applicable allocation guidelines (such as, the number of claims processed for each program). The operations of the FEHBP do not result in any excess or deficiency of revenue or expense as this program has a special account available to compensate any excess or deficiency on its operations to the benefit or detriment of the federal government. Any transfer to/from the special account necessary to cover any excess or deficiency in the operations of the FEHBP is recorded as a reduction/increment to the premiums earned. The contract with OPM provides that the cumulative excess of the FEHBP earned income over health benefits charges and expenses represents a restricted fund balance denoted as the special account. Upon termination of the contract and satisfaction of all the FEHBP's obligations, any unused remainder of the special reserve would revert to the Federal Employees Health Benefit Fund. In the event that the contract terminates and the special reserve is not sufficient to meet the FEHBP's obligations, the FEHBP contingency reserve will be used to meet such obligations. If the contingency reserve is not sufficient to meet such obligations, the Company is at risk for the amount not covered by the contingency reserve. The contract with OPM allows for the payment to the Company of service fees as negotiated between TSS and OPM. Service fees, which are included within the other income, net in the accompanying consolidated statements of earnings, amounted to \$988, \$931, and \$895, respectively, for each of the years in the three-year period ended December 31, 2009.

The Company also has funds available related to the FEHBP amounting to \$22,797 and \$20,055 as of December 31, 2009 and 2008, respectively and are included within the cash and cash equivalents in the accompanying consolidated balance sheets. Such funds must only be used to cover health benefits charges, administrative expenses and service charges required by the FEHBP.

A contingency reserve is maintained by the OPM at the U.S. Treasury, and is available to the Company under certain conditions as specified in government regulations. Accordingly, such reserve is not reflected in the accompanying consolidated balance sheets. The balance of such reserve as of December 31, 2009 and 2008 was \$20,483 and \$23,365, respectively. The Company received \$6,343, \$2,540, and \$5,512, of payments made from the contingency reserve fund of OPM during 2009, 2008, and 2007, respectively.

The claim payments and operating expenses charged to the FEHBP are subject to audit by the U.S. government. Management is of the opinion that an adjustment, if any, resulting from such audits will not have a significant effect on the accompanying financial statements. The claim payments and operating expenses reimbursed in connection with the FEHBP have been audited through 2004 by OPM.

**12. Borrowings**

A summary of the borrowings entered by the Company at December 31, 2009 and 2008 is as follows:

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|  | <b>2009</b> | <b>2008</b> |
|--|-------------|-------------|
| Senior unsecured notes payable of \$50,000 issued on September 2004; due September 2019. Interest is payable semiannually at a fixed rate of 6.30%.  | \$ 50,000   | \$ 50,000   |
| Senior unsecured notes payable of \$60,000 issued on December 2005; due December 2020. Interest is payable monthly at a fixed rate of 6.60%.   | 60,000      | 60,000      |
| Senior unsecured notes payable of \$35,000 issued on January 2006; due January 2021. Interest is payable monthly at a fixed rate of 6.70%.   | 35,000      | 35,000      |
| Secured loan payable of \$41,000, payable in monthly installments of \$137 through July 1, 2024, plus interest at a rate reset periodically of 100 basis points over selected LIBOR maturity (which was 1.28% and 2.43% at December 31, 2009, and 2008, respectively). | 22,667      | 24,307      |
| Total borrowings   | \$ 167,667  | \$ 169,307  |

Aggregate maturities of the Company's borrowings as of December 31, 2009 are summarized as follows:

**Year ending December 31**

|            |            |
|------------|------------|
| 2010       | \$ 1,640   |
| 2011       | 1,640      |
| 2012       | 1,640      |
| 2013       | 1,640      |
| 2014       | 1,640      |
| Thereafter | 159,467    |
|            | \$ 167,667 |

All of the Company's senior notes may be prepaid at par, in total or partially, five years after issuance as determined by the Company. The Company's senior unsecured notes contain certain non-financial covenants with which TSS and the Company have complied with at December 31, 2009.

Debt issuance costs related to each of the Company's senior unsecured notes were deferred and are being amortized over the term of its respective senior note. Unamortized debt issuance costs related to these senior unsecured notes as of December 31, 2009 and 2008 amounted to \$1,041 and \$1,140, respectively and are included within other assets in the accompanying consolidated balance sheets.

The secured loan payable previously described is guaranteed by a first position held by the bank on the Company's land, building, and substantially all leasehold improvements, as collateral for the term of the loan under a continuing general security agreement. This secured loan contains certain non-financial covenants, which are customary for this type of facility, including but not limited to,

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restrictions on the granting of certain liens, limitations on acquisitions and limitations on changes in control. Interest expense on the above borrowings amounted to \$9,870, \$10,451, and \$11,565, for the years ended December 31, 2009, 2008, and 2007, respectively.

**13. Derivative Instruments and Hedging Activities**

By using derivative financial instruments the Company exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty is obligated to the Company, which creates credit risk for the Company. When the fair value of a derivative contract is negative, the Company owes the counterparty and, therefore, it does not possess credit risk. The Company minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties.

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates, currency exchange rates, commodity prices, or market indexes. The market risk associated with derivative instruments is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

The Company has invested in certain derivative instruments in order to diversify its investment in securities and participate in the foreign stock market.

During 2005 the Company invested in two structured note agreements amounting to \$5,000 each, maturing in May 25, 2012, where the interest income received is linked to the performance of the Dow Jones Euro STOXX 50 and Nikkei 225 Equity Indexes (the Indexes). Under these agreements the principal invested by the Company is protected, the only amount that varies according to the performance of the Indexes is the interest to be received upon the maturity of the instruments. Should the Indexes experience a negative performance during the holding period of the structured notes, no interest will be received. The contingent interest payment component within the structured note agreements meets the definition of an embedded derivative. In accordance with the provisions of current ASC, the embedded derivative component of the structured notes is separated from the structured notes and accounted for separately as a derivative instrument.

The changes in the fair value of the embedded derivative component are recorded as gains or losses in earnings in the period of change. During the years ended December 31, 2009, 2008 and 2007 the Company recorded a loss associated with the change in the fair value of this derivative component of \$66, \$4,658 and \$45, respectively. The change in the fair value of the embedded derivative component is included within the other income, net in the accompanying consolidated statement of earnings.

As of December 31, 2009 and 2008, the fair value of the derivative component of the structured notes amounted to \$1,608 and \$1,674, respectively, and is included within the Company's other assets in the accompanying consolidated balance sheets. The investment component of the structured notes is accounted for as held-to-maturity debt securities and is included within the investment in securities in the accompanying consolidated balance sheets. As of December 31, 2009 the fair value and amortized cost of the investment component of both structured notes amounted to \$9,597 and \$9,063, respectively. As of December 31, 2008 the fair value and

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amortized cost of the investment component of both structured notes amounted to \$9,396 and \$8,698, respectively.

**14. Agency Contract and Expense Reimbursement**

TSS processed and paid claims as fiscal intermediary for the Medicare Part B Program until February 2009, the contract termination date. TSS was reimbursed for administrative expenses incurred in performing this service. For the years ended December 31, 2009, 2008, and 2007, TSS was reimbursed by \$1,842, \$8,678, and \$10,783, respectively, for such services, which are deducted from operating expenses in the accompanying consolidated statements of earnings.

The operating expense reimbursements in connection with processing Medicare claims have been audited through 2005 by federal government representatives. Management is of the opinion that no significant adjustments will be made affecting cost reimbursements through December 31, 2009.

On September 12, 2008, the Centers for Medicare and Medicaid Services (CMS) announced that First Coast Service Options (FCSO), a non-affiliated third party organization based in Jacksonville, Florida, was awarded the Medicare Administrative Contract (MAC) for Jurisdiction 9 (Florida, Puerto Rico and the U.S. Virgin Islands). FCSO proposed TSS as a subcontractor in MAC Jurisdiction 9 to perform certain provider customer service functions, subject to terms and conditions negotiated between FCSO and TSS. Pursuant to this, TSS was reimbursed \$2,650 for performing the customer service functions during the year ended December 31, 2009.

**15. Reinsurance Activity**

The effect of reinsurance on premiums earned and claims incurred is as follows:

|                  | Premiums Earned |              |              | Claims Incurred <sup>(1)</sup> |              |              |
|------------------|-----------------|--------------|--------------|--------------------------------|--------------|--------------|
|                  | 2009            | 2008         | 2007         | 2009                           | 2008         | 2007         |
| Premiums written | \$ 1,957,085    | \$ 1,780,765 | \$ 1,564,873 | \$ 1,618,663                   | \$ 1,443,046 | \$ 1,249,554 |
| Premiums ceded   | (81,013)        | (85,308)     | (81,325)     | (18,748)                       | (20,121)     | (38,695)     |
|                  | \$ 1,876,072    | \$ 1,695,457 | \$ 1,483,548 | \$ 1,599,915                   | \$ 1,422,925 | \$ 1,210,859 |

(1) The claims incurred disclosed in this table exclude the change in the liability for future policy benefits amounting to \$12,945, \$11,989 and \$12,916 during the years ended December 31,

2009, 2008 and  
2007,  
respectively.

TSS, TSP and TSV, in accordance with general industry practices, annually purchase reinsurance to protect them from the impact of large unforeseen losses and prevent sudden and unpredictable changes in net income and stockholders' equity of the Company. Reinsurance contracts do not relieve any of the subsidiaries from their obligations to policyholders. In the event that all or any of the reinsuring companies might be unable to meet their obligations under existing reinsurance agreements, the subsidiaries would be liable for such defaulted amounts. During 2009, 2008 and 2007 TSP placed 13.53%, 11.84% and 10.92% of its reinsurance business with one reinsurance company.

TSS has two excess of loss reinsurance treaties whereby it cedes a portion of its premiums to third parties. Reinsurance contracts are primarily for periods of one year, and are subject to modifications and negotiations in each renewal date. Premiums ceded under these contracts amounted to \$7,341, \$5,623 and \$3,349 in 2009, 2008 and 2007, respectively. Claims ceded

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amounted to \$3,870, \$8,407 and \$2,957 in 2009, 2008 and 2007, respectively. Principal reinsurance agreements are as follows:

Organ transplant excess of loss treaty covering 100% of the claims up to a maximum of \$1,000 per person, per life.

Routine medical care excess of loss treaty covering 100% of claims from the amount of \$100 and up to a maximum of \$900 per covered person, per contract year.

TSP has a number of pro rata and excess of loss reinsurance treaties whereby the subsidiary retains for its own account all loss payments for each occurrence that does not exceed the stated amount in the agreements and a catastrophe cover, whereby it protects itself from a loss or disaster of a catastrophic nature. Under these treaties, TSP ceded premiums of \$67,541, \$72,115, and \$69,137, in 2009, 2008, and 2007, respectively.

Reinsurance cessions are made on excess of loss and on a proportional basis. Principal reinsurance agreements are as follows:

Property quota share treaty covering for a maximum of \$20,000 for any one risk. Under this treaty 35% of the risk is ceded to reinsurers. The remaining exposure is covered by a property per risk excess of loss treaty that provides reinsurance in excess of \$500 up to a maximum of \$10,000, or the remaining 65% for any one risk. In addition, TSP has an additional property catastrophe excess of loss contract that provides protection for losses in excess of \$5,000 resulting from any catastrophe, subject to a maximum loss of \$10,000.

Personal property catastrophe excess of loss. This treaty provides protection for losses in excess of \$5,000 resulting from any catastrophe, subject to a maximum loss of \$80,000.

Commercial property catastrophe excess of loss. This treaty provides protection for losses in excess of \$5,000 resulting from any catastrophe, subject to a maximum loss of \$205,000.

Property catastrophe excess of loss. This treaty provides protection for \$185,000 in excess of \$80,000 and \$205,000 with respect to personal and commercial lines, respectively, resulting from any catastrophe, subject to a maximum loss of \$157,500 in respect of the ceded portion of the Commercial Lines Quota Share.

