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

Combined Financial Statements

For the nine months ended September 30, 2018 and 2017

(Unaudited)

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

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

Combined Balance Sheets

September 30, 2018 and December 31, 2017

(In millions)

Assets	**2018**	**2017**
Current assets:		
Cash and cash equivalents	$ 462	$ 552
Current investments	8,013	6,742
Securities lending collateral	1,070	1,249
Broker receivables	354	388
Due from associated medical groups	40	11
Accounts receivable – net	2,143	2,013
Inventories and other current assets	1,831	1,543
Total current assets	13,913	12,498
Noncurrent investments	34,394	33,819
Land, buildings, equipment, and software – net	26,278	25,907
Goodwill	297	297
Other acquired intangible assets – net	306	293
Other long-term assets	615	569
Total assets	$ 75,803	$ 73,383

Liabilities and Net Worth		
Current liabilities:		
Accounts payable and accrued expenses	$ 4,823	$ 4,085
Medical claims payable	2,371	2,303
Due to associated medical groups	929	1,212
Payroll and related charges	1,955	2,134
Securities lending payable	1,070	1,249
Broker payables	762	520
Long-term debt subject to short-term remarketing arrangements – net	475	492
Other current debt	1,001	769
Other current liabilities	2,634	2,791
Total current liabilities	16,020	15,555
Long-term debt	8,652	8,891
Physicians’ retirement plan liability	8,383	7,966
Pension and other retirement liabilities	8,651	9,378
Other long-term liabilities	2,627	2,640
Total liabilities	44,333	44,430
Net worth	31,470	28,953
Total liabilities and net worth	$ 75,803	$ 73,383

See accompanying notes to combined financial statements.

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

Combined Statements of Operations and Changes in Net Worth

Nine months ended September 30, 2018 and 2017

(In millions)

	2018	2017
Revenues:		
Members' dues	$ 40,715	$ 36,890
Medicare	13,683	12,652
Copays, deductibles, fees, and other	5,347	4,955
Total operating revenues	59,745	54,497
Expenses:		
Medical services	28,578	26,356
Hospital services	14,960	13,565
Outpatient pharmacy and optical services	6,722	6,172
Other benefit costs	4,113	3,470
Total medical and hospital services	54,373	49,563
Health Plan administration	3,338	2,603
Total operating expenses	57,711	52,166
Operating income	2,034	2,331
Other income and expense:		
Investment income – net	932	1,370
Interest expense and other income (expense) – net	(42)	132
Total other income and expense	890	1,502
Net income	2,924	3,833
Change in pension and other retirement liability charges	255	47
Change in net unrealized gains on investments	(661)	1,237
Other	(1)	16
Change in net worth	2,517	5,133
Net worth at beginning of year	28,953	27,090
Net worth at end of period	$ 31,470	$ 32,223

See accompanying notes to combined financial statements.

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

Combined Statements of Operations and Changes in Net Worth

Three months ended September 30, 2018 and 2017

(In millions)

	2018	2017
Revenues:		
Members' dues	$ 13,611	$ 12,384
Medicare	4,554	4,232
Copays, deductibles, fees, and other	1,702	1,670
Total operating revenues	19,867	18,286
Expenses:		
Medical services	9,531	8,954
Hospital services	4,927	4,515
Outpatient pharmacy and optical services	2,232	2,084
Other benefit costs	1,454	1,141
Total medical and hospital services	18,144	16,694
Health Plan administration	1,087	852
Total operating expenses	19,231	17,546
Operating income	636	740
Other income and expense:		
Investment income – net	265	491
Interest expense and other income (expense) – net	(17)	27
Total other income and expense	248	518
Net income	884	1,258
Change in pension and other retirement liability charges	85	(2)
Change in net unrealized gains on investments	345	396
Other	20	31
Change in net worth	1,334	1,683
Net worth at beginning of quarter	30,136	30,540
Net worth at end of quarter	$ 31,470	$ 32,223

See accompanying notes to combined financial statements.

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

Combined Statements of Cash Flows

Nine months ended September, 2018 and 2017

(In millions)

	2018	2017
Cash flows from operating activities:		
Net income	$ 2,924	$ 3,833
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and software amortization	1,908	1,847
Other amortization	(45)	(28)
Gain recognized on investments – net	(196)	(734)
Loss on land, buildings, equipment, and software – net	11	64
Releases of restricted donations	(23)	—
Changes in assets and liabilities:		
Accounts receivable – net	(102)	223
Due from associated medical groups	(29)	(48)
Other assets	(355)	(45)
Accounts payable and accrued expenses	808	(215)
Medical claims payable	68	121
Due to associated medical groups	(263)	(52)
Payroll and related charges	(179)	(53)
Medicare payments received in advance	—	1,394
Pension and other retirement liabilities	(560)	(2,746)
Other liabilities	(119)	230
Net cash provided by operating activities	3,848	3,791
Cash flows from investing activities:		
Additions to land, buildings, equipment, and software	(2,376)	(2,367)
Proceeds from sales of land, buildings, and equipment	2	3
Proceeds from investments	22,557	27,371
Investment purchases	(24,759)	(30,560)
Decrease (increase) in securities lending collateral	179	(531)
Broker receivables / payables	276	307
Issuance of notes receivable	(110)	(108)
Prepayment and repayment of notes receivable	130	132
Physicians’ retirement plan liability	505	373
Cash paid for acquisition, net of cash assumed	(7)	(1,686)
Other investing	(89)	(72)
Net cash used in investing activities	(3,692)	(7,138)
Cash flows from financing activities:		
Issuance of debt	1,307	5,976
Prepayment and repayment of debt	(1,368)	(3,242)
Increase (decrease) in securities lending payable	(179)	531
Change in noncontrolling interest	(6)	(22)
Net cash provided by (used in) financing activities	(246)	3,262
Net change in cash and cash equivalents	(90)	(85)
Cash and cash equivalents at beginning of year	552	434
Cash and cash equivalents at end of period	$ 462	$ 349
Supplemental cash flows disclosure:		
Cash paid for interest – net of capitalized amounts	$ 200	$ 115

See accompanying notes to combined financial statements.

(1) Description of Business

The accompanying combined financial statements include Kaiser Foundation Health Plan, Inc. and Subsidiaries (Health Plans) and Kaiser Foundation Hospitals and Subsidiaries (Hospitals) (collectively referred to herein as Health Plans and Hospitals). Health Plans and Hospitals are primarily not-for-profit corporations whose capital is available for charitable, educational, research, and related purposes. Health Plans are primarily health maintenance organizations and are generally exempt from federal and state income taxes. Membership at September 30, 2018 and December 31, 2017 was 12.2 million and 11.8 million, respectively. At September 30, 2018 and December 31, 2017, the percentage of enrolled membership in California was approximately 72% and 73%, respectively. The principal operating subsidiary of Kaiser Foundation Hospitals is Kaiser Hospital Asset Management, Inc. The principal operating subsidiaries of Kaiser Foundation Health Plan, Inc. (Health Plan, Inc.) are:

Kaiser Foundation Health Plan of Colorado

Kaiser Foundation Health Plan of Georgia, Inc.

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

Kaiser Foundation Health Plan of the Northwest

Kaiser Foundation Health Plan of Washington

Kaiser Health Plan Asset Management, Inc.

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

At both September 30, 2018 and December 31, 2017, the percentage of Health Plans and Hospitals' total labor force covered under collective bargaining agreements was approximately 71%. At September 30, 2018, approximately 25% of the workforce was covered under collective bargaining agreements that were scheduled to expire within one year. At September 30, 2018, less than 1% of the workforce was working under an expired agreement, and approximately less than 1% of the workforce was in a new bargaining unit that was negotiating an agreement.

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

Cost-based methods are used to account for losses incurred under the care and coverage lines of business qualifying for treatment as Community Benefit. Patients assigned to these lines of business must first prove eligibility based upon family income relative to the Federal Poverty Guidelines. Most costs determined to be Community Benefit are allocated across the lines of business following pre-determined allocation rules applied within the organization’s cost accounting systems. Certain Community Benefit costs are determined using the out-of-pocket costs directly billed to patients or a cost-to-charge ratio applied to uncompensated charges associated with care provided to these patients.