Personal lines quota share. This treaty provides protection of 4.5% on all ground-up losses, subject to a limit of \$1,000 for any one risk.

Reinstatement premium protection. This treaty provides a maximum limit of approximately \$5,000 for personal lines and \$13,800 in commercial lines to cover the necessity of reinstating the catastrophe program in the event it is activated.

Casualty excess of loss treaty. This treaty provides reinsurance for losses in excess of \$225 up to a maximum of \$12,000.

Medical malpractice excess of loss. This treaty provides reinsurance in excess of \$150 up to a maximum of \$1,500 per incident.



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Builders risk quota share and first surplus covering contractors risk. This treaty provides protection on a 20/80 quota share basis for the initial \$2,500 and a first surplus of \$10,000 for a maximum of \$12,000 for any one risk.

Surety quota share treaty covering contract and miscellaneous surety bond business. This treaty provides reinsurance of up to \$5,000 for contract surety bonds, subject to an aggregate of \$10,000 per contractor and \$3,000 per miscellaneous surety bond.

Facultative reinsurance is obtained when coverage per risk is required. During the year 2007 the ceded claims incurred of TSP include approximately \$23.4 million related to one policy ceded under a facultative reinsurance treaty. No individually significant policies were ceded during the years 2009 and 2008. All principal reinsurance contracts are for a period of one year, on a calendar basis, and are subject to modifications and negotiations in each renewal.

The ceded unearned reinsurance premiums on TSP arising from these reinsurance transactions amounted to \$16,746 and \$20,357 at December 31, 2009 and 2008, respectively, and are reported as other assets in the accompanying consolidated balance sheets.

TSV also cedes insurance with various reinsurance companies under a number of pro rata, excess of loss and catastrophe treaties. Under these treaties, TSV ceded premiums of \$6,131, \$7,570, and \$8,839, in 2009, 2008, and 2007, respectively. Principal reinsurance agreements are as follows:

Group life pro rata agreement, reinsuring 50% of the risk up to \$250 on the life of any participating individual of certain groups insured. This contract was cancelled on June 30, 2009.

Group life insurance facultative agreement, reinsuring risk in excess of \$25 of certain group life policies and a combined pro rata and excess of loss agreement effective July 1, 2008, reinsuring 50% of the risk up to \$200 and ceding the excess.

Group life insurance facultative excess of loss agreements in which TSV retains a portion of the losses on the life of any participating individual of certain groups insured. Any excess will be recovered from the reinsurer. This agreement provides for various retentions (\$25, \$50 and \$75) of the losses.

Facultative pro rata agreements for the long-term disability insurance, reinsuring 65% of the risk.

Accidental death catastrophic reinsurance covering each and every accident arising out of one event or occurrence resulting in the death or dismemberment of five or more persons. The retention for each event is \$250 with a maximum of \$1,000 for each event and \$2,000 per year.

Several reinsurance agreements, mostly on an excess of loss basis up to a maximum retention of \$50. For certain new life products that have been issued after 1999, the retention limit is \$175.

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**16. Income Taxes**

Under Puerto Rico income tax law, the Company is not allowed to file consolidated tax returns with its subsidiaries. The Company and its subsidiaries are subject to Puerto Rico income taxes. The Company's insurance subsidiaries are also subject to U.S. federal income taxes for foreign source dividend income. As of December 31, 2009, tax years 2004 through 2009 of the Company and its subsidiaries are subject to examination by Puerto Rico taxing authorities.

TSS and TSP are taxed essentially the same as other corporations, with taxable income primarily determined on the basis of the statutory annual statements filed with the insurance regulatory authorities. Also, operations are subject to an alternative minimum income tax, which is calculated based on the formula established by existing tax laws. Any alternative minimum income tax paid may be used as a credit against the excess, if any, of regular income tax over the alternative minimum income tax in future years.

TSV operates as a qualified domestic life insurance company and is subject to the alternative minimum tax and taxes on its capital gains.

Federal income taxes recognized by the Company's insurance subsidiaries amounted to approximately \$125, \$112, and \$164, in 2009, 2008, and 2007, respectively.

TSM, TC, and ISI are subject to Puerto Rico income taxes as a regular corporation, as defined in the P.R. Internal Revenue Code, as amended.

On July 10, 2009 the Governor of Puerto Rico signed into law Puerto Rico's Act No. 37, which requires certain corporations to pay a 5% additional special tax over the tax obligation through December 31, 2011. The effective tax rate includes the additional special tax, as enacted.

The income tax expense differs from the amount computed by applying the Puerto Rico statutory income tax rate to the income before income taxes as a result of the following:

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|   | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|-------------|
| Income before taxes   | \$ 83,651   | \$ 31,944   | \$ 72,645   |
| Statutory tax rate  | 40.95%      | 39.0%       | 39.0%       |
| <br>  |             |             |             |
| Income tax expense at statutory rate  | 34,255      | 12,458      | 28,332      |
| <br>  |             |             |             |
| Increase (decrease) in taxes resulting from   |             |             |             |
| Exempt interest income  | (13,201)    | (13,561)    | (9,990)     |
| Effect of taxing life insurance operations as a qualified domestic life insurance company instead of as a regular corporation | (4,759)     | (1,336)     | (1,115)     |
| Effect of using earnings under statutory accounting principles instead of GAAP for TSS and TSP                                | (3,089)     | 6,406       | 371         |
| Effect of taxing capital gains at a preferential rate   | 446         | (237)       | (1,406)     |
| Dividends received deduction  | (262)       | (810)       | (821)       |
| Other permanent disallowances, net:   |             |             |             |
| Effect of capital gains preferential rate on impairments  | 1,385       | 2,916       | 140         |
| Disallowance of expenses related to exempt interest income  | 871         | 1,792       | 603         |
| Disallowed interest expense   | 730         | 1,014       | 1,086       |
| Other   | 1,404       | (158)       | 600         |
| <br>  |             |             |             |
| Total other permanent differences   | 4,151       | 5,564       | 2,429       |
| <br>  |             |             |             |
| Adjustment to deferred tax assets and liabilities for changes in effective tax rates  | (239)       |             | (2,131)     |
| Other adjustments to deferred tax assets and liabilities  | (771)       | (300)       | (423)       |
| Tax credit benefit  | (2,386)     | (1,286)     |             |
| Other   | 487         | 256         | (1,119)     |
| <br>  |             |             |             |
| Total income tax expense  | \$ 14,871   | \$ 7,154    | \$ 14,127   |

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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 net deferred tax asset at December 31, 2009 and 2008 of the Company and its subsidiaries is composed of the following:

|  | <b>2009</b> | <b>2008</b> |
|--|-------------|-------------|
| <b>Deferred tax assets</b>                       |             |             |
| Allowance for doubtful receivables               | \$ 9,869    | \$ 5,325    |
| Liability for pension benefits                   | 13,161      | 14,681      |
| Employee benefits plan                           | 3,142       | 4,214       |
| Postretirement benefits                          | 1,668       | 1,454       |
| Deferred compensation                            | 1,952       | 1,661       |
| Accumulated depreciation                         | 312         | 334         |
| Impairment loss on investments                   | 3,654       | 2,816       |
| Contingency reserves                             | 214         |             |
| Share-based compensation                         | 592         |             |
| Unrealized loss on trading securities            |             | 1,300       |
| Unrealized loss on derivative instruments        | 89          | 82          |
| Alternative minimum income tax credit            | 955         | 940         |
| Purchased tax credits                            | 7,388       | 8,337       |
| Other  | 754         | 767         |
| Gross deferred tax assets                        | 43,750      | 41,911      |
| <b>Deferred tax liabilities</b>                  |             |             |
| Deferred policy acquisition costs                | (8,103)     | (7,531)     |
| Catastrophe loss reserve trust fund              | (5,935)     | (5,495)     |
| Unrealized gain upon acquisition of GA Life      | (982)       | (1,753)     |
| Unrealized gain on trading securities            | (285)       |             |
| Unrealized gain on securities available for sale | (1,626)     | (988)       |
| Unamortized bond issue costs                     | (318)       | (347)       |
| Contingency reserves                             |             | (302)       |
| Other  | (38)        | (300)       |
| Gross deferred tax liabilities                   | (17,287)    | (16,716)    |
| Net deferred tax asset                           | \$ 26,463   | \$ 25,195   |

The net deferred tax asset shown in the table above at December 31, 2009 and 2008 is reflected in the consolidated balance sheets as \$37,551 and \$35,926, respectively, in deferred tax assets and \$11,088 and \$10,731 in deferred tax liabilities, respectively, reflecting the aggregate deferred tax assets or liabilities of individual tax-paying subsidiaries of the Company.

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 believes that it is more likely than not that the Company will realize the benefits of these deductible differences.

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**17. Pension Plans**

**Noncontributory Defined-Benefit Pension Plan**

The Company sponsors a noncontributory defined-benefit pension plan for all of its employees and for the employees for certain of its subsidiaries. Pension benefits begin to vest after five years of vesting service, as defined, and are based on years of service and final average salary, as defined. The funding policy is to contribute to the plan as necessary to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974, as amended, plus such additional amounts as the Company may determine to be appropriate from time to time. The measurement date used to determine pension benefit measures for the pension plan is December 31.

The following table sets forth the plan's benefit obligations, fair value of plan assets, and funded status as of December 31, 2009 and 2008, accordingly:

|  | <b>2009</b> | <b>2008</b> |
|--|-------------|-------------|
| <b>Change in benefit obligation</b>  |             |             |
| Projected benefit obligation at beginning of year  | \$ 84,776   | \$ 89,598   |
| Service cost   | 4,912       | 5,287       |
| Interest cost  | 5,712       | 5,458       |
| Benefit payments   | (7,004)     | (7,926)     |
| Actuarial losses (gains)   | 2,492       | (7,641)     |
| Projected benefit obligation at end of year  | \$ 90,888   | \$ 84,776   |
| Accumulated benefit obligation at end of year  | \$ 67,825   | \$ 62,371   |
| <b>Change in fair value of plan assets</b>   |             |             |
| Fair value of plan assets at beginning of year   | \$ 44,100   | \$ 63,614   |
| Actual return on assets (net of expenses)  | 8,337       | (16,588)    |
| Employer contributions   | 8,000       | 5,000       |
| Benefit payments   | (7,004)     | (7,926)     |
| Fair value of plan assets at end of year   | \$ 53,433   | \$ 44,100   |
| Funded status at end of year   | \$ (37,455) | \$ (40,676) |
| Amounts in accumulated other comprehensive income not yet recognized as a component of net periodic pension cost |             |             |
| Development of prior service credit Balance at beginning of year   | \$ (5,372)  | \$ (5,822)  |
| Amortization   | 450         | 450         |
| Net prior service credit   | (4,922)     | (5,372)     |
| Development of actuarial loss  |             |             |
| Balance at beginning of year   | 42,559      | 30,373      |
| Amortization   | (2,487)     | (1,788)     |
| (Gain)/Loss arising during the year  | (1,827)     | 13,974      |
| Actuarial net loss   | 38,245      | 42,559      |
| Sum of deferrals   | \$ 33,323   | \$ 37,187   |
| Net amount recognized  | \$ (4,132)  | \$ (3,489)  |

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The amounts recognized in the balance sheets as of December 31, 2009 and 2008 consist of the following:

|   | <b>2009</b> | <b>2008</b> |
|---|-------------|-------------|
| Pension liability   | \$ 37,455   | \$ 40,676   |
| Accumulated other comprehensive loss, net of a deferred tax of \$12,944 and \$14,383 in 2009 and 2008, respectively | 20,379      | 22,805      |

The components of net periodic benefit cost income for 2009, 2008, and 2007 were as follows:

|  | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|-------------|
| <b>Components of net periodic benefit cost</b> |             |             |             |
| Service cost                                   | \$ 4,912    | \$ 5,287    | \$ 5,489    |
| Interest cost                                  | 5,712       | 5,458       | 5,072       |
| Expected return on assets                      | (4,018)     | (5,027)     | (4,383)     |
| Amortization of prior service (benefit) cost   | (450)       | (450)       | 58          |
| Amortization of actuarial loss                 | 2,487       | 1,788       | 1,959       |
| Net periodic benefit cost                      | \$ 8,643    | \$ 7,056    | \$ 8,195    |

Net periodic pension expense may include settlement charges as a result of retirees selecting lump-sum distributions. Settlement charges may increase in the future if the number of eligible participants deciding to receive distributions and the amount of their benefits increases.

The estimated net loss and prior service benefit that will be amortized from accumulated other comprehensive loss into net periodic pension benefits cost during the next twelve months is as follows:

|                    |          |
|--------------------|----------|
| Prior service cost | \$ (450) |
| Actuarial loss     | 2,281    |

The following assumptions were used on a weighted average basis to determine benefit obligations of the plan and in computing the periodic benefit cost as of and for the years ended December 31, 2009, 2008, and 2007:

|                                | <b>2009</b>                  | <b>2008</b>                  | <b>2007</b>                  |
|--------------------------------|------------------------------|------------------------------|------------------------------|
| Discount rate                  | 6.75%                        | 6.75%                        | 6.25%                        |
| Expected return on plan assets | 7.75%                        | 8.00%                        | 8.00%                        |
| Rate of compensation increase  | Graded;<br>3.50%<br>to 8.00% | Graded;<br>3.50%<br>to 8.00% | Graded;<br>3.50%<br>to 8.00% |

As of December 31, 2009, the basis of the overall expected long-term rate of return on assets assumption is a forward-looking approach based on the current long-term capital market outlook assumptions of the assets categories the trust invests in and the trust's target asset allocation. At December 31, 2009, the assumed target asset allocation for the program is: 44%-56% equity securities, 35%-45% debt securities, and 6%-14% other securities. Using a mean-variance model to project return over 15-years horizon under the target asset allocation, the 35% to 65% percentile

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range of annual rates of return is 6.4%-8.4%. The Company selected a rate from within this range of 7.75%, which reflects the Company's best estimate for this assumption based on the data described above, information on the historical returns on assets invested in the pension trust, and expected future conditions. This rate is net of both investment related expenses and a 0.10% reduction for other administrative expenses charged to the trust.

The assumed discount rate of 6.75% at December 31, 2009 reflects the hypothetical rate at which the projected benefit obligations could be effectively settled or paid out to participants on that date. The Company determined the discount rate based on a range of factors, including a yield curve comprised of the rates of return on high-quality, fixed-income corporate bonds available at the measurement date and the related expected duration for the obligations.

**Plan Assets**

Plan assets recorded at fair value are categorized based upon the level of judgment associated with the inputs used to measure their fair value. For level inputs and input definition, see note 9.

The following table summarizes fair value measurements by level at December 31, 2009 for assets measured at fair value on a recurring basis.

|                          | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|--------------------------|----------------|----------------|----------------|--------------|
| Equity Investments       |                |                |                |              |
| Domestic Large Cap       | \$ 2,557       | \$ 13,624      | \$ 961         | \$ 17,142    |
| Domestic Small Cap       | 107            | 4,204          |                | 4,311        |
| International Large Cap  | 2              | 4,198          |                | 4,200        |
| International Small Cap  | 717            |                |                | 717          |
| Emerging Markets         |                | 2,014          |                | 2,014        |
| Fixed Income Investments |                |                |                |              |
| High Yield               | 145            | 2,586          | 277            | 3,008        |
| Core                     | 989            | 12,594         | 28             | 13,611       |
| Long Duration            | 82             | 5,352          |                | 5,434        |
| Real Estate Investments  |                |                |                |              |
| REIT                     |                | 655            |                | 655          |
| Real Estate Assets       | 47             | 4              | 2,290          | 2,341        |
|                          | \$ 4,646       | \$ 45,231      | \$ 3,556       | \$ 53,433    |

A reconciliation of the beginning and ending balances of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2009 is as follows:

|  | <b>Domestic</b> |               | <b>Fixed</b>  |               |              |
|--|-----------------|---------------|---------------|---------------|--------------|
|  | <b>Large</b>    | <b>Fixed</b>  | <b>Income</b> | <b>Real</b>   | <b>Total</b> |
|  | <b>Cap</b>      | <b>Income</b> | <b>Core</b>   | <b>Estate</b> |              |
|  |                 | <b>High</b>   |               |               |              |
|  |                 | <b>Yield</b>  |               |               |              |
| Beginning Balance at December 31, 2008 | \$ 695          | \$ 212        | \$ 33         | \$ 3,508      | \$ 4,448     |
| Actual return on program assets:       |                 |               |               |               |              |



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|   |        |        |         |          |
|---|--------|--------|---------|----------|
| Relating to assets still held at the reporting date | 266    | 52     | (1,343) | (1,025)  |
| Relating to assets sold during the period           |        | 2      | (5)     | (23)     |
| Purchases   |        | 11     | 148     | 159      |
| Ending balance at December 31, 2009                 | \$ 961 | \$ 277 | \$ 28   | \$ 2,290 |
|   |        |        |         | \$ 3,556 |

The Company's plan assets are invested in the National Retirement Trust. The National Retirement Trust was formed to provide financial and legal resources to help members of the BCBSA offer retirement benefits to their employees.

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The investment program for the National Retirement Trust is based on the precepts of capital market theory that are generally followed by institutional investors, who by definition are long-term oriented investors. This philosophy holds that:

Increasing risk is rewarded with compensating returns over time, and therefore, prudent risk taking is justifiable for long-term investors.

Risk can be controlled through diversification of asset classes and investment approaches, as well as diversification of individual securities.

Risk is reduced by time, and over time the relative performance of different asset classes is reasonably consistent. Over the long-term, equity investments have provided and should continue to provide superior returns over other security types. Fixed-income securities can dampen volatility and provide liquidity in periods of depressed economic activity. Lengthening duration of fixed income securities may reduce surplus volatility.

The strategic or long-term allocation of assets among various asset classes is an important driver of long-term returns.

Relative performance of various asset classes is unpredictable in the short-term and attempts to shift tactically between asset classes are unlikely to be rewarded.

Investments will be made for the sole interest of the participants and beneficiaries of the programs participating in the National Retirement Trust. Accordingly, the assets of the National Retirement Trust shall be invested in accordance with these objectives:

Ensure assets are available to meet current and future obligations of the participating programs when due.

Earn a minimum rate of return no less than the actuarial interest rate.

Earn the maximum return that can be realistically achieved in the markets over the long-term at a specified and controlled level of risk in order to minimize future contributions.

Invest the assets with the care, skill, and diligence that a prudent person acting in a like capacity would undertake. In the process, the Administration of the Trust has the objective of controlling the costs involved with administering and managing the investments of the National Retirement Trust.

**Cash Flows**

The Company expects to contribute \$7,000 to its pension program in 2010.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

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|           |          |
|-----------|----------|
| 2010      | \$ 3,809 |
| 2011      | 4,145    |
| 2012      | 4,770    |
| 2013      | 5,641    |
| 2014      | 6,236    |
| 2015 2019 | 46,530   |

**Noncontributory Supplemental Pension Plan**

In addition, the Company sponsors a noncontributory supplemental pension plan. This plan covers employees with qualified defined benefit retirement plan benefits limited by the U.S. Internal Revenue Code maximum compensation and benefit limits. At December 31, 2009 and 2008, the Company has recorded a pension liability of \$3,033 and \$3,426, respectively. The charge to accumulated other comprehensive loss related to the noncontributory pension plan at December 31, 2009 and 2008 amounted to \$339 and \$464, respectively, net of a deferred tax asset of \$217 and \$296, respectively.

**18. Catastrophe Loss Reserve and Trust Fund**

In accordance with Chapter 25 of the Insurance Code, as amended, TSP is required to record a catastrophe loss reserve. This catastrophe loss reserve is supported by a trust fund for the payment of catastrophe losses. The reserve increases by amounts determined by applying a contribution rate, not in excess of 5%, to catastrophe written premiums as instructed annually by the Commissioner of Insurance, unless the level of the reserve exceeds 8% of catastrophe exposure, as defined. The reserve also increases by an amount equal to the resulting return in the supporting trust fund and decreases by payments on catastrophe losses or authorized withdrawals from the trust fund. Additions to the catastrophe loss reserve are deductible for income tax purposes.

This trust may invest its funds in securities authorized by the Insurance Code, but not in investments whose value may be affected by hazards covered by the catastrophic insurance losses. The interest earned on these investments and any realized gains (loss) on investment transactions are part of the trust fund and are recorded as income (expense) of the Company. An amount equal to the investment returns is recorded as an addition to the catastrophe loss reserve.

The interest earning assets in this fund, which amounted to \$33,489 and \$31,359 as of December 31, 2009 and 2008, respectively, are to be used solely and exclusively to pay catastrophe losses covered under policies written in Puerto Rico.

TSP is required to make deposits to the trust fund, if any, on or before January 31 of the following year. Contributions are determined by a rate imposed by the Commissioner of Insurance for the catastrophe policies written in that year. Additions in 2009 and 2008, amounting to \$810 and \$850, respectively, were determined by applying a rate of 1% to catastrophe premiums written.

The amount in the trust fund may be withdrawn or released in the case that TSP ceases to underwrite risks subject to catastrophe losses. Also, authorized withdrawals are allowed when the catastrophe loss reserve exceeds 8% of the catastrophe exposure, as defined.



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Retained earnings are restricted in the accompanying consolidated balance sheets by the total catastrophe loss reserve balance, which as of December 31, 2009 and 2008 amounted to \$34,411 and \$32,200, respectively.

**19. Stockholders Equity**

**a. Common Stock**

On April 24, 2007, the Company's board of directors (the Board) authorized a 3,000-for-one stock split of its Class A common stock effected in the form of a dividend of 2,999 shares for every one share outstanding. This stock split was effective on May 1, 2007 to all stockholders of record at the close of business on April 24, 2007. The total number of authorized shares and par value per share were unchanged by this action. The par value of the additional shares resulting from the stock split was reclassified from additional paid in capital to common stock. All references to the number of shares and per share amounts in this consolidated financial statements are presented after giving retroactive effect to the stock split.

In May 2007, the Company cancelled 24,000 director qualifying shares. Since February 2007, Board members are no longer required to hold qualifying shares to participate in the Board of the Company.

In December 7, 2007, the Company completed the initial public offering (IPO) of its Class B common stock. In this public offering the Company sold 16,100,000 shares, 10,813,191 of which were shares previously owned by selling shareholders. Proceeds received under this public offering amounted to \$70,279, net of \$6,380 of expenses directly related to the offering.

For a period of five years after the completion of the IPO, subject to the extension or shortening under certain circumstances, each holder of Class B common stock will benefit from anti-dilution protections provided in the Company's amended and restated certificate of incorporation.

On December 8, 2008, the Company converted 7 million issued and outstanding Class A shares into Class B shares, in conjunction with the expiration of the lockup agreements signed by holders of Class A shares at the time of the Company's initial public offering.

**b. Stock Repurchase Program**

The Company repurchased shares of its common stock under a \$40,000 share repurchase program authorized by the Company's Board in October 2008. Repurchases were conducted through open-market purchases of Class B shares only, in accordance with Rule 10b-18 under the Securities Exchange Act of 1934, as amended. During 2009 and 2008, the Company repurchased and retired 2,021,960 and 1,181,500 shares at an average per share price of \$12.92 and \$11.75, for an aggregate cost of \$26,120 and \$13,880. The repurchase program was completed during 2009. At December 31, 2008, the Company had unsettled shares repurchases amounting to \$6,235 under this program. Such amount is included in the accompanying consolidated balance sheet as account payable and accrued liabilities.

**c. Preferred Stock**

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Authorized capital stock includes 100,000,000 of preferred stock with a par value of \$1.00 per share. As of December 31, 2009 and 2008, there are no issued and outstanding preferred shares.