For the year ended December 31, 2017, Community Benefit expenditures (at cost, net of approximately $3.2 billion of related revenues) were $2.8 billion, representing 3.9% of operating revenue.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The financial statements of Health Plans and Hospitals are presented on a combined basis due to the operational interdependence of these organizations and because their governing boards and management are substantially the same. These combined financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All material intercompany balances and transactions have been eliminated. Management has evaluated subsequent events through November 14, 2018, which is the date that these combined financial statements were issued.

(b) Cash and Cash Equivalents

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

(c) Investments

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

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

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

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

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

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

(d) Securities Lending Collateral and Payable

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

(e) Broker Receivables and Payables

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

(f) Accounts Receivable – Net

Accounts receivable – net are comprised of members' dues, Medicare receivables, patient receivables, and other receivables. Health Plans and Hospitals provides an allowance for potential uncollectible accounts receivable.

(g) Inventory

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

(h) Land, Buildings, Equipment, and Software

Land, buildings, equipment, and software are stated at cost less accumulated depreciation and amortization. Interest is capitalized on facilities construction and internally developed software work in progress and is added to the cost of the underlying asset. Software, which includes internal and external costs incurred in developing or obtaining computer software for internal use, is capitalized. Qualifying costs incurred during the application development stage are capitalized. Depreciation and amortization begin when the project is substantially complete and ready for its intended use. Software is amortized on a straight-line basis over the estimated useful lives, generally ranging from three to seven years. Buildings and equipment are depreciated on a straight-line basis over the estimated useful lives of the various classes of assets, generally ranging from three to 40 years.

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

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

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

(i) Goodwill and Other Acquired Intangible Assets

Goodwill and other acquired intangible assets arise from acquisition related activity. Goodwill represents the excess of the purchase price over the fair value of net assets acquired when accounted for using the acquisition method of accounting. Goodwill is required to be tested for impairment at least annually, or sooner, whenever events or circumstances indicate that the asset may be impaired.

Other acquired intangible assets are recognized at fair value on the date of purchase and are amortized on a straight-line basis or accelerated basis over periods from two to 16 years. These intangible assets are subject to impairment tests whenever events or circumstances indicate that these assets may be impaired.

(j) Medical Claims Payable

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

(k) Due to Associated Medical Groups

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

(l) Self-Insured Risks

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

(m) Premium Deficiency Reserves

Premium deficiency reserves and the related expense are recognized when it is probable that expected future health care and maintenance costs under a group of existing contracts will exceed anticipated future premiums and reinsurance recoveries over the contract period. If applicable, premium deficiency reserves extending beyond one year are shown as a long-term liability. Expected investment income and interest expense are included in the calculation of premium deficiency reserves, as appropriate. The level at which contracts are grouped for evaluation purposes is generally by geographic region.

The methods for making such estimates and for establishing the resulting reserves are reviewed and estimates are periodically updated, and any resulting adjustments are reflected in current operations. At September 30, 2018 and December 31, 2017, premium deficiency reserves were $252 million and $0 million, respectively. Given the inherent variability of such estimates, the actual liability could differ significantly from the calculated amount.

(n) Derivative Financial Instruments

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

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

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

(o) Revenue Recognition

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

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

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

Members' Dues

Members' dues generally includes amounts received from employer groups, individuals, and government entities. The service promised is access to integrated health care services for a typical term of one year. Members' dues are generally based on a prepaid fee and billed on a monthly, fixed, per member per month basis.

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

- *Copays and Deductibles:* These are member cost share amounts due to Health Plans and Hospitals. Amounts due are based on contractual agreements and evidence of coverage documentation and are typically calculated and collected at the point of service. Amounts may be fixed per unit/service or vary based on venue of care, coverage, and/or whether certain maximum out of pocket or deductible thresholds have been met. Member cost share amounts qualify as variable consideration within the members' dues revenue stream as they would not occur without the existence of a members' dues contract and are not separated from the primary obligation of providing access to integrated health care services.

- *Risk Adjustment:* Health Plans participates in certain contracts with commercial large groups that include provision for risk adjustment of members' dues based on comparative data provided by Health Plans as well as other health plan vendors participating in these same arrangements. Settlements are typically calculated and paid according to the contract provisions and final settlements are made after the contract terms expire. For both the nine months ended September 30, 2018 and 2017, dues subject to these risk adjustment arrangements comprise 8.2% of total members' dues. During the nine months ended September 30, 2018 and 2017, $61 million and $23 million, respectively, have been recorded as reductions to revenue for these risk adjustment arrangements.

Medicare

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

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

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

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

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

Significant variable consideration items related to Medicare include the following:

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

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

Third Party Medicaid

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

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

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

For the nine months ended September 30, 2018 and 2017, revenues related to third party Medicaid contracts were $1.3 billion and $1.1 billion, respectively.

Collectability Assessment

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

Disaggregation of Revenue

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

For the nine months ended September 30, 2018, contracts with customers revenue disaggregated by geographical market were as follows (in millions):

Primary Geographical Markets:		
Northern California	$	23,281
Southern California		20,790
Colorado		3,172
Georgia		1,686
Hawaii		1,258
Mid Atlantic		3,439
Northwest		3,254
Washington		3,388
Other		390
Total Contracts with Customers Revenue		60,658
Other Revenue		(913)
Total Operating Revenue	$	59,745

Contract Asset / Liability Balances

Health Plans and Hospitals generally satisfies its performance obligation when it provides access to integrated health care services in exchange for consideration from its customers. The timing of Health Plans and Hospitals' performance may differ from the timing of the customer's payment, which may result in the recognition of a contract asset or a contract liability. At September 30, 2018, there were no material contract assets with customers. The opening and closing balances of Health Plans and Hospitals' contract liabilities were as follows (in millions):

		Contract Liabilities
Opening (January 1, 2018)	$	954
Closing (September 30, 2018)		1,143
Increase	$	189

For the nine months ended September 30, 2018, the majority of the $954 million contract liability balance at January 1, 2018 was recognized.

Significant Judgments

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

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

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

Practical Expedients

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

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

Remaining Performance Obligations

The remaining performance obligations for contracts that are greater than one year were not material for Health Plans and Hospitals.

(p) Pension and Other Postretirement Benefits

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

Health Plans and Hospitals uses a discount rate to determine the present value of the future benefit obligations. The discount rate is established based on rates available for high-quality fixed-income debt securities at the measurement date whose maturity dates match the expected cash flows of the retirement plans.

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

In March 2017, the FASB issued ASU No. 2017-07 *Compensation - Retirement Benefits (Topic 715), Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The amendments in this update require that an employer disaggregate the service cost component from the other components of net benefit cost and provide explicit guidance on how to present the service cost component and the other components of net benefit cost in the income statement. The new standard is required to be adopted by January 1, 2019, but early adoption is permitted.

Health Plans and Hospitals elected to early adopt the provisions of ASU No. 2017-07 as of January 1, 2018 and as a result has changed the method used to report the service and non-service costs of net benefit expense for pension, other postretirement benefits, and the physicians' retirement plan. The impact of this change resulted in the non-service cost components of pension and postretirement benefit costs, previously presented within operating expense, being reported as interest expense and other income (expense) – net. For the nine months ended September 30, 2018, non-service pension and postretirement benefit costs were $226 million. For the nine months ended September 30, 2017, $327 million in non-service cost components of pension and postretirement benefit costs, previously presented within operating expense, have been reclassified as interest expense and other income (expense) – net.

(q) Donations and Grants Made or Received

Donations and grants made are recognized at fair value in the period in which a commitment is made, provided the payment of the donation or grant is probable and the amount is determinable. Donations or grants received, including research grants, are recognized at fair value in the period the donation or grant was committed unconditionally by the grantor or in the period the donation or grant requirements are met, if later.

(r) Income Taxes

Health Plans and Hospitals are not-for-profit corporations exempt from income taxes under Internal Revenue Code Section 501(a) as organizations described in section 501(c)(3) and the laws of the states in which they operate. Accordingly, Health Plans and Hospitals are generally not subject to federal or state income taxes. Health Plans and Hospitals are subject to income taxes on unrelated business income. A limited number of Health Plans and Hospitals’ subsidiaries are for profit entities and are subject to income taxes. For the nine months ended September 30, 2018 and 2017, no significant income tax provision has been recorded.