**d. Dividends**

During the years 2009 and 2008 there were no dividends declared or paid to the Company's stockholders.

On March 12, 2007, the Board declared a cash dividend of \$2,448 distributed pro rata among all of the Company's issued and outstanding Class A common shares, excluding those shares issued to the representatives of the community that were members of the Board (the qualifying shares). All stockholders of record as of the close of business on March 23, 2007, except those who only hold qualifying shares, received a dividend per share of \$0.09 for each share held on that date.

**e. Liquidity Requirements**

As members of the BCBSA, the Company and TSS are required by membership standards of the association to maintain liquidity as defined by BCBSA. That is, to maintain net worth exceeding the Company Action Level as defined in the National Association of Insurance Commissioners (NAIC) Risk-Based Capital for Insurers Model Act. The companies are in compliance with this requirement.

**20. Comprehensive Income**

The accumulated balances for each classification of other comprehensive income (loss) are as follows:

|  | <b>Unrealized<br/>Gains (Losses)<br/>on<br/>securities</b> | <b>Liability<br/>for<br/>Pension<br/>Benefits</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> |
|--|--|---|---|
| <b>Beginning balance</b>   | \$ 5,602   | \$ (23,267)                                       | \$ (17,665)   |
| Net current period change  | 4,630  | 2,550   | 7,180   |
| Reclassification adjustments for gains and losses reclassified in income | (1,091)  |   | (1,091)   |
| <b>Ending balance</b>  | \$ 9,141   | \$ (20,717)                                       | \$ (11,576)   |

The related deferred tax effects allocated to each component of other comprehensive income in the accompanying consolidated statements of stockholders' equity and comprehensive income in 2009, 2008 and 2007 are as follows:

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|  | <b>Before-Tax<br/>Amount</b> | <b>2009<br/>Deferred<br/>Tax<br/>(Expense)<br/>Benefit</b> | <b>Net-of-Tax<br/>Amount</b> |
|--|------------------------------|--|------------------------------|
| Unrealized holding losses on securities arising during the period        | \$ 5,455                     | \$ (825)   | \$ 4,630                     |
| Less reclassification adjustment for gains and losses realized in income | (1,278)                      | 187  | (1,091)                      |
| Net change in unrealized loss  | 4,177                        | (638)  | 3,539                        |
| Liability for pension benefits   | 4,070                        | (1,520)  | 2,550                        |
| Net current period change  | \$ 8,247                     | \$ (2,158)   | \$ 6,089                     |
|  |                              | <b>2008<br/>Deferred<br/>Tax<br/>(Expense)<br/>Benefit</b> |                              |
|  | <b>Before-Tax<br/>Amount</b> | <b>Net-of-Tax<br/>Amount</b>                               |                              |
| Unrealized holding losses on securities arising during the period        | \$ (18,944)                  | \$ 2,088   | \$ (16,856)                  |
| Less reclassification adjustment for gains and losses realized in income | 14,138                       | (1,234)  | 12,904                       |
| Net change in unrealized loss  | (4,806)                      | 854  | (3,952)                      |
| Liability for pension benefits   | (12,411)                     | 4,796  | (7,615)                      |
| Cash-flow hedges   | (93)                         | 37   | (56)                         |
| Net current period change  | \$ (17,310)                  | \$ 5,687   | \$ (11,623)                  |
|  |                              | <b>2007<br/>Deferred<br/>Tax<br/>(Expense)<br/>Benefit</b> |                              |
|  | <b>Before-Tax<br/>Amount</b> | <b>Net-of-Tax<br/>Amount</b>                               |                              |
| Unrealized holding losses on securities arising during the period        | \$ 10,005                    | \$ (1,622)   | \$ 8,383                     |
| Less reclassification adjustment for gains and losses realized in income | 1,384                        | (218)  | 1,166                        |
| Net change in unrealized loss  | 11,389                       | (1,840)  | 9,549                        |

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|                                |           |            |           |
|--------------------------------|-----------|------------|-----------|
| Liability for pension benefits | 6,697     | (2,607)    | 4,090     |
| Cash-flow hedges               | (409)     | 159        | (250)     |
| Net current period change      | \$ 17,677 | \$ (4,288) | \$ 13,389 |



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**21. Share-Based Compensation**

In December 2007 the Company adopted the 2007 Incentive Plan (the Plan), which permits the Board the grant of stock options, restricted stock awards and performance awards to eligible officers, directors and key employees. The Plan authorizes grants to issue up to 4,700,000 of Class B common shares of authorized but unissued stock. At December 31, 2009, there were 3,303,963 shares available for the Company to grant under the Plan. Stock options can be granted with an exercise price at least equal the stock's fair market value at the date of grant. The stock option awards vest in equal annual installments over 3 years and its expiration date cannot exceed 7 years. The restricted stock and performance awards are issued at the fair value of the stock on the grant date with vesting periods ranging from one to three years. Restricted stock awards vest in installments, as stipulated in each restricted stock agreement. Performance awards vest on the last day of the performance period, provided that at least minimum performance standards were achieved.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model that used the weighted average assumptions in the following table. In absence of adequate historical data, the Company estimates the expected life of the option using the simplified method allowed by Staff Accounting Bulletin (SAB) No. 107. Since the Company was a newly public entity, expected volatility was computed based on the average historical volatility of similar entities with publicly traded shares. The risk-free rate for the expected term of the option was based on the U.S. Treasury zero-coupon bonds yield curve in effect at the time of grant.

The following assumptions were used in the development of fair value of option awards:

|                                | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|--------------------------------|-------------|-------------|-------------|
| Expected dividend yield        |             |             |             |
| Expected volatility (per year) | 53.85%      |             | 33.00%      |
| Expected term (in years)       | 4.50        |             | 4.50        |
| Risk-free interest rate        | 1.47%       |             | 3.51%       |

Stock option activity during the year ended December 31, 2009 is as follows:

|  | <b>Number of<br/>Shares</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Contractual<br/>Term<br/>(Years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|--|-----------------------------|--|--|--|
| Outstanding balance at January 1, 2009   | 999,309                     | \$ 14.50   |  |  |
| Grants                                   | 13,321                      | \$ 12.49   |  |  |
| Outstanding balance at December 31, 2009 | 1,012,630                   | \$ 14.47   | 4.95   | \$ 3,166                                 |
| Exercisable at December 31, 2009         | 666,206                     | \$ 14.50   | 4.93   | \$ 2,065                                 |

The weighted average grant date fair value of options granted during 2009 and 2007 was \$5.63 and \$4.83, respectively. No options were granted in 2008. There were no options exercised during the years ended December 31, 2009, 2008 and 2007.



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A summary of the status of the Company's nonvested restricted and performance shares as of December 31, 2009, and changes during the year ended December 31, 2009, are presented below:

|  | <b>Restricted Awards</b> |                 | <b>Performance Awards</b> |                 |
|--|--------------------------|-----------------|---------------------------|-----------------|
|  | <b>Number</b>            | <b>Weighted</b> | <b>Number</b>             | <b>Weighted</b> |
|  | <b>of</b>                | <b>Average</b>  | <b>of</b>                 | <b>Average</b>  |
|  | <b>Shares</b>            | <b>Fair</b>     | <b>Shares</b>             | <b>Exercise</b> |
|  |                          | <b>Value</b>    |                           | <b>Price</b>    |
| Outstanding balance at January 1, 2009   | 130,973                  | \$ 15.16        | 166,554                   | \$ 14.50        |
| Granted                                  | 27,362                   | 12.33           | 3,002                     | 12.49           |
| Vested                                   | (76,660)                 | 15.62           |                           |                 |
| Forefeited                               |                          |                 | (2,414)                   | 14.50           |
| Outstanding balance at December 31, 2009 | 81,675                   | \$ 13.77        | 167,142                   | \$ 14.46        |

The weighted average grant date fair value of restricted shares granted during the year 2009, 2008 and 2007 were \$12.33, \$18.81 and \$14.50, respectively. Total fair value of restricted stock vested during the year ended December 31, 2009 was \$1,158.

At December 31, 2009 there was \$2,571 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted average period of 0.97 years. The Company currently uses authorized and unissued Class B common shares to satisfy share award exercises.

**22. Net Income Available to Stockholders and Basic Net Income per Share**

The following table sets forth the computation of basic and diluted earnings per share for the three-year period ended December 31, 2009.

|   | <b>2009</b>   | <b>2008</b>   | <b>2007</b> |
|---|---------------|---------------|-------------|
| Numerator for earnings per share                                  |               |               |             |
| Net income available to stockholders                              | \$ 68,780     | \$ 24,790     | \$ 58,518   |
| Denominator for basic earnings per share                          |               |               |             |
| Weighted average of common shares                                 | 29,494,468    | 32,120,461    | 27,200,067  |
| Effect of dilutive securities - Nonvested restricted stock awards | 68,862        | 42,094        | 2,038       |
| Denominator for diluted earnings per share                        | \$ 29,563,330 | \$ 32,162,555 | 27,202,105  |
| Basic net income per share  | \$ 2.33       | \$ 0.77       | \$ 2.15     |
| Diluted net income per share                                      | 2.33          | 0.77          | 2.15        |

During the years ended December 31, 2009, 2008 and 2007, the weighted average of stock option shares of 1,012,594, 999,309 and 83,276, respectively, were excluded from the denominator for diluted earnings per share because the stock options were anti-dilutive.



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The Company leases its regional offices, certain equipment, and warehouse facilities under noncancelable operating leases. Minimum annual rental commitments at December 31, 2009 under existing agreements are summarized as follows:

**Year ending December 31**

|              |                  |
|--------------|------------------|
| 2010         | \$ 4,557         |
| 2011         | 3,344            |
| 2012         | 2,243            |
| 2013         | 1,689            |
| 2014         | 1,561            |
| Thereafter   | 6,690            |
| <b>Total</b> | <b>\$ 20,084</b> |

Rental expense for 2009, 2008, and 2007 was \$4,690, \$3,532, and \$4,007, respectively, after deducting the amount of \$132, \$265, and \$303, respectively, reimbursed by CMS for the administration of the Medicare Part B Program (see note 14).

**24. Contingencies****Legal Proceedings**

As of December 31, 2009, the Company is a defendant in various lawsuits arising in the ordinary course of business. The Company is also a defendant in various other claims and proceedings, some of which are described below. Furthermore, the Commissioner of Insurance, as well as other Federal and Puerto Rico government authorities, regularly make inquiries and conduct audits concerning the Company's compliance with applicable insurance and other laws and regulations.

Management believes that the aggregate liabilities, if any, arising from all such claims, assessments, audits and lawsuits will not have a material adverse effect on the consolidated financial position or results of operations of the Company. However, given the inherent unpredictability of these matters, it is possible that an adverse outcome in certain matters could have a material adverse effect on the Company's financial condition, operating results and/or cash flows. Where the Company believes that a loss is both probable and estimable, such amounts have been recorded. In other cases, it is at least reasonably possible that the Company may incur a loss related to one or more of the mentioned pending lawsuits or investigations, but the Company is unable to estimate the range of possible loss which may be ultimately realized, either individually or in the aggregate, upon their resolution.

Additionally, the Company may face various potential litigation claims that have not been asserted to date, including claims from persons purporting to have contractual rights to acquire shares of the Company on favorable terms or to have inherited such shares notwithstanding applicable transfer and ownership restrictions.

**Hau et al Litigation (formerly known as Jordan et al)**

On April 24, 2002, Octavio Jordán, Agripino Lugo, Ramón Vidal, and others filed a suit against the Company, TSS and others in the Court of First Instance for San Juan, Superior Section (the Court), alleging, among other

things, violations by the defendants of provisions of the Puerto Rico Insurance Code, antitrust violations, unfair business practices, RICO violations, breach of contract with providers, and damages in the amount of \$12 million. Following years of complaint

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amendments, motions practice and interim appeals up to the level of the Puerto Rico Supreme Court, the plaintiffs amended their complaint on June 20, 2008 to allege with particularity the same claims initially asserted but on behalf of a more limited group of plaintiffs, and increase their claim for damages to approximately \$207 million. Discovery is expected to conclude by March 2010. The Company intends to vigorously defend this claim.

**Colón Litigation**

On October 15, 2007, José L. Colón-Dueño, a former holder of one share of TSS predecessor stock, filed suit against TSS and the Commissioner of Insurance in the Court of First Instance. The sale of that share to Mr. Colón-Dueño was voided in 1999 pursuant to an order issued by the Commissioner of Insurance in which the sale of 1,582 shares to a number of TSS shareholders was voided. TSS, however, appealed the Commissioner of Insurance's order before the Puerto Rico Court of Appeals, which upheld the order on March 31, 2000. Plaintiff requests that the court direct TSS to return his share of stock and compensate him for alleged damages in excess of \$500,000 plus attorney's fees. The Company is vigorously contesting this lawsuit because, among other reasons, the Commissioner of Insurance's order is final and cannot be collaterally attacked in this litigation.

**Puerto Rico Center for Municipal Revenue Collection**

On March 1, 2006 and March 3, 2006, respectively, the Puerto Rico Center for Municipal Revenue Collection (CRIM) imposed a real property tax assessment of approximately \$1.3 million and a personal property tax assessment of approximately \$4.0 million upon TSS for fiscal years 1992-1993 through 2002-2003. During that time, TSS qualified as a tax-exempt entity under Puerto Rico law pursuant to rulings issued by the Puerto Rico tax authorities. In imposing the tax assessments, CRIM revoked the tax rulings retroactively, based on its contention that a for-profit corporation such as TSS is not entitled to such an exemption. On March 28, 2006 and March 29, 2006, respectively, TSS challenged the real and personal property tax assessments in the Court of First Instance. The court granted summary judgment affirming the real property and personal property tax assessments on October 29, 2007 and December 5, 2007, respectively.

After unsuccessfully filing motions for reconsideration in both cases, TSS appealed the court's decisions before the Puerto Rico Court of Appeals on November 29, 2007 and February 21, 2008, respectively. TSS also requested a consolidation of both cases, which the Court of Appeals approved on April 17, 2008. On June 30, 2008 the Court of Appeals confirmed the summary judgment issued by the Court of First Instance in both property tax cases. On September 29, 2008, TSS timely filed a certiorari petition with the Puerto Rico Supreme Court. The court denied the petition on March 13, 2009. TSS filed a request for reconsideration before the Puerto Rico Supreme Court on March 30, 2009, which was denied on April 29, 2009. TSS filed a second request for reconsideration, which was denied on May 22, 2009. The Company recorded an accrual which is included within accounts payable and accrued liabilities in the accompanying consolidated financial statements.

The Company submitted a petition for certiorari to the U.S. Supreme Court on August 26, 2009, based on its strong belief that CRIM's retroactive revocation of applicable tax rulings and its imposition of a tax liability reaching back over ten years constituted a violation of the Company's due process rights. The U.S. Supreme Court has requested that CRIM file a response on December 2, 2009. On January 11, 2010, the U.S. Supreme Court invited the Solicitor General of the U.S. to file a brief in this case expressing the views of the United States.

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**Dentists Association Litigation**

On February 11, 2009, the Puerto Rico Dentists Association (Colegio de Cirujanos Dentistas de Puerto Rico) filed a complaint in the Court of First Instance against 24 health plans operating in Puerto Rico that offer dental health coverage. The Company and two of its subsidiaries, TSS and TC were included as defendants. This litigation purports to be a class action filed on behalf of Puerto Rico dentists who are similarly situated; however, the complaint does not include a single dentist as a class representative nor a definition of the intended class.

The complaint alleges that the defendants, on their own and as part of a common scheme, systematically deny, delay and diminish the payments due to dentists so that they are not paid in a timely and complete manner for the covered medically necessary services they render. The complaint also alleges, among other things, violations to the Puerto Rico Insurance Code, antitrust laws, the Puerto Rico racketeering statute, unfair business practices, breach of contract with providers, and total damages in the amount of \$150 million. In addition, the complaint claims that the Puerto Rico Insurance Companies Association is the hub of an alleged conspiracy concocted by the member plans to defraud dentists.

There are numerous available defenses to oppose both the request for class certification and the merits. The Company intends to vigorously defend this claim.

Two codefendant plans removed the case to federal court, which the plaintiffs and the other codefendants, including the Company, opposed. The federal District Court decided that it lacked jurisdiction under the Class Action Fairness Act ( CAFA ) and remanded the case to state court. The removing defendants petitioned to appeal to the First Circuit Court of Appeals. Having accepted the appeal, the First Circuit Court of Appeals issued an order in late October 2009 which found the lower court's decision premature. The Court of Appeals remanded the case to the federal District Court and allowed limited discovery to determine whether the case should be heard in federal court pursuant to CAFA.

**Claims by Heirs of Former Shareholders**

The Company and TSS are defending four individual lawsuits, all filed in state court, from persons who claim to have inherited a total of 90 shares of the Company or one of its predecessors or affiliates (before giving effect to the 3,000-for-one stock split). While each case presents unique facts, the lawsuits generally allege that the redemption of the shares by the Company pursuant to transfer and ownership restrictions contained in the Company's (or its predecessors' or affiliates') articles of incorporation and bylaws was improper. Discovery is underway in each case. Management believes all these claims are time barred under one or more statutes of limitations and is vigorously defending them.

**Guarantee Associations**

Pursuant to the Insurance Code, TSP is a member of Sindicato de Aseguradores para la Suscripción Conjunta de Seguros de Responsabilidad Profesional Médico-Hospitalaria (SIMED) and of the Sindicato de Aseguradores de Responsabilidad Profesional para Médicos. Both syndicates were organized for the purpose of underwriting medical-hospital professional liability insurance. As a member, the subsidiary shares risks with other member companies and, accordingly, is contingently liable in the event that the above-mentioned syndicates cannot meet their obligations. During 2009, 2008, and 2007, no assessments or payments were made for this contingency.





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Additionally, pursuant to Article 12 of Rule LXIX of the Insurance Code, TSP is a member of the Compulsory Vehicle Liability Insurance Joint Underwriting Association (the Association). The Association was organized during 1997 to underwrite insurance coverage of motor vehicle property damage liability risks effective January 1, 1998. As a participant, TSP shares the risk, proportionately with other members, based on a formula established by the Insurance Code. During the three-year period ended December 31, 2009, the Association distributed good experience refunds. TSP received refunds amounting to \$1,193, \$1,131, and \$1,023, in 2009, 2008, and 2007, respectively.

TSP is a member of the Asociación de Garantía de Seguros de Todas Clases, excepto Vida, Incapacidad y Salud and TSS and TSV are members of the Asociación de Garantía de Seguros de Vida, Incapacidad y Salud. As members, they are required to provide funds for the payment of claims and unearned premiums reimbursements for policies issued by insurance companies declared insolvent. During 2009, 2008 and 2007 no assessment or payment was made by TSP in connection with insurance companies declared insolvent. Moreover, no assessments were attributable to TSS and TSV during 2009, 2008, and 2007.

**25. Statutory Accounting**

TSS, TSV and TPS (collectively known as the regulated subsidiaries) are regulated by the Commissioner of Insurance. The regulated subsidiaries are required to prepare financial statements using accounting practices prescribed or permitted by the Commissioner of Insurance, which differ from GAAP.

The accumulated earnings of TSS, TSV, and TSP 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. As more fully described in note 18, a portion of the accumulated earnings of TSP are also restricted by the catastrophe loss reserve balance (amounting to \$34,411 and \$32,200 as of December 31, 2009 and 2008, respectively) as required by the Insurance Code.

The combined net admitted assets, unassigned surplus and net income of the regulated subsidiaries at December 31, 2009, 2008 and 2007 are as follows:

| (dollar amounts in millions) | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|------------------------------|-------------|-------------|-------------|
| Net admitted assets          | \$1,298     | \$1,197     | \$1,286     |
| Capital and surplus          | 416         | 260         | 359         |
| Net income                   | 43          | 30          | 64          |

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**26. Supplementary Information on Cash Flow Activities**

|  | 2009     | 2008       | 2007      |
|--|----------|------------|-----------|
| <b>Supplementary information</b>   |          |            |           |
| Noncash transactions affecting cash flows activities   |          |            |           |
| Change in net unrealized gain on securities available for sale, including deferred income tax (asset)/liability of \$(638), \$854, and \$1,840 in 2009, 2008, and 2007, respectively | \$ 3,539 | \$ (3,952) | \$ 9,549  |
| Change in cash-flow hedges, including deferred income tax liability of \$37 and \$159 in 2008 and 2007, respectively   | \$       | \$ (56)    | \$ (250)  |
| Change in liability for pension benefits, and deferred income tax (liability)/asset of \$(1,520), \$4,796, \$2,189, in 2009, 2008, and 2007, respectively                            | \$ 2,550 | \$ (7,615) | \$ 4,090  |
| Unsettled shares repurchases   | \$       | \$ 6,235   | \$        |
| Unsettled investment acquisitions  | \$       | \$         | \$117,706 |
| Unsettled investment sales   | \$       | \$ (1,500) | \$        |
| Other  |          |            |           |
| Income taxes paid  | \$15,552 | \$25,597   | \$ 25,940 |
| Interest paid  | \$11,605 | \$14,330   | \$ 14,102 |

**27. Segment Information**

The operations of the Company are conducted principally through three business segments: Managed Care, Life Insurance, and Property and Casualty Insurance. Business segments were identified according to the type of insurance products offered and consistent with the information provided to the chief operating decision maker.

These segments and a description of their respective operations are as follows:

**Managed Care segment** TSS is engaged in the sale of managed care products to the Commercial, Medicare and Reform market sectors. The Commercial accounts sector includes corporate accounts, U.S. federal government employees, individual accounts, local government employees, and Medicare supplement. The following represents a description of the major contracts by sector:

TSS is a qualified contractor to provide health coverage to federal government employees within Puerto Rico. Earned premiums revenue related to this contract amounted to \$125,994, \$124,239, and \$121,126 for the three-year period ended December 31, 2009, 2008, and 2007, respectively (see note 11).

Under its commercial business, TSS also provides health coverage to certain employees of the Commonwealth of Puerto Rico and its instrumentalities. Earned premium revenue

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related to such health plans amounted to \$46,114, \$40,686, and \$46,649, for the three-year period ended December 31, 2009, 2008, and 2007, respectively.

TSS provides services through its Medicare health plans pursuant to a limited number of contracts with CMS. Earned premium revenue related to the Medicare business amounted to \$513,823, \$438,723, and \$255,570, for the three-year period ended December 31, 2009, 2008, and 2007, respectively.

TSS participates in the Reform program to provide health coverage to medically indigent citizens in Puerto Rico, as defined by the laws of the Commonwealth of Puerto Rico. TSS provides managed care services to Reform members in the North and Southwest regions on a fully-insured basis and in the Metro-North region on an Administrative Service Only (ASO) basis. Earned premium revenue related to this business amounted to \$348,096, \$340,123, and \$327,544, for three-year period ended December 31, 2009, 2008, and 2007, respectively. Administrative service fee for the Metro-North Region for the year ended December 31, 2009 and 2008 amounted to \$23,299 and \$2,712; which is included in the Administrative service fee in the accompanying consolidated statement of earnings.

***Life Insurance segment*** This segment offers primarily life and accident and health insurance coverage, and annuity products. The premiums for this segment are mainly subscribed through TSV's internal sales force and a network of independent brokers and agents.

***Property and Casualty Insurance segment*** The predominant insurance lines of business of this segment are commercial multiple peril, auto physical damage, auto liability, and dwelling. The premiums for this segment are originated through a network of independent insurance agents and brokers. Agents or general agencies collect the premiums from the insureds, which are subsequently remitted to TSP, net of commissions.