(s) Use of Estimates

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

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

The ACA requires Health Plans to pay a Health Insurance Providers (HIP) fee that is assessed based on Health Plans' prior year net premiums as a percentage of total premiums for all U.S. health plans. The Internal Revenue Service (IRS) has provided Health Plans its final assessment of $676 million for 2018. The amount was paid in September 2018 and will continue to be expensed throughout 2018. The HIP fee was suspended for the 2017 calendar year.

The ACA Risk Adjustment Program provides for retrospective adjustment of revenue for non-grandfathered individual and small group market plans, whether inside or outside ACA exchanges. The ACA Risk Adjustment Program is designed such that payments to plans with higher relative risk are funded by transfers from plans with lower relative risk. For the nine months ended September 30, 2018 and 2017, Health Plans recorded $1,082 million and $606 million, respectively, in net revenue reductions related to the ACA Risk Adjustment Program. At September 30, 2018 and December 31, 2017, net payables for Risk Adjustment settlements were $999 million and $851 million, respectively.

(u) Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09 *Revenue from Contracts with Customers (Topic 606)*. The ASU replaces most existing revenue recognition guidance in U.S. GAAP. Topic 606 was adopted January 1, 2018. The standard permits the use of either the retrospective or cumulative effect transition method. Management selected the cumulative effect transition method. Management has applied the standard to contracts that are not completed at the date of adoption. The adoption of Topic 606 did not have a significant impact on the results of operations. There would not have been a material impact to any financial statement line item in the current period as compared with the guidance that was in effect prior to the change. Disclosures in the *Summary of Significant Accounting Policies – Revenue Recognition* note have been updated as required by the standard.

In January 2016, the FASB issued ASU No. 2016-01 *Financial Instruments – Overall (Subtopic 825-10)*. The standard requires entities to measure equity investments that are not accounted for under the equity method or do not result in consolidation to be recorded at fair value and recognize any changes in fair value to net income. Investments that qualify for a practicability exception would not require a change in accounting. The disclosure of fair value of investments held at amortized cost will no longer be required. The new standard is effective for Health Plans and Hospitals on January 1, 2019. The standard requires the use of the cumulative effect transition method, except for equity securities without readily determinable fair values, for which the standard requires the application of the prospective transition method. Management expects the cumulative effect adjustment upon adoption to be significant.

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

Health Plans and Hospitals expects to elect certain relief options offered in Topic 842 including the package of transition practical expedients, the option not to separate lease and non-lease components and instead to account for them as a single lease component, and the option not to recognize right-of-use assets and lease liabilities that arise from short-term leases (i.e. leases with terms of twelve months or less). Health Plans and Hospitals does not expect to elect the hindsight practical expedient, which allows entities to use hindsight when determining lease term and impairment of right-of-use assets.

Management is in the process of evaluating necessary changes to information technology systems, accounting policies, and processes to support the adoption of the standard. Management expects to record significant amounts for right-of-use assets and lease liabilities on its combined balance sheets from a lessee perspective but does not expect a significant impact on the results of operations or cash flows. Health Plans and Hospitals does not have significant lessor activity. Management will include new disclosures in 2019 in accordance with Topic 842.

In August 2016, the FASB issued ASU No. 2016-14 *Not-for-Profit Entities (Topic 958)*. The amendments in this update make certain improvements that address many, but not all, of the identified issues about the current financial reporting for not-for-profits. The new standard is effective for Health Plans and Hospitals for the annual period beginning on January 1, 2018. The standard requires the use of the retrospective transition method with the option to omit certain disclosures for any periods presented before the period of adoption. The impact of adoption will result in enhanced disclosures about the classification of expenses and management of liquid resources.

In January 2017, the FASB issued ASU No. 2017-04 *Intangibles – Goodwill and Other (Topic 350)*, *Simplifying the Test for Goodwill Impairment*. The amendments in this update eliminate Step 2 from the goodwill impairment test in an effort to simplify the subsequent measurement of goodwill. Step 2 requires determining the fair value at the impairment testing date of assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. The new standard is effective for Health Plans and Hospitals on January 1, 2022. Early application is permitted. The impact of adoption will result in goodwill impairment being measured based on comparison with the fair value of the reporting unit.

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

(3) Acquisition of Group Health Cooperative

On February 1, 2017, KFHPW Holdings (Holdings), a subsidiary of Health Plan, Inc., acquired and became the sole corporate member of Group Health Cooperative (GHC), a Washington nonprofit corporation (the “Acquisition”). After closing of the Acquisition, GHC remained the sole shareholder of Group Health Options, Inc. (GHO), a Washington for-profit corporation. Following the Acquisition, GHC was renamed “Kaiser Foundation Health Plan of Washington”, and GHO was renamed “Kaiser Foundation Health Plan of Washington Options, Inc.” (Kaiser Foundation Health Plan of Washington and its subsidiaries are collectively referred to herein as Washington Health Plans).

Washington Health Plans offers comprehensive, coordinated health care to an enrolled membership primarily for a fixed fee through its owned and leased facilities, employed providers, and contracted providers. In addition, Washington Health Plans provides certain health care services on a fee for service basis to both members and nonmembers. Through this Acquisition, Health Plans expects to better meet the needs of individuals as well as large commercial and national accounts with employees who live and work in the State of Washington.

At closing, Holdings transferred approximately $1.8 billion in cash, of which $75 million was deposited into escrow for possible future indemnity claims. In addition to and separate from this transaction consideration, the Acquisition Agreement requires $1 billion to be spent over the 10 year period following closing (subject to standard capital and budget approval processes) for capital improvements and key investments in infrastructure and other improvements at Washington Health Plans, and also states that $800 million in community benefit contributions is expected to be made over the same period. During the nine months ended September 30, 2018 and 2017, $81 million and $80 million, respectively, in capital and other investments were made. At September 30, 2018, $704 million of remaining capital and other investment commitments are required to be made relating to the Acquisition.

Prior to the Acquisition, Group Health Permanente, P.C. (GHP), which is an independent medical group, provided physician and certain other medical services exclusively to Washington Health Plans' members. GHP continues to be an independent medical group, not controlled by Health Plans or Hospitals or any of its subsidiaries; therefore, their financial statements are not combined or consolidated by Health Plans or Hospitals. As part of the successful completion of the Acquisition, Holdings and GHP entered into agreements to continue that arrangement following closing of the Acquisition, including payments to GHP of up to $200 million, recognized primarily as operating expenses and intangible assets. Payments of $159 million have been made to GHP. Additional payments may be made based on achieved milestones. Following the Acquisition, GHP was renamed "Washington Permanente Medical Group, P.C.".

The following table summarizes the fair value measurement of the assets acquired and liabilities assumed at the date of the acquisition (in millions):

Current investments	$	274
Accounts receivable		199
Other current assets		179
Noncurrent investments		777
Land, buildings, equipment, and software		794
Goodwill		297
Other acquired intangible assets		251
Other long-term assets		26
Medical claims payable		(277)
Other current liabilities		(451)
Pension and other retirement liabilities		(110)
Other long-term liabilities		(159)
Total purchase price	$	1,800

Goodwill represents the excess of the purchase price over the fair value of net tangible and intangible assets acquired and primarily relates to expected contributions of Washington Health Plans to the overall corporate strategy.

(4) Fair Value Estimates

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

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

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

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

The fair value of long-term debt is based on level 2 inputs for debt with similar risk, terms, and remaining maturities. At both September 30, 2018 and December 31, 2017, the carrying amount of long-term debt totaled $9.4 billion. At September 30, 2018 and December 31, 2017, the estimated fair value of long-term debt was approximately $9.5 billion and $9.9 billion, respectively.

At September 30, 2018 and December 31, 2017, Health Plans and Hospitals held derivative financial instruments including interest rate swaps, as well as futures, swaps, and forwards held within investment portfolios. The estimated fair values of derivative instruments were determined using level 2 inputs, including available market information and valuation methodologies, primarily discounted cash flows. Additional description and the fair value of derivative instruments are contained in the *Derivative Instruments* note.

(5) Investments

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

At September 30, 2018, the estimated fair value of current investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	$ 23	$ —	$ —	$ 23
Foreign equity securities	3	—	—	3
Debt securities issued by the U.S. government	—	1,898	—	1,898
Debt securities issued by U.S. government agencies and corporations	—	23	—	23
Debt securities issued by U.S. states and political subdivisions of states	—	61	—	61
Foreign government debt securities	—	83	—	83
U.S. corporate debt securities	—	2,373	—	2,373
Foreign corporate debt securities	—	965	—	965
U.S. agency mortgage-backed securities	—	392	—	392
Non-U.S. agency mortgage-backed securities	—	247	—	247
Other asset-backed securities	—	828	—	828
Short-term investment funds	—	567	—	567
Other	550	—	—	550
Total	$ 576	$ 7,437	$ —	$ 8,013

At September 30, 2018, the estimated fair value of noncurrent investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	$ 6,851	$ 850	$ —	$ 7,701
Foreign equity securities	2,953	1,246	—	4,199
Global equity funds	—	558	—	558
Debt securities issued by the U.S. government	—	1,508	—	1,508
Debt securities issued by U.S. government agencies and corporations	—	51	—	51
Debt securities issued by U.S. states and political subdivisions of states	—	200	—	200
Foreign government debt securities	—	1,555	—	1,555
U.S. corporate debt securities	—	5,222	—	5,222
Foreign corporate debt securities	—	1,913	—	1,913
U.S. agency mortgage-backed securities	—	763	—	763
Non-U.S. agency mortgage-backed securities	—	208	2	210
Other asset-backed securities	—	333	—	333
Short-term investment funds	—	1,125	—	1,125
Other	—	768	—	768
	$ 9,804	$ 16,300	$ 2	26,106
Alternative investments:				
Absolute return				2,080
Private equity				5,353
Risk parity				855
Total				$ 34,394

At December 31, 2017, the estimated fair value of current investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	$ 22	$ —	$ —	$ 22
Debt securities issued by the U.S. government	—	1,691	—	1,691
Debt securities issued by U.S. government agencies and corporations	—	30	—	30
Debt securities issued by U.S. states and political subdivisions of states	—	79	—	79
Foreign government debt securities	—	83	—	83
U.S. corporate debt securities	—	2,336	—	2,336
Foreign corporate debt securities	—	909	—	909
U.S. agency mortgage-backed securities	—	492	—	492
Non-U.S. agency mortgage-backed securities	—	210	—	210
Other asset-backed securities	—	648	—	648
Short-term investment funds	—	242	—	242
Total	$ 22	$ 6,720	$ —	$ 6,742

At December 31, 2017, the estimated fair value of noncurrent investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	$ 6,155	$ 1,312	$ —	$ 7,467
Foreign equity securities	2,603	2,198	—	4,801
Global equity funds	—	541	—	541
Debt securities issued by the U.S. government	—	1,747	—	1,747
Debt securities issued by U.S. government agencies and corporations	—	65	—	65
Debt securities issued by U.S. states and political subdivisions of states	—	214	—	214
Foreign government debt securities	—	1,735	—	1,735
U.S. corporate debt securities	—	4,934	—	4,934
Foreign corporate debt securities	—	1,830	—	1,830
U.S. agency mortgage-backed securities	—	698	—	698
Non-U.S. agency mortgage-backed securities	—	270	2	272
Other asset-backed securities	—	312	—	312
Short-term investment funds	—	710	—	710
Other	132	633	1	766
	$ 8,890	$ 17,199	$ 3	26,092
Alternative investments:				
Absolute return				2,164
Private equity				4,806
Risk parity				757
Total				$ 33,819

At September 30, 2018, debt and equity securities available-for-sale were as follows (in millions):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. equity securities	$ 6,072	$ 1,652	$ —	$ 7,724
Foreign equity securities	3,510	692	—	4,202
Global equity funds	406	152	—	558
Debt securities issued by the U.S. government	3,402	4	—	3,406
Debt securities issued by U.S. government agencies and corporations	72	2	—	74
Debt securities issued by U.S. states and political subdivisions of states	237	24	—	261
Foreign government debt securities	1,595	43	—	1,638
U.S. corporate debt securities	7,446	149	—	7,595
Foreign corporate debt securities	2,833	45	—	2,878
U.S. agency mortgage-backed securities	1,150	5	—	1,155
Non-U.S. agency mortgage-backed securities	449	8	—	457
Other asset-backed securities	1,152	9	—	1,161
Short-term investment funds	1,692	—	—	1,692
Other	1,306	12	—	1,318
Total	$ 31,322	$ 2,797	$ —	$ 34,119

At December 31, 2017, debt and equity securities available-for-sale were as follows (in millions):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. equity securities	$ 6,135	$ 1,354	$ —	$ 7,489
Foreign equity securities	3,571	1,230	—	4,801
Global equity funds	379	162	—	541
Debt securities issued by the U.S. government	3,413	25	—	3,438
Debt securities issued by U.S. government agencies and corporations	91	4	—	95
Debt securities issued by U.S. states and political subdivisions of states	253	40	—	293
Foreign government debt securities	1,690	128	—	1,818
U.S. corporate debt securities	6,958	312	—	7,270
Foreign corporate debt securities	2,606	133	—	2,739
U.S. agency mortgage-backed securities	1,180	10	—	1,190
Non-U.S. agency mortgage-backed securities	472	10	—	482
Other asset-backed securities	947	13	—	960
Short-term investment funds	952	—	—	952
Other	729	37	—	766
Total	$ 29,376	$ 3,458	$ —	$ 32,834

Available-for-sale debt securities by contractual maturity and mortgage-backed and other asset-backed debt securities were as follows (in millions):

	At September 30, 2018		At December 31, 2017	
	Amortized cost	Fair value	Amortized cost	Fair value
Due in one year or less	$ 3,347	$ 3,348	$ 2,197	$ 2,208
Due after one year through five years	6,275	6,333	5,776	5,870
Due after five years through ten years	4,396	4,457	4,342	4,483
Due after ten years	4,565	4,724	4,377	4,810
U.S. agency mortgage-backed securities	1,150	1,155	1,180	1,190
Non-U.S. agency mortgage-backed securities	449	457	472	482
Other asset-backed securities	1,152	1,161	947	960
Total	$ 21,334	$ 21,635	$ 19,291	$ 20,003

For the nine months ended September 30, 2018, the reconciliation of investments with fair value measurements using significant unobservable inputs (level 3) was as follows (in millions):

	Debt securities
Beginning balance	$ 3
Transfers into level 3	—
Total net losses:	
Realized	1
Unrealized	—
Purchases	—
Sales	—
Settlements	(2)
Ending balance	$ 2
Total realized and unrealized year-to-date net gains (losses) related to assets held at September 30, 2018	$ —

For the year ended December 31, 2017, the reconciliation of investments with fair value measurements using significant unobservable inputs (level 3) was as follows (in millions):

	Equity securities	Debt securities	Total
Beginning balance	$ —	$ 9	$ 9
Transfers into level 3	5	—	5
Total net losses:			
Realized	—	—	—
Unrealized	(1)	(1)	(2)
Purchases	—	—	—
Sales	(4)	—	(4)
Settlements	—	(5)	(5)
Ending balance	$ —	$ 3	$ 3
Total realized and unrealized year-to-date net gains (losses) related to assets held at December 31, 2017	$ —	$ —	$ —

Transfers between fair value input levels, if any, are recorded at the end of the reporting period. Transfers between fair value input levels occur when valuation inputs used to record or disclose assets or liabilities change from one level of the valuation hierarchy to another. During the nine months ended September 30, 2018 and the year ended December 31, 2017, there were no transfers between assets with inputs with quoted prices in active markets for identical assets (level 1) and assets with inputs with significant other observable inputs (level 2).

Investments include specific funds held in trust accounts related to collateral requirements for certain reinsurance agreements. At September 30, 2018 and December 31, 2017, the values of these funds were $39 million and $34 million, respectively.

Absolute return investments use advanced investment strategies, including derivatives, to generate positive long-term risk adjusted returns. Private equity investments consist of funds that make direct investments in private companies. Risk parity funds use risk as the primary factor to allocate investments among asset classes. Management meets with alternative investment fund managers periodically to assess portfolio performance and reporting and exercises oversight over fund managers. At September 30, 2018, Hospitals had original commitments related to alternative investments of $10.6 billion, of which $6.2 billion was invested, leaving $4.4 billion of remaining commitments. At December 31, 2017, Hospitals had original commitments related to alternative investments of $9.1 billion, of which $5.6 billion was invested, leaving $3.5 billion of remaining commitments.