Remittances are due 60 days after the closing date of the general agent's account current.

The Company evaluates performance based primarily on the operating revenues and operating income of each segment. Operating revenues include premiums earned, net, administrative service fees and net investment income. Operating costs include claims incurred and operating expenses. The Company calculates operating income or loss as operating revenues less operating costs.

The accounting policies for the segments are the same as those described in the summary of significant accounting policies included in the notes to consolidated financial statements. The financial data of each segment is accounted for separately; therefore no segment allocation is necessary. However, certain operating expenses are centrally managed, therefore requiring an allocation to each segment. Most of these expenses are distributed to each segment based on different parameters, such as payroll hours, processed claims, or square footage, among others. In addition, some depreciable assets are kept by one segment, while allocating the depreciation expense to other segments. The allocation of the depreciation expense is based on the proportion of asset used by each segment. Certain expenses are not allocated to the segments and are kept within TSM's operations.

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The following tables summarize the operations by operating segment for each of the years in the three-year period ended December 31, 2009, 2008, and 2007.

|   | <b>2009</b>      | <b>2008</b>      | <b>2007</b>      |
|---|------------------|------------------|------------------|
| <b>Operating revenues</b>                         |                  |                  |                  |
| Managed care                                      |                  |                  |                  |
| Premiums earned, net                              | \$ 1,680,750     | \$ 1,509,778     | \$ 1,298,776     |
| Fee revenue                                       | 48,643           | 19,187           | 14,018           |
| Intersegment premiums/fee revenue                 | 5,995            | 6,538            | 6,229            |
| Net investment income                             | 21,641           | 23,091           | 19,673           |
| <br>Total managed care                            | <br>\$ 1,757,029 | <br>1,558,594    | <br>1,338,696    |
| <br>Life  |                  |                  |                  |
| Premiums earned, net                              | 99,726           | 92,469           | 88,505           |
| Intersegment premiums                             | 386              | 374              | 356              |
| Net investment income                             | 16,763           | 16,482           | 15,016           |
| <br>Total life                                    | <br>116,875      | <br>109,325      | <br>103,877      |
| <br>Property and casualty                         |                  |                  |                  |
| Premiums earned, net                              | 95,596           | 93,211           | 96,267           |
| Intersegment premiums                             | 613              | 610              | 616              |
| Net investment income                             | 11,679           | 12,545           | 11,849           |
| <br>Total property and casualty                   | <br>107,888      | <br>106,366      | <br>108,732      |
| <br>Other segments intersegment service revenues* | <br>52,997       | <br>46,578       | <br>44,971       |
| <br>Total business segments                       | <br>2,034,789    | <br>1,820,863    | <br>1,596,276    |
| <br>TSM operating revenues from external sources  | <br>2,053        | <br>4,135        | <br>656          |
| Elimination of intersegment premiums              | (6,994)          | (7,523)          | (7,201)          |
| Elimination of intersegment service revenue       | (52,997)         | (46,578)         | (44,971)         |
| <br>Consolidated operating revenues               | <br>\$ 1,976,851 | <br>\$ 1,770,897 | <br>\$ 1,544,760 |

\* Includes segments that are not required to be reported separately. These segments include the data

processing  
services  
organization as  
well as the  
third-party  
administrator of  
health insurance  
services.

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|   | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|-------------|
| <b>Operating income</b>                                       |             |             |             |
| Managed care  | \$ 57,193   | \$ 52,632   | \$ 57,392   |
| Life  | 14,555      | 12,489      | 10,716      |
| Property and casualty   | 8,746       | 13,147      | 10,740      |
| Other segments*   | 1,482       | 985         | 891         |
| <br>  |             |             |             |
| Total business segments                                       | 81,976      | 79,253      | 79,739      |
| TSM operating revenues from external sources                  | 2,053       | 4,135       | 656         |
| TSM unallocated operating expenses                            | (9,004)     | (9,283)     | (7,846)     |
| Elimination of TSM charges                                    | 9,548       | 9,991       | 10,903      |
| <br>  |             |             |             |
| Consolidated operating income                                 | 84,573      | 84,096      | 83,452      |
| Consolidated net realized investment gains (losses)           | 614         | (13,940)    | 5,931       |
| Consolidated net unrealized gain (loss) on trading securities | 10,497      | (21,064)    | (4,116)     |
| Consolidated interest expense                                 | (13,270)    | (14,681)    | (15,839)    |
| Consolidated other income (expense), net                      | 1,237       | (2,467)     | 3,217       |
| <br>  |             |             |             |
| Consolidated income before taxes                              | \$ 83,651   | \$ 31,944   | \$ 72,645   |
| <br>  |             |             |             |
|   | <b>2009</b> | <b>2008</b> | <b>2007</b> |
| <b>Depreciation expense</b>                                   |             |             |             |
| Managed care  | \$ 6,640    | \$ 4,339    | \$ 4,277    |
| Life  | 663         | 656         | 677         |
| Property and casualty   | 1,477       | 1,450       | 1,488       |
| <br>  |             |             |             |
| Total business segments                                       | 8,780       | 6,445       | 6,442       |
| TSM depreciation expense                                      | \$ 863      | 922         | 1,120       |
| <br>  |             |             |             |
| Consolidated depreciation expense                             | \$ 9,643    | \$ 7,367    | \$ 7,562    |

\* Includes segments that are not required to be reported separately. These segments include the data processing services organization as well as the third-party

administrator of  
health insurance  
services.



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|   | <b>2009</b>      | <b>2008</b>      |
|---|------------------|------------------|
| <b>Assets</b>   |                  |                  |
| Managed care  | \$ 746,674       | \$ 678,889       |
| Life  | 487,290          | 460,109          |
| Property and casualty   | 351,793          | 337,869          |
| Other segments*   | 14,193           | 12,620           |
| <br>Total business segments   | <br>1,599,950    | <br>1,489,487    |
| <br>Unallocated amounts related to TSM  |                  |                  |
| Cash, cash equivalents, and investments   | 39,029           | 58,480           |
| Property and equipment, net   | 21,577           | 21,648           |
| Other assets  | 4,780            | 4,079            |
|   | 65,386           | 84,207           |
| Elimination entries intersegment receivables and others                         | (16,632)         | (14,504)         |
| <br>Consolidated total assets   | <br>\$ 1,648,704 | <br>\$ 1,559,190 |
|   | <br><b>2009</b>  | <br><b>2008</b>  |
| <b>Significant noncash items</b>  |                  |                  |
| Net change in unrealized gain on securities available for sale                  |                  |                  |
| Managed care  | \$ (282)         | \$ (4,359)       |
| Life  | (2,427)          | 538              |
| Property and casualty   | (489)            | 1,139            |
| <br>Total business segments   | <br>(3,198)      | <br>(2,682)      |
| Amount related to TSM   | (341)            | (1,270)          |
| <br>Consolidated net change in unrealized gain on securities available for sale | <br>\$ (3,539)   | <br>\$ (3,952)   |
| <br>Net change in liability for pension benefits                                |                  |                  |
| Managed care  | \$ 2,254         | \$ (4,946)       |
| Life  | 212              | (81)             |
| Property and casualty   | (78)             | (490)            |
| Other segments*   | 74               | (1,948)          |
| <br>Total business segments   | <br>2,462        | <br>(7,465)      |
| Amount related to TSM   | 88               | (150)            |
| <br>Consolidated net change in liability for pension benefits                   | <br>\$ 2,550     | <br>\$ (7,615)   |

- \* Includes segments that are not required to be reported separately. These segments include the data processing services organization as well as the third-party administrator of health insurance services.

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|  | <b>March</b> |                | <b>2009</b>      |                 |              |
|--|--------------|----------------|------------------|-----------------|--------------|
|  | <b>31</b>    | <b>June 30</b> | <b>September</b> | <b>December</b> | <b>Total</b> |
|  |              |                | <b>30</b>        | <b>31</b>       |              |
| <b>Revenues</b>  |              |                |                  |                 |              |
| Premiums earned, net   | \$ 452,484   | \$ 466,221     | \$ 477,503       | \$ 479,864      | \$ 1,876,072 |
| Administrative service fees                                    | 8,866        | 11,319         | 9,797            | 18,661          | 48,643       |
| Net investment income  | 12,541       | 13,360         | 12,955           | 13,280          | 52,136       |
| Total operating revenues                                       | 473,891      | 490,900        | 500,255          | 511,805         | 1,976,851    |
| Net realized investment (losses) gains                         | (1,727)      | (1,625)        | 2,150            | 1,816           | 614          |
| Net unrealized investment (losses) gains on trading securities | (2,476)      | 5,652          | 4,860            | 2,461           | 10,497       |
| Other (loss) income, net                                       | (379)        | 704            | 67               | 845             | 1,237        |
| Total revenues   | 469,309      | 495,631        | 507,332          | 516,927         | 1,989,199    |
| <b>Benefits and expenses</b>                                   |              |                |                  |                 |              |
| Claims incurred  | 394,532      | 398,420        | 413,626          | 406,282         | 1,612,860    |
| Operating expenses   | 68,252       | 68,603         | 71,205           | 71,358          | 279,418      |
| Total operating costs  | 462,784      | 467,023        | 484,831          | 477,640         | 1,892,278    |
| Interest expense   | 3,264        | 3,357          | 3,338            | 3,311           | 13,270       |
| Total benefits and expenses                                    | 466,048      | 470,380        | 488,169          | 480,951         | 1,905,548    |
| Income before taxes  | 3,261        | 25,251         | 19,163           | 35,976          | 83,651       |
| <b>Income tax expense (benefit)</b>                            |              |                |                  |                 |              |
| Current  | 451          | 9,090          | 2,096            | 7,560           | 19,197       |
| Deferred   | (1,122)      | (2,499)        | (1,017)          | 312             | (4,326)      |
| Total income taxes   | (671)        | 6,591          | 1,079            | 7,872           | 14,871       |
| Net income   | \$ 3,932     | \$ 18,660      | \$ 18,084        | \$ 28,104       | \$ 68,780    |
| Basic net income per share                                     | \$ 0.13      | \$ 0.64        | \$ 0.62          | \$ 0.96         | \$ 2.33      |
| Diluted net income per share                                   | 0.13         | 0.63           | 0.62             | 0.96            | 2.33         |

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|   | <b>March<br/>31</b> | <b>June 30</b> | <b>2008<br/>September<br/>30</b> | <b>December<br/>31</b> | <b>Total</b> |
|---|---------------------|----------------|----------------------------------|------------------------|--------------|
| <b>Revenues</b>   |                     |                |                                  |                        |              |
| Premiums earned, net                                    | \$ 404,399          | \$ 419,157     | \$ 433,219                       | \$ 438,682             | \$ 1,695,457 |
| Administrative service fees                             | 3,713               | 3,920          | 4,448                            | 7,106                  | 19,187       |
| Net investment income                                   | 13,432              | 14,302         | 14,072                           | 14,447                 | 56,253       |
| Total operating revenues                                | 421,544             | 437,379        | 451,739                          | 460,235                | 1,770,897    |
| Net realized investment gains<br>(losses)               | 609                 | (1,741)        | (1,101)                          | (11,707)               | (13,940)     |
| Net unrealized investment loss on<br>trading securities | (6,250)             | (951)          | (3,605)                          | (10,258)               | (21,064)     |
| Other (loss) income, net                                | (1,521)             | 1,360          | (1,147)                          | (1,159)                | (2,467)      |
| Total revenues  | 414,382             | 436,047        | 445,886                          | 437,111                | 1,733,426    |
| <b>Benefits and expenses</b>                            |                     |                |                                  |                        |              |
| Claims incurred   | 350,207             | 354,780        | 365,585                          | 364,342                | 1,434,914    |
| Operating expenses                                      | 60,031              | 61,399         | 63,572                           | 66,885                 | 251,887      |
| Total operating costs                                   | 410,238             | 416,179        | 429,157                          | 431,227                | 1,686,801    |
| Interest expense  | 3,673               | 3,926          | 3,749                            | 3,333                  | 14,681       |
| Total benefits and expenses                             | 413,911             | 420,105        | 432,906                          | 434,560                | 1,701,482    |
| Income before taxes                                     | 471                 | 15,942         | 12,980                           | 2,551                  | 31,944       |
| Income tax expense (benefit)                            |                     |                |                                  |                        |              |
| Current   | (184)               | 4,291          | 4,580                            | 2,855                  | 11,542       |
| Deferred  | (547)               | (486)          | (1,071)                          | (2,284)                | (4,388)      |
| Total income taxes                                      | (731)               | 3,805          | 3,509                            | 571                    | 7,154        |
| Net income  | \$ 1,202            | \$ 12,137      | \$ 9,471                         | \$ 1,980               | \$ 24,790    |
| Basic net income per share                              | \$ 0.04             | \$ 0.38        | \$ 0.29                          | \$ 0.06                | \$ 0.77      |
| Diluted net income per share                            | 0.04                | 0.38           | 0.29                             | 0.06                   | 0.77         |

**29. Subsequent Events**

The Company evaluated subsequent events through the date the financial statements were issued. No events, other than those described in these notes, have occurred that require disclosure pursuant to current ASC.