For the nine months ended September 30, investment income – net was comprised of the following (in millions):

		2018		2017
Other-than-temporary impairment	$	(934)	$	(263)
Recognized gains		1,072		888
Recognized losses		(163)		(122)
Income (loss) from equity method alternative investments		505		563
Interest, dividends, and other income – net		818		701
Derivative income		62		(46)
Total investment income (loss) – net		1,360		1,721
Less investment income included in interest expense and other income (expense) – net		(428)		(351)
Investment income – net	$	932	$	1,370

For the nine months ended September 30, 2018 and 2017, Health Plans and Hospitals recorded impairment of certain investments in accordance with the policy described in the *Summary of Significant Accounting Policies – Investments* note. During the nine months ended September 30, 2018 and 2017, there was $18 million and $5 million, respectively, of impairment of alternative investments.

Absolute return, risk parity, and private equity investments include redemption restrictions. Absolute return and risk parity investments require 10 to 90 day written notice of intent to withdraw and are often subject to the approval and capital requirements of the fund manager. At September 30, 2018, absolute return and risk parity investments of $605 million were subject to lock-up periods of up to two years. Private equity agreements do not include provisions for redemption. Distributions will be received as the underlying investments of the funds are liquidated, which is expected over the next 11 years.

The majority of debt and equity securities can be redeemed within 10 days. At September 30, 2018, debt and equity investment funds of $1.7 billion were redeemable between 10 and 30 days. At September 30, 2018, equity investment funds of $853 million had a redemption period of between 30 days and one year. No debt or equity investments require a redemption period of greater than one year.

(6) Derivative Instruments

(a) Interest Rate Swaps

At both September 30, 2018 and December 31, 2017, Health Plans and Hospitals had 11 agreements to manage interest rate fluctuations (Interest Rate Swaps) with a total notional amount of $1.1 billion and $1.2 billion, respectively. At September 30, 2018 and December 31, 2017, the fair values of these agreements were $(161) million and $(229) million, respectively, and were recorded in other long-term liabilities. For the nine months ended September 30, 2018 and 2017, Health Plans and Hospitals recorded $16 million and $21 million, respectively, in interest expense relating to the Interest Rate

Swaps. For the nine months ended September 30, 2018 and 2017, net changes in fair values totaled $68 million and $14 million, respectively, and were recorded in investment income – net.

These derivatives contain reciprocal provisions whereby if Health Plans and Hospitals' or the counterparties' credit rating was to decline to certain levels, provisions would be triggered requiring Health Plans and Hospitals or the counterparties to provide certain collateral. At September 30, 2018 and December 31, 2017, no collateral was required to be posted by either Health Plans and Hospitals or the counterparties.

(b) Derivatives Held in Investment Portfolios

At September 30, 2018 and December 31, 2017, Health Plans and Hospitals' portfolio managers held $12 million and $1 million, respectively, of futures, forwards, options, and swaps to attempt to protect investments against volatility. For the nine months ended September 30, 2018 and 2017, net changes in fair values totaled $37 million and $(64) million, respectively, and were recorded in investment income – net. For the nine months ended September 30, 2018 and 2017, gains (losses) resulting from derivative settlements totaled $(43) million and $4 million, respectively, and were recorded in investment income – net.

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

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

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

(In millions)

Derivatives not designated as hedging instruments	Statement of operations category	Gain (loss) recognized in income on derivatives for the nine months ended September 30, 2018	2017
Interest rate swaps – related to debt	Investment income – net	$ 68	$ 14
Interest rate swaps – other	Investment income – net	4	(16)
Futures and forwards	Investment income – net	36	(47)
Options, rights, and warrants	Investment income – net	(3)	(1)
		$ 105	$ (50)

Information on Derivative Settlement Costs Recognized in Income

(In millions)

Derivatives not designated as hedging instruments	Statement of operations category	Gain (loss) recognized in income on derivatives for the nine months ended September 30, 2018	2017
Interest rate swaps – related to debt	Interest expense	$ (16)	$ (21)
Interest rate swaps – other	Investment income – net	45	(5)
Futures and forwards	Investment income – net	(94)	4
Options, rights, and warrants	Investment income – net	6	5
		$ (59)	$ (17)

Information on Fair Value of Derivative Instruments – Assets

(In millions)

Derivatives not designated as hedging instruments	Balance sheet category	Fair value at September 30, 2018	Fair value at December 31, 2017
Interest rate swaps – other	Noncurrent investments	$ 51	$ 36
Futures and forwards	Noncurrent investments	38	51
Options, rights, and warrants	Noncurrent investments	13	13
		$ 102	$ 100

Information on Fair Value of Derivative Instruments – Liabilities

(In millions)

Derivatives not designated as hedging instruments	Balance sheet category	Fair value September 30, 2018	Fair value December 31, 2017
Interest rate swaps – related to debt	Other long-term liabilities	$ 161	$ 229
Interest rate swaps – other	Other long-term liabilities	47	36
Futures and forwards	Other long-term liabilities	29	52
Options, rights, and warrants	Other long-term liabilities	14	11
		$ 251	$ 328

(7) Accounts Receivable – Net

Accounts receivable – net were as follows (in millions):

	At September 30, 2018	At December 31, 2017
Members' dues	$ 860	$ 889
Patient services	466	600
Medicare	217	196
Risk Adjustment receivables	8	9
Other	599	573
	2,150	2,267
Allowances for bad debt	(7)	(254)
Total	$ 2,143	$ 2,013

(8) Inventories and Other Current Assets

Inventories and other current assets were as follows (in millions):

	At September 30, 2018	At December 31, 2017
Inventories – net	$ 847	$ 840
Prepaid expenses	732	577
Other	252	126
Total	$ 1,831	$ 1,543

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

Land, buildings, equipment, and software – net were as follows (in millions):

		At September 30, 2018		At December 31, 2017
Land	$	2,115	$	2,070
Buildings and improvements		35,758		34,835
Furniture, equipment, and software		12,646		12,324
Construction and software development in progress		2,219		1,716
		52,738		50,945
Accumulated depreciation and amortization		(26,460)		(25,038)
Total	$	26,278	$	25,907

Health Plans and Hospitals capitalizes interest costs on borrowings incurred during the construction, upgrade, or development of qualifying assets. Capitalized interest is added to the cost of the underlying assets and is depreciated or amortized over the useful lives of the assets. During the nine months ended September 30, 2018 and 2017, Health Plans and Hospitals capitalized $26 million and $15 million, respectively, of interest in connection with various capital projects.

Asset retirement obligations relate primarily to the following: leased building restoration, building demolition, building materials containing asbestos, leaded wall shielding, storage tanks (above ground and below ground), chillers or cooling tower chemicals, mercury in large fixed-components, polychlorinated biphenyl window caulk, and hard drives requiring data wiping prior to disposal. At September 30, 2018 and December 31, 2017, the liability for asset retirement obligations was $99 million and $121 million, respectively. At September 30, 2018 and December 31, 2017, the unamortized asset related to these retirement obligations was $37 million and $42 million, respectively.

(10) Other Acquired Intangible Assets – Net

At September 30, 2018, other acquired intangible assets – net were as follows (in millions):

		Gross carrying amount		Accumulated amortization		Net carrying amount
Intangible assets						
Amortizing intangible assets:						
Member relationships	$	133	$	(46)	$	87
Intellectual property		78		(9)		69
Other		174		(24)		150
Total intangible assets	$	385	$	(79)	$	306

At December 31, 2017, other acquired intangible assets – net were as follows (in millions):

	Weighted average amortization period		Gross carrying amount		Accumulated amortization		Net carrying amount
Intangible assets							
Amortizing intangible assets:							
GHC acquired intangible assets:							
Member relationships	9 years	$	133	$	(25)	$	108
Intellectual property	15 years		39		(2)		37
Other	11 years		79		(9)		70
Total GHC acquired intangible assets	11 years		251		(36)		215
Other acquired intangible assets:							
Intellectual property	15 years		39		(2)		37
Other	13 years		44		(3)		41
Total other acquired intangible assets	14 years		83		(5)		78
Total intangible assets	11 years	$	334	$	(41)	$	293

Intangible assets subject to amortization are amortized on a straight-line or accelerated basis over their useful lives. For the nine months ended September 30, 2018 and 2017, aggregate amortization expense related to amortizing intangible assets was $38 million and $29 million, respectively.

The estimated aggregate amortization expense for the next five years at December 31 is as follows (in millions):

2018	$	52
2019		46
2020		40
2021		33
2022		29

(11) Medical Claims Payable

Activity in the liability for medical claims payable was as follows (in millions):

	At September 30, 2018	At December 31, 2017
Balances at January 1	$ 2,303	$ 1,862
Acquired business during the period	—	277
Incurred related to:		
Current year	9,931	11,816
Prior years	(138)	(95)
Total incurred	9,793	11,721
Paid related to:		
Current year	7,827	9,740
Prior years	1,898	1,817
Total paid	9,725	11,557
Ending balances	$ 2,371	$ 2,303

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

(12) Other Liabilities

Other current liabilities were as follows (in millions):

	At September 30, 2018	At December 31, 2017
Self-insured risks	$ 378	$ 378
Dues collected in advance	771	768
Physicians' retirement plan liability	199	199
Other	1,286	1,446
Total	$ 2,634	$ 2,791

Other long-term liabilities were as follows (in millions):

	At September 30, 2018	At December 31, 2017
Self-insured risks	$ 1,607	$ 1,632
Derivatives liability	251	328
Due to associated medical groups	219	199
Other	550	481
Total	$ 2,627	$ 2,640

(13) Debt

Debt was as follows (in millions):

	At September 30, 2018	At December 31, 2017
Tax-exempt revenue bonds and taxable bonds and notes:		
1.20% to 1.85% variable rate due through 2049	$ 3,645	$ 3,660
3.15% to 5.00% fixed rate due through 2051	6,464	6,473
Others at various rates due through 2031	19	19
Total	$ 10,128	$ 10,152
Other current debt:		
Commercial paper	$ 753	$ 750
Current portion of long-term debt	248	19
Long-term debt subject to short-term remarketing arrangements – net	475	492
Long-term debt classified as a long-term liability	8,652	8,891
Total	$ 10,128	$ 10,152

In May 2017, Hospitals issued $2.1 billion of taxable bonds and $2.1 billion of tax-exempt revenue bonds. Total proceeds from issuance, which included $200 million of bond premium, were $4.4 billion. Additionally, in May 2017, $1.4 billion of bond proceeds were used to refinance taxable commercial paper.

At both September 30, 2018 and December 31, 2017, repurchase of variable rate bonds totaling $2.9 billion may be required at earlier than stated maturity. These bonds may be remarketed rather than repurchased. Health Plans and Hospitals has provided self liquidity for the variable rate demand bonds with put options. Additionally, at both September 30, 2018 and December 31, 2017, management had the ability to finance the acquisition of up to $2.4 billion of any unremarketed bonds that are put, using available credit facilities. At September 30, 2018 and December 31, 2017, $475 million and $492 million, respectively, of these variable rate demand bonds were classified in current liabilities, net of available long-term credit facilities of $2.4 billion.

At September 30, 2018 and December 31, 2017, $203 million and $215 million, respectively, of the above tax-exempt fixed-rate revenue bonds and taxable fixed-rate bonds represented a net unamortized premium balance. At September 30, 2018 and December 31, 2017, $(40) million and $(42) million, respectively, of unamortized debt issuance cost was presented within long-term debt.

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

2018	$	773
2019		248
2020		20
2021		20
2022		799
Thereafter		8,105
Total	$	9,965

Credit Facility

Hospitals' credit facility of $2.4 billion terminates in September 2022. Various interest rate options are available under this facility. Any revolving borrowings mature on the termination date. Hospitals pays facility fees, which range from 0.05% to 0.15% per annum, depending upon Hospitals' long-term senior unsecured debt rating. At September 30, 2018, the facility fee was at an annual rate of 0.05%. At September 30, 2018 and December 31, 2017, no amounts were outstanding under this credit facility.

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

Taxable Commercial Paper Program

Hospitals maintains a commercial paper program providing for the issuance of up to $2.4 billion in aggregate maturity value of short-term indebtedness. The commercial paper is issued in denominations of $100,000 and will bear such interest rates, if interest-bearing, or will be sold at such discount from their face amounts, as agreed upon by Hospitals and the dealer acting in connection with the commercial paper program. The commercial paper may be issued with varying maturities up to a maximum of 270 days from the date of issuance. At September 30, 2018 and December 31, 2017, commercial paper of $753 million and $750 million, respectively, was outstanding under this program and is included within other current debt.

(14) Pension Plans

(a) Defined Benefit Plan

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

For financial reporting purposes, the projected unit credit method is used. At September 30, 2018 and December 31, 2017, substantially all pension fund assets were held in a group trust. At September 30, 2018 and December 31, 2017, trust assets were invested primarily in fixed-income and equity securities, with approximately 22% and 21%, respectively, of trust assets, net of liabilities, invested in alternative investments.

At December 31, 2017 the funded status of the Plan was as follows (in millions):

Change in projected benefit obligation (PBO):		
Benefit obligation at beginning of year	$	18,578
Pension benefit obligation acquired through acquisition		844
Service cost		1,167
Interest cost		724
Net actuarial loss		3,782
Benefits paid		(1,463)
Benefit obligation at end of year	$	23,632
Accumulated benefit obligation at end of year	$	17,925
Change in Health Plans and Hospitals’ share of trust assets:		
Fair value of plan assets at beginning of year	$	11,771
Fair value of plan assets acquired through acquisition		770
Actual return on plan assets		2,214
Contributions		2,401
Benefits paid		(1,463)
Fair value of plan assets at end of year	$	15,693
Funded status	$	(7,939)
Amounts recognized in the balance sheet consist of:		
Noncurrent assets	$	—
Current liabilities		—
Pension and other retirement liabilities		(7,939)
	$	(7,939)
Amounts recognized in net worth:		
Net actuarial loss	$	7,882
Prior service cost		87
	$	7,969

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

The accrued pension plan liability at December 31, 2017 and the change through September 30, 2018 are as follows (in millions):

Accrued pension plan liability at December 31, 2017	$	7,939
Provision		911
Plan amendments		—
Plan contributions		(1,593)
Accrued pension plan liability at September 30, 2018		7,257
Less: current portion		—
Long-term portion of accrued pension liability at September 30, 2018	$	7,257

For the nine months ended September 30, pension expense was as follows (in millions):

		2018		2017
Service cost	$	1,113	$	874
Interest cost		607		543
Expected return on plan assets		(809)		(741)
Amortization of net actuarial loss		406		208
Amortization of prior service cost		7		9
Net pension expense		1,324		893
Other changes in plan assets and PBO recognized in net worth:				
Amortization of net actuarial loss		(406)		(208)
Amortization of prior service cost		(7)		(9)
Total recognized in net worth		(413)		(217)
Total recognized in net periodic benefit cost and net worth	$	911	$	676

During 2018, $541 million and $10 million in estimated net actuarial loss and prior service cost, respectively, will be amortized from net worth into net pension expense.

Actuarial assumptions used were as follows:

	2018	2017
Discount rates at January 1 for calculating pension expense	3.80%	4.15% - 4.45%
Discount rate for calculating December 31 PBO	N/A	3.60% - 3.80%
Discount rates for calculating February 1 PBO	N/A	4.15% - 4.35%
Salary scale for calculating pension expense	4.20%	3.00% - 4.50%
Salary scale for calculating December 31 PBO	N/A	3.50% - 4.50%
Salary scale for calculating February 1 PBO	N/A	3.50% - 4.50%
Expected long-term rates of return on plan assets for calculating pension expense	7.00%	5.25% - 7.00%

During 2018, management expects to contribute approximately $1.6 billion to the Plan.