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**Triple-S Management Corporation**  
**Schedule II**  
**Condensed Financial Information of Triple-S Management Corporation**  
**(Registrant)**  
**Balance Sheets**  
**(in thousands)**

|   | <b>As of December 31,</b> |                   |
|---|---------------------------|-------------------|
|   | <b>2009</b>               | <b>2008</b>       |
| Assets:   |                           |                   |
| Cash and cash equivalents   | \$ 361                    | \$ 1,952          |
| Investment securities available for sale, at fair value (amortized cost \$39,713 and \$57,975 in 2009 and 2008, respectively) | 38,668                    | 56,528            |
| Investment in subsidiaries  | 560,448                   | 484,535           |
| Note receivable and accrued interest from subsidiary  | 46,354                    | 48,339            |
| Due from subsidiaries   | 2,552                     | 8,956             |
| Other assets  | 26,357                    | 25,727            |
| <b>Total assets</b>   | <b>\$ 674,740</b>         | <b>\$ 626,037</b> |
| Liabilities:  |                           |                   |
| Due to subsidiary   | 4,335                     | 197               |
| Borrowings  | 117,667                   | 119,307           |
| Other liabilities   | 14,966                    | 21,434            |
| <b>Total liabilities</b>  | <b>136,968</b>            | <b>140,938</b>    |
| Stockholders' equity:   |                           |                   |
| Common stock, class A   | 9,043                     | 9,043             |
| Common stock, class B   | 20,110                    | 22,105            |
| Additional paid-in-capital  | 159,303                   | 179,504           |
| Retained earnings   | 360,892                   | 292,112           |
| Accumulated other comprehensive loss, net   | (11,576)                  | (17,665)          |
| <b>Total stockholders' equity</b>   | <b>537,772</b>            | <b>485,099</b>    |
| <b>Total liabilities and stockholders' equity</b>   | <b>\$ 674,740</b>         | <b>\$ 626,037</b> |

The accompanying notes are an integral part of these condensed financial statements

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**Triple-S Management Corporation**  
**Schedule II**  
**Condensed Financial Information of Triple-S Management Corporation**  
**Triple-S Management Corporation**  
**Statements of Earnings**  
**(in thousands)**

|                                     | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|-------------------------------------|-------------|-------------|-------------|
| Investment income                   | \$ 5,068    | \$ 7,324    | \$ 5,477    |
| Other revenues                      | 8,690       | 8,215       | 11,373      |
| Total revenues                      | 13,758      | 15,539      | 16,850      |
| Operating expenses:                 |             |             |             |
| General and administrative expenses | 9,004       | 9,283       | 7,846       |
| Interest expense                    | 6,693       | 7,301       | 8,034       |
| Total operating expenses            | 15,697      | 16,584      | 15,880      |
| (Loss) income before income taxes   | (1,939)     | (1,045)     | 970         |
| Income tax (benefit) expense        | (463)       | 268         | 432         |
| (Loss) Income of parent company     | (1,476)     | (1,313)     | 538         |
| Equity in income of subsidiaries    | 70,256      | 26,103      | 57,980      |
| Net income                          | \$68,780    | \$24,790    | \$58,518    |

The accompanying notes are an integral part of these condensed financial statements

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**Triple-S Management Corporation**  
**Schedule II**  
**Condensed Financial Information of Triple-S Management Corporation**  
**(Registrant)**  
**Statements of Cash Flows**  
**(in thousands)**

|  | <b>12/31/2009</b> | <b>12/31/2008</b> | <b>12/31/2007</b> |
|--|-------------------|-------------------|-------------------|
| Net income   | \$ 68,780         | \$ 24,790         | \$ 58,518         |
| Adjustment to reconcile net income to net cash (used in) provided by operating activities:     |                   |                   |                   |
| Equity in net income of subsidiaries   | (70,256)          | (26,103)          | (57,980)          |
| Depreciation and amortization  | 863               | 922               | 1,120             |
| Shared- based compensation   | 3,924             | 3,268             | 200               |
| Deferred income tax benefit  | (644)             | (363)             | (88)              |
| Other  | 934               | 1,965             | (394)             |
| Changes in assets and liabilities:   |                   |                   |                   |
| Accrued interest from subsidiary   | 1,985             | (3,188)           | (4,150)           |
| Due from subsidiaries  | 6,404             | (8,359)           | (237)             |
| Other assets   | (175)             | (1,173)           | (236)             |
| Due to subsidiary  | 4,138             | (5,818)           | (9,144)           |
| Other liabilities  | (85)              | 2,343             | 4,908             |
| Net cash provided by (used in) operating activities  | 15,868            | (11,716)          | (7,483)           |
| Cash flows from investing activities:  |                   |                   |                   |
| Acquisition of investment in securities classified as available for sale                       | (40,996)          | (70,684)          | (28,202)          |
| Proceeds from sale and maturities of investment in securities classified as available for sale | 58,324            | 45,905            | 4,393             |
| Notes receivable from subsidiaries   |                   |                   | 22,000            |
| Net (acquisition) retirement of property and equipment   | (792)             | (47)              | 149               |
| Net cash provided by (used in) investing activities  | 16,536            | (24,826)          | (1,660)           |
| Cash flow from financing activities:   |                   |                   |                   |
| Repayments of borrowings   | (1,640)           | (1,639)           | (12,141)          |
| Net proceeds from initial public offering  |                   |                   | 70,279            |
| Dividends  |                   |                   | (2,448)           |
| Repurchase of common stock   | (32,355)          | (7,645)           |                   |
| Other  |                   | 6                 | 1                 |
| Net cash (used in) provided by financing activities  | (33,995)          | (9,278)           | 55,691            |
| Net increase (decrease) in cash and cash equivalents   | (1,591)           | (45,820)          | 46,548            |
| Cash and cash equivalents, beginning of year   | 1,952             | 47,772            | 1,224             |
| Cash and cash equivalents, end of year   | \$ 361            | \$ 1,952          | \$ 47,772         |

The accompanying notes are an integral part of these condensed financial statements

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**Table of Contents****Triple-S Management Corporation**

(Parent Company Only)

Notes to Condensed Financial Statements

December 31, 2009, 2008 and 2007

The accompanying notes to the condensed financial statements should be read in conjunction with the consolidated financial statements and the accompanying notes thereto included in Item 15 to the Annual Report on Form 10-K.

(1) For purposes of these condensed financial statements, Triple-S Management Corporation's (the Company or TSM) investment in its wholly owned subsidiaries is recorded using the equity basis accounting.

**(2) Significant Accounting Policies**

The significant accounting policies followed by the Company are set forth in the notes to the consolidated financial statements and the accompanying notes thereto. Refer to Item 15 to the Annual Report of Form 10-K.

**(3) Long-Term Borrowings**

A summary of the long-term borrowings entered into by the Company at December 31, 2009 and 2008 follows:

|  | <b>2009</b>       | <b>2008</b>       |
|--|-------------------|-------------------|
| Senior unsecured notes payable of \$60,000 issued on December 2005; due December 2020. Interest is payable monthly at a fixed rate of 6.60%.   | \$ 60,000         | \$ 60,000         |
| Senior unsecured notes payable of \$35,000 issued on January 2006; due January 2021. Interest is payable monthly at a fixed rate of 6.70%.   | 35,000            | 35,000            |
| Secured loan payable of \$41,000, payable in monthly installments of \$137 through July 1, 2024, plus interest at a rate reset periodically of 100 basis points over selected LIBOR maturity (which was 1.28% and 2.43% at December 31, 2009, and 2008, respectively). | 22,667            | 24,307            |
| <b>Total borrowings</b>  | <b>\$ 117,667</b> | <b>\$ 119,307</b> |

Aggregate maturities of the Company's long term borrowings as of December 31, 2009 are summarized as follows:

**Year ending December 31**

|            |                   |
|------------|-------------------|
| 2010       | \$ 1,640          |
| 2011       | 1,640             |
| 2012       | 1,640             |
| 2013       | 1,640             |
| 2014       | 1,640             |
| Thereafter | 109,467           |
|            | <b>\$ 117,667</b> |

All of the Company's senior notes can be prepaid at par, in total or partially, five years after issuance as determined by the Company.

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(Parent Company Only)

Notes to Condensed Financial Statements

December 31, 2009, 2008 and 2007

Debt issuance costs related to each of the Company's senior unsecured notes were deferred and are being amortized over the term of its respective senior note. Unamortized debt issuance costs related to these senior unsecured notes as of December 31, 2009 and 2008 amounted to \$651 and \$710, respectively, and are included within the other assets in the accompanying condensed balance sheets.

The secured loan note payable previously described is guaranteed by a first position held by the bank on the Company's and its subsidiaries land, building, and substantially all leasehold improvements, as collateral for the term of the loans under a continuing general security agreement. This secured loan contains certain non-financial covenants, which are customary in this type of facility, including but not limited to, restrictions on the granting of certain liens, limitations on acquisitions and limitation on changes in control.

**(4) Transactions with Related Parties**

The following are the significant related-party transactions made for the three-year period ended December 31, 2009, 2008 and 2007:

|   | <b>2009</b> | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|-------------|
| Rent charges to subsidiaries                      | \$7,422     | \$7,286     | \$7,023     |
| Interest charged to subsidiary on note receivable | 3,015       | 3,189       | 4,821       |

As of December 31, 2009 the Company has a note receivable from a subsidiary pursuant to the provisions of Article 29.30 of the Puerto Rico Insurance Code.

On December 22, 2005, TSV borrowed \$57,000 from TSM. This note receivable has a balance of \$37,000 as of December 31, 2009 and 2008 and bears interest at an annual rate 6.6%. Accrued interest at December 31, 2009 and 2008 amounted to \$9,354 and \$11,339, respectively.

The note receivable from subsidiary is due on demand; however, pursuant to the requirements established by the Commissioner of Insurance, the parties agreed that no payment of the total principal nor the interest due on the loan will be made without first obtaining written authorization from the Commissioner of Insurance within at least 60 days prior to the proposed payment date. Written authorization to convert \$20,000 of the TSV's note receivable into a capital contribution was obtained from the Commissioner of Insurance during 2008.

**(5) Contingencies**

At December 31, 2009 and 2008, the Company is defendant in various lawsuits in the ordinary course of business. In the opinion of management, with the advice of its legal counsel, the ultimate disposition of these matters will not have a material adverse effect on the position and results of operations of the Company.