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

2018	$	865
2019		948
2020		1,048
2021		1,134
2022		1,213
2023–2027		7,260

Explanation of Investment Strategies and Policies

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

Capital Market Assumption Methodology

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

At September 30, 2018, the estimated fair value of total pension trust assets – net by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Total
Assets:			
Cash and cash equivalents	$ 192	$ 1,730	$ 1,922
Broker receivables	—	494	494
Securities lending collateral	—	1,034	1,034
U.S. equity securities	7,342	670	8,012
Foreign equity securities	6,240	2,176	8,416
Global equity funds	—	363	363
Debt securities issued by the U.S. government	—	1,649	1,649
Debt securities issued by U.S. government agencies and corporations	—	45	45
Debt securities issued by U.S. states and political subdivisions of states	—	227	227
Foreign government debt securities	—	624	624
U.S. corporate debt securities	—	4,892	4,892
Non-U.S. corporate debt securities	—	1,283	1,283
U.S. agency mortgage-backed securities	—	129	129
Non-U.S. agency mortgage-backed securities	—	42	42
Other	—	980	980
Total assets	13,774	16,338	30,112
Liabilities:			
Broker payables	—	868	868
Securities lending payable	—	1,034	1,034
Other liabilities	12	331	343
Total liabilities	12	2,233	2,245
Fair value of pension trust assets – net	$ 13,762	$ 14,105	27,867
Investments measured at net asset value (NAV):			
Alternative investments:			
Absolute return			1,688
Private equity			4,899
Risk parity			1,084
Total pension trust assets – net			$ 35,538

At September 30, 2018, Health Plans and Hospitals' share of pension trust assets was 47.8%, or $17.0 billion. The remaining share of pension trust assets is for Medical Groups and a related party associated with Medical Groups.

At December 31, 2017, the estimated fair value of total pension trust assets – net by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Total
Assets:			
Cash and cash equivalents	$ 686	$ 1,083	$ 1,769
Broker receivables	—	331	331
Securities lending collateral	—	1,181	1,181
U.S. equity securities	6,371	494	6,865
Foreign equity securities	6,144	2,657	8,801
Global equity funds	—	276	276
Debt securities issued by the U.S. government	—	1,463	1,463
Debt securities issued by U.S. government agencies and corporations	—	53	53
Debt securities issued by U.S. states and political subdivisions of states	—	214	214
Foreign government debt securities	—	614	614
U.S. corporate debt securities	—	4,675	4,675
Non-U.S. corporate debt securities	—	1,295	1,295
U.S. agency mortgage-backed securities	—	82	82
Non-U.S. agency mortgage-backed securities	—	47	47
Other	1	720	721
Total assets	13,202	15,185	28,387
Liabilities:			
Broker payables	—	609	609
Securities lending payable	—	1,181	1,181
Other liabilities	12	296	308
Total liabilities	12	2,086	2,098
Fair value of pension trust assets – net	$ 13,190	$ 13,099	26,289
Investments measured at NAV:			
Alternative investments:			
Absolute return			1,770
Private equity			4,150
Risk parity			1,090
Total pension trust assets – net			$ 33,299

At December 31, 2017, Health Plans and Hospitals' share of pension trust assets was 47.1%, or $15.7 billion. The remaining share of pension trust assets is for Medical Groups and a related party associated with Medical Groups.

During the nine months ended September 30, 2018 and 2017, there were no significant transfers of assets with inputs with quoted prices in active markets for identical assets (level 1) and assets with inputs with significant other observable inputs (level 2).

The target asset allocation for calculating pension expense was as follows:

	2018 and 2017 target
Equity securities	45%
Debt securities	30%
Alternative investments	25%
Total	100%

Alternative investments, which include absolute return, risk parity, and private equity, held in the pension trust are reported at NAV as a practical expedient for fair value. Absolute return investments use advanced investment strategies, including derivatives, to generate positive long-term risk adjusted returns. Private equity investments consist of funds that make direct investments in private companies. Risk parity funds use risk as the primary factor to allocate investments among asset classes. At September 30, 2018, the trust had original commitments related to alternative investments of $9.4 billion, of which $5.2 billion was invested, leaving $4.2 billion of remaining commitments. At December 31, 2017, the trust had original commitments related to alternative investments of $8.0 billion, of which $4.5 billion was invested, leaving $3.5 billion of remaining commitments.

Absolute return, risk parity, and private equity investments include redemption restrictions. Absolute return and risk parity investments require 10 to 90 day written notice of intent to withdraw and are often subject to the approval and capital requirements of the fund manager. At September 30, 2018, absolute return and risk parity investments of $539 million were subject to lock-up periods of up to two years. Private equity agreements do not include provisions for redemption. Distributions will be received as the underlying investments of the funds are liquidated, which is expected over the next 11 years.

The majority of debt and equity securities can be redeemed within 10 days. At September 30, 2018, debt and equity investment funds of $2.4 billion were redeemable between 10 and 30 days. Debt and equity investment funds of $202 million have a redemption period of up to 120 days. No debt or equity investments require a redemption period of greater than 120 days.

(b) Defined Contribution Plans

Health Plans and Hospitals has defined contribution plans for eligible employees. Employer contributions and costs are typically based on a percentage of covered employees' eligible compensation. During the nine months ended September 30, 2018 and 2017, there were no required employee contributions. For the nine months ended September 30, 2018 and 2017, plan expense, primarily employer contributions, was $253 million and $239 million, respectively.

(c) Multi-Employer Plans

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

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

Health Plans and Hospitals' participation in these plans for the nine months ended September 30, 2018 and 2017 is outlined in the table below. The "EIN/PN" column provides the Employer Identification Number (EIN) and the three-digit plan number (PN), if applicable. Unless otherwise noted, the most recent Pension Protection Act (PPA) zone status available in 2018 and 2017 is for the plan's year-end in 2017 and 2016, respectively. The zone status is based on information that Health Plans and Hospitals obtained from publicly available information provided by the United States Department of Labor. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow zone are between 65% and 80% funded, and plans in the green zone are at least 80% funded. The "FIP/RP status pending/implemented" column indicates plans for which a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented. The "Health Plans and Hospitals' contributions to plan exceeded more than 5% of total contributions" columns represent those plans where Health Plans and Hospitals was listed in the plans' Forms 5500 as providing more than 5% of the total contributions for the plan years listed. The last column lists the expiration dates of the collective bargaining agreements to which the plans are subject. There have been no significant changes that affect the comparability of 2018 and 2017 employer expense.

Pension fund	EIN-PN	Pension Protection Act zone status 2018	Pension Protection Act zone status 2017	FIP/RP status pending / implemented	(in millions) Health Plans and Hospitals' contributions September 30, 2018	(in millions) Health Plans and Hospitals' contributions September 30, 2017	Surcharge imposed	Health Plans and Hospitals' contributions to plan exceeded more than 5% of total contributions [1] 2017	Health Plans and Hospitals' contributions to plan exceeded more than 5% of total contributions [1] 2016	Expiration date of collective bargaining agreement
IUOE Stationary Engineers Local 39 Pension Fund	946118939 -001	Green	Green	N/A	$ 9	$ 9	No	Yes	Yes	9/17/2018
Southern California United Food and Commercial Workers Unions and Drug Employers Pension Fund	516029925 -001	Red	Red	Implemented	4	4	No	Yes	Yes	2/1/2020
Oregon Retail Employees Pension Trust[2]	936074377 -001	Red	Red	Implemented	3	3	No	Yes	Yes	9/30/2018-10/31/2018
Solano - Napa County Electrical Workers Pensions Trust (IBEW Local 180)[3]	946220673 -001	Green	Green	N/A	—	—	No	Yes	No	5/31/2019
Other[4]	Various	Red	Red	Implemented	8	6	Yes/No	No	No	6/30/2018-4/30/2020
Other	Various	Green	Green		11	11		No	No	7/31/2018-5/31/2022
Other	Various	Yellow	Yellow		3	3		No	No	6/30/2019-6/30/2020
Total expense					$ 38	$ 36				

(1) Forms 5500 information was available for all plan years ended in 2017. The majority of plans have a plan year end of December 31.

(2) Includes UFCW Local 555 Pharmacy Techs and Radiologists expiring September 30, 2018 and October 31, 2018, respectively.

(3) 2017 was the first year that KP reached the 5% contribution threshold for this union. Total 2017 pension contributions for the year were $81K. For QTD 2018 total pension contributions were $71K.

(4) Surcharge imposed on the Sound Retirement Trust comprised of UFCW Local 21 Pro-Tech and Optical and Pharmacy. The other red plan included in this grouping does not have a surcharge imposed.