**Hau et al Litigation (formerly known as Jordan et al)**

On April 24, 2002, Octavio Jordán, Agripino Lugo, Ramón Vidal, and others filed a suit against the Company, TSS and others in the Court of First Instance for San Juan, Superior Section (the Court), alleging, among other things, violations by the defendants of provisions of the Puerto Rico Insurance Code, antitrust violations, unfair business practices, RICO violations, breach of contract with providers, and damages in the amount of \$12 million. Following years of complaint amendments, motions practice and interim appeals up to the level of the Puerto Rico Supreme Court, the plaintiffs amended their complaint on

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**Triple-S Management Corporation**

(Parent Company Only)

Notes to Condensed Financial Statements

December 31, 2009, 2008 and 2007

June 20, 2008 to allege with particularity the same claims initially asserted but on behalf of a more limited group of plaintiffs, and increase their claim for damages to approximately \$207 million. Discovery is expected to conclude by March 2010. The Company intends to vigorously defend this claim.

**Dentists Association Litigation**

On February 11, 2009, the Puerto Rico Dentists Association (Colegio de Cirujanos Dentistas de Puerto Rico) filed a complaint in the Court of First Instance against 24 health plans operating in Puerto Rico that offer dental health coverage. The Company and two of its subsidiaries, TSS and TC were included as defendants. This litigation purports to be a class action filed on behalf of Puerto Rico dentists who are similarly situated; however, the complaint does not include a single dentist as a class representative nor a definition of the intended class. The complaint alleges that the defendants, on their own and as part of a common scheme, systematically deny, delay and diminish the payments due to dentists so that they are not paid in a timely and complete manner for the covered medically necessary services they render. The complaint also alleges, among other things, violations to the Puerto Rico Insurance Code, antitrust laws, the Puerto Rico racketeering statute, unfair business practices, breach of contract with providers, and total damages in the amount of \$150 million. In addition, the complaint claims that the Puerto Rico Insurance Companies Association is the hub of an alleged conspiracy concocted by the member plans to defraud dentists.

There are numerous available defenses to oppose both the request for class certification and the merits. The Company intends to vigorously defend this claim.

Two codefendant plans removed the case to federal court, which the plaintiffs and the other codefendants, including the Company, opposed. The federal District Court decided that it lacked jurisdiction under the Class Action Fairness Act ( CAFA ) and remanded the case to state court. The removing defendants petitioned to appeal to the First Circuit Court of Appeals. Having accepted the appeal, the First Circuit Court of Appeals issued an order in late October 2009 which found the lower court's decision premature. The Court of Appeals remanded the case to the federal District Court and allowed limited discovery to determine whether the case should be heard in federal court pursuant to CAFA.

**Claims by Heirs of Former Shareholders**

The Company and TSS are defending four individual lawsuits, all filed in state court, from persons who claim to have inherited a total of 90 shares of the Company or one of its predecessors or affiliates (before giving effect to the 3,000-for-one stock split). While each case presents unique facts, the lawsuits generally allege that the redemption of the shares by the Company pursuant to transfer and ownership restrictions contained in the Company's (or its predecessors' or affiliates') articles of incorporation and bylaws was improper. Discovery is underway in each case. Management believes all these claims are time barred under one or more statutes of limitations and is vigorously defending them.

**(6) Stockholders' Equity**

**Dividends**

On March 12, 2007, the Board declared a cash dividend of \$2,448 distributed pro rata among all of the Company's issued and outstanding Class A common shares, excluding those shares issued to the representatives of the community that are members of the Board (the qualifying shares). All stockholders of record as of the close of business on March 23, 2007, except those who only hold qualifying shares, received a dividend per share of \$0.09 for each share held on that date.

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**Triple-S Management Corporation and Subsidiaries**  
**Schedule III Supplementary Insurance Information**  
**For the years ended December 31, 2009, 2008 and 2007**  
**(Dollar amounts in thousands)**

| Segment  | Deferred Policy                                  |                   | Liability for Future Policy Benefits | Other Policy Claims and Benefits Payable | Net Investment Income | Claims Incurred | Amortization of Deferred Policy                  |                          | Net Premiums Written |
|--|--|-------------------|--------------------------------------|--|-----------------------|-----------------|--|--------------------------|----------------------|
|  | Acquisition Costs and Value of Business Acquired | Claim Liabilities |                                      |  |                       |                 | Acquisition Costs and Value of Business Acquired | Other Operating Expenses |                      |
| 2009   |  |                   |                                      |  |                       |                 |  |                          |                      |
| Managed care life insurance  | \$ 112,908                                       | \$ 236,366        | \$ 222,619                           | \$ 6,996                                 | \$ 21,641             | \$ 1,515,173    | \$ 16,844  | \$ 184,663               | \$ 1,684,068         |
| Property and casualty insurance  | 27,009   | 83,980            |                                      | 4,163                                    | 96,209                | 11,679          | 28,284   | 23,524                   | 95,811               |
| Other non-reportable segments, parent company operations and net consolidating entries |  |                   |                                      |  | (4,317)               | 2,053           |  | (9,020)                  |                      |
| Total  | \$ 139,917                                       | \$ 360,446        | \$ 222,619                           | \$ 108,342                               | \$ 52,136             | \$ 1,612,860    | \$ 45,128  | \$ 234,290               | \$ 1,879,999         |
| 2008   |  |                   |                                      |  |                       |                 |  |                          |                      |
| Managed care life insurance  | \$ 101,243                                       | \$ 201,849        | \$ 207,545                           | \$ 5,585                                 | \$ 23,091             | \$ 1,345,371    | \$ 16,404  | \$ 160,591               | \$ 1,513,025         |
| Property and casualty insurance  | 25,104   | 81,913            |                                      | 3,370                                    | 93,821                | 12,546          | 27,383   | 23,725                   | 95,861               |
| Other non-reportable segments, parent  |  |                   |                                      |  |                       |                 |  |                          |                      |

|   |            |                      |            |                    |                        |                     |                        |           |                      |                        |
|---|------------|----------------------|------------|--------------------|------------------------|---------------------|------------------------|-----------|----------------------|------------------------|
| Company<br>operations and<br>net<br>consolidating<br>entries  |            |                      |            |                    | (4,232)                | 4,134               |                        |           | (9,216)              |                        |
| Total   | \$ 126,347 | \$ 323,710           | \$ 207,545 | \$ 110,141         | \$ 1,695,457           | \$ 56,253           | \$ 1,434,914           | \$ 43,787 | \$ 208,100           | \$ 1,701,733           |
| 2007  |            |                      |            |                    |                        |                     |                        |           |                      |                        |
| Managed care<br>life insurance<br>property and<br>casualty<br>insurance<br>other<br>non-reportable<br>segments,<br>parent<br>company<br>operations and<br>net<br>consolidating<br>entries | \$ 93,564  | \$ 201,604<br>35,485 | \$ 194,131 | \$ 27,923<br>2,931 | \$ 1,301,792<br>88,861 | \$ 19,673<br>15,016 | \$ 1,133,241<br>45,669 | \$ 16,033 | \$ 148,063<br>31,459 | \$ 1,301,792<br>88,861 |
|   | 23,675     | 116,741              |            | 101,745            | 96,883                 | 11,849              | 44,865                 | 28,917    | 24,210               | 101,745                |
| Total   | \$ 117,239 | \$ 353,830           | \$ 194,131 | \$ 132,599         | \$ 1,483,548           | \$ 47,194           | \$ 1,223,775           | \$ 44,950 | \$ 192,583           | \$ 1,492,400           |

See accompanying independent registered public accounting firm's report and notes to financial statements.

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**Triple-S Management Corporation and Subsidiaries**  
**Schedule IV Reinsurance**  
**For the years ended December 31, 2009, 2008 and 2007**  
**(Dollar amounts in thousands)**

|                                 | <b>Gross</b>  | <b>Ceded to</b>  | <b>Assumed</b>   | <b>Net</b>    | <b>Percentage</b> |
|---------------------------------|---------------|------------------|------------------|---------------|-------------------|
|                                 | <b>Amount</b> | <b>Other</b>     | <b>from</b>      | <b>Amount</b> | <b>of</b>         |
|                                 |               | <b>Companies</b> | <b>Other</b>     |               | <b>Amount</b>     |
|                                 |               | <b>(1)</b>       | <b>Companies</b> |               | <b>Assumed</b>    |
|                                 |               |                  |                  |               | <b>to Net</b>     |
| <b>2009</b>                     |               |                  |                  |               |                   |
| Life insurance in force         | \$ 10,714,252 | \$ 2,937,377     | \$               | \$ 7,776,875  | 0.0%              |
| Premiums:                       |               |                  |                  |               |                   |
| Life insurance                  | \$ 106,243    | \$ 6,131         | \$               | \$ 100,112    | 0.0%              |
| Accident and health insurance   | 1,691,409     | 7,341            |                  | 1,684,068     | 0.0%              |
| Property and casualty insurance | 163,358       | 67,541           |                  | 95,817        | 0.0%              |
| Total premiums                  | \$ 1,961,010  | \$ 81,013        | \$               | \$ 1,879,997  | 0.0%              |
| <b>2008</b>                     |               |                  |                  |               |                   |
| Life insurance in force         | \$ 10,503,170 | \$ 2,823,647     | \$               | \$ 7,679,523  | 0.0%              |
| Premiums:                       |               |                  |                  |               |                   |
| Life insurance                  | \$ 100,413    | \$ 7,570         | \$               | \$ 92,843     | 0.0%              |
| Accident and health insurance   | 1,518,648     | 5,623            |                  | 1,513,025     | 0.0%              |
| Property and casualty insurance | 167,982       | 72,115           |                  | 95,867        | 0.0%              |
| Total premiums                  | \$ 1,787,043  | \$ 85,308        | \$               | \$ 1,701,735  | 0.0%              |
| <b>2007</b>                     |               |                  |                  |               |                   |
| Life insurance in force         | \$ 10,321,749 | \$ 2,459,100     | \$               | \$ 7,862,649  | 0.0%              |
| Premiums:                       |               |                  |                  |               |                   |
| Life insurance                  | \$ 97,700     | \$ 8,839         | \$               | \$ 88,861     | 0.0%              |
| Accident and health insurance   | 1,305,141     | 3,349            |                  | 1,301,792     | 0.0%              |
| Property and casualty insurance | 170,884       | 69,137           |                  | 101,747       | 0.0%              |
| Total premiums                  | \$ 1,573,725  | \$ 81,325        | \$               | \$ 1,492,400  | 0.0%              |

- (1) Premiums ceded on the life insurance business are net of commission income on reinsurance amounting to \$42, \$287 and \$258 for the years ended December 31, 2009, 2008 and 2007.

See accompanying independent registered public accounting firm's report and notes to financial statements.

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**Triple-S Management Corporation and Subsidiaries**  
**Schedule V Valuation and Qualifying Accounts**  
**For the years ended December 31, 2009, 2008 and 2007**  
**(Dollar amounts in thousands)**

|                                    | <b>Balance at<br/>Beginning<br/>of<br/>Period</b> | <b>Charged<br/>to<br/>Costs<br/>and<br/>Expenses</b> | <b>Charged to<br/>Other<br/>Accounts<br/>- Describe (1)</b> | <b>Additions</b><br><b>Deductions<br/>-<br/>Describe<br/>(2)</b> | <b>Balance<br/>at<br/>End of<br/>Period</b> |
|------------------------------------|---|--|---|--|---|
| <b>2009</b>                        |   |  |   |  |   |
| Allowance for doubtful receivables | \$ 14,745   | 2,149  | 10,065  | (1,725)  | 25,234                                      |
| <b>2008</b>                        |   |  |   |  |   |
| Allowance for doubtful receivables | \$ 15,925   | 821  |   | (2,001)  | 14,745                                      |
| <b>2007</b>                        |   |  |   |  |   |
| Allowance for doubtful receivables | \$ 18,230   | 6,661  |   | (8,966)  | 15,925                                      |

**(1)** Represents premiums adjustment to provide for unresolved reconciliation items with the Government of Puerto Rico and other entities.

**(2)** Deductions represent the write-off of accounts deemed uncollectible.

See accompanying independent registered public accounting firm's report and notes to financial statements.