(15) Postretirement Benefits Other than Pensions

(a) Defined Benefit Plan

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

At December 31, 2017, the accrued liability for postretirement benefits was as follows (in millions):

Change in benefit obligation:		
Benefit obligation at beginning of year	$	5,436
Benefit obligation acquired through acquisition		40
Service cost		156
Interest cost		206
Plan amendments		(36)
Benefits paid or provided		(151)
Net actuarial loss		275
Benefit obligation at end of year	$	5,926
Change in plan assets:		
Fair value of plan assets at beginning of year		3,095
Actual return on plan assets		388
Contributions		1,151
Benefits paid or provided		(151)
Fair value of plan assets at end of year	$	4,483
Funded status	$	(1,443)
Amounts recognized in the balance sheet consist of:		
Noncurrent assets	$	—
Current liabilities		(4)
Pension and other retirement liabilities		(1,439)
	$	(1,443)
Amounts recognized in net worth:		
Net actuarial loss	$	2,184
Prior service credit		(1,889)
	$	295

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

The accrued liability for postretirement benefits at December 31, 2017 and the change through September 30, 2018 are as follows (in millions):

Accrued postretirement benefits liability at December 31, 2017	$	1,443
Provision		76
Plan amendments		1
Plan contributions		—
Benefits paid or provided		(122)
Accrued postretirement benefits liability at September 30, 2018		1,398
Less: current portion		(4)
Long-term portion of accrued postretirement benefits liability at September 30, 2018	$	1,394

For the nine months ended September 30, postretirement benefits expense was as follows (in millions):

		2018		2017
Service cost	$	146	$	117
Interest cost		158		154
Expected return on plan assets		(228)		(141)
Amortization of net actuarial loss		77		70
Amortization of prior service credit		(324)		(325)
Postretirement benefits expense		(171)		(125)
Other changes in plan assets and benefit obligations recognized in net worth:				
Prior service credit		(1)		(36)
Amortization of net actuarial loss		(77)		(70)
Amortization of prior service credit		324		325
Total recognized in net worth		246		219
Total recognized in net periodic benefit cost and net worth	$	75	$	94

During 2018, $103 million and $(432) million in estimated net actuarial loss and prior service credit, respectively, will be amortized from net worth into postretirement benefits expense.

During the nine months ended September 30, 2018 the employer contributions and benefits paid or provided were $0 million and $122 million, respectively. During the nine months ended September 30, 2017 the employer contributions and benefits paid or provided were $112 million and $100 million, respectively. During 2018 and 2017, there were no participant contributions from active employees.

Actuarial assumptions used were as follows:

	2018	2017
Discount rates used for calculating postretirement benefits expense from January 1 to December 31	3.80%	3.70% – 4.45%
Discount rates for calculating December 31 accumulated postretirement benefit obligation	N/A	3.35% – 3.80%
Discount rate for calculating February 1 accumulated postretirement benefit obligation	N/A	3.70%
Expected long-term rate of return on plan assets for calculating benefits expense	7.00%	6.00%

The following were the assumed health care cost trend rates used to determine the December 31, 2017 benefit obligation and postretirement benefits expense for the nine months ended September 30, 2018 and 2017:

	Basic medical pre-65/post-65	Prescription drug pre-65/post-65	Medicare Part D	Dental	Medicare Part A&B	Medicare Part C	Supplemental medical pre-65/post-65
Initial trend rate – 2017	5.25% / 5.25%	6.50% / 6.50%	4.00%	4.50%	5.25%	4.25%	5.25% / 5.25%
Initial trend rate – 2018	5.25% / 5.25%	6.50% / 6.50%	4.00%	4.50%	5.25%	4.25%	5.25% / 5.25%
Ultimate trend rate	4.50% / 4.50%	4.50% / 4.50%	4.50%	4.50%	4.50%	4.50%	4.50% / 4.50%
First year at ultimate trend rate	2026 / 2022	2025 / 2025	2026	n/a	2022	2018	2026 / 2022

A 1% increase in the health care medical trend rate would increase the benefit obligation by $624 million and the service cost plus interest by $33 million. A decrease of 1% in the health care medical trend rate would decrease the benefit obligation by $582 million and the service cost plus interest by $34 million.

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

2018	$	158
2019		171
2020		186
2021		203
2022		222
2023-2027		1,397

Explanation of Investment Strategies and Policies

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

Capital Market Assumption Methodology

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

At September 30, 2018, the estimated fair value of retirement benefit trust assets by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Total
Assets:			
Cash and cash equivalents	$ —	$ 235	$ 235
Broker receivables	—	19	19
U.S. equity securities	1,592	—	1,592
Foreign equity securities	645	—	645
Debt securities issued by the U.S. government	—	611	611
Foreign government debt securities	—	1	1
U.S. corporate debt securities	—	43	43
Non-U.S. corporate debt securities	—	6	6
U.S. agency mortgage-backed securities	—	15	15
Non-U.S. agency mortgage-backed securities	—	6	6
Other	—	14	14
Total assets	2,237	950	3,187
Liabilities:			
Broker payables	—	34	34
Other liabilities	—	2	2
Total liabilities	—	36	36
Total fair value of retirement benefit trust assets	$ 2,237	$ 914	3,151
Investments measured at NAV:			
Alternative investments:			
Absolute return			401
Risk parity			1,075
Total retirement benefit trust assets			$ 4,627

At December 31, 2017, the estimated fair value of retirement benefit trust assets by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Total
Assets:			
Cash and cash equivalents	$ —	$ 263	$ 263
Broker receivables	—	1	1
U.S. equity securities	1,523	—	1,523
Foreign equity securities	605	—	605
Other	—	5	5
Total assets	2,128	269	2,397
Liabilities:			
Broker payables	—	—	—
Total liabilities	—	—	—
Total fair value of retirement benefit trust assets	$ 2,128	$ 269	2,397
Investments measured at NAV:			
Alternative investments:			
Absolute return			401
Risk parity			1,685
Total retirement benefit trust assets			$ 4,483

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

	2018 target	2017 target
Equity securities	45%	—%
Debt securities	30%	—%
Alternative investments	25%	100%
Total	100%	100%

Absolute return and risk parity investments include redemption restrictions. Absolute return and risk parity investments require 10 to 90 day written notice of intent to withdraw and are often subject to the approval and capital requirements of the fund manager. At September 30, 2018, absolute return and risk parity investments of $232 million were subject to lock-up periods of up to two years.

(b) Multi-Employer Plans

Health Plans and Hospitals participates in multi-employer union-administered retiree medical health and welfare plans that provide benefits to some union employees. Benefits for retirees under these plans are negotiated as part of the collective bargaining process. For the nine months ended September 30, 2018 and 2017, Health Plans and Hospitals' employer expense for both current and retiree benefits was $67 million and $62 million, respectively.

(16) Physicians' Retirement Plan

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

At December 31, 2017 the accrued liability for physicians' retirement plan was as follows (in millions):

Change in projected benefit obligation:		
Physicians' retirement plan liability at January 1	$	6,751
Service cost		342
Interest cost		266
Net actuarial loss		982
Benefits paid		(176)
Physicians' retirement plan liability at December 31	$	8,165
Accumulated benefit obligation at end of year	$	6,325
Change in plan assets:		
Fair value of plan assets at the beginning of year	$	—
Company contributions		176
Benefits paid		(176)
Fair value of plan assets at end of year	$	—
Funded status	$	(8,165)
Amounts recognized in the balance sheet consist of:		
Noncurrent assets	$	—
Current liabilities		(199)
Physicians' retirement plan liability		(7,966)
	$	(8,165)
Amounts recognized in net worth:		
Net actuarial loss	$	2,650

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

The accrued liability for the physicians' retirement plan liability at December 31, 2017 and the change through September 30, 2018 are as follows (in millions):

Accrued physicians' retirement plan liability at December 31, 2017	$	8,165
Provision		559
Payments		(142)
Accrued physicians' retirement plan liability at September 30, 2018		8,582
Less: current portion		(199)
Long-term portion of accrued physicians' retirement plan liability at September 30, 2018	$	8,383

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

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

For the nine months ended September 30, physicians' retirement plan provision was as follows (in millions):

	2018	2017
Service cost	$ 341	$ 257
Interest cost	218	199
Amortization of net actuarial loss	88	49
Total benefit expense	647	505
Expected return on assets – investment income included in interest expense and other income (expense) – net	(428)	(351)
Net benefit expense	219	154
Other changes in projected benefit obligations recognized in net worth:		
Amortization of net actuarial loss	(88)	(49)
Total recognized in net worth	(88)	(49)
Total recognized in net periodic benefit cost and net worth	$ 131	$ 105

During 2018, $117 million in estimated net actuarial loss will be amortized from net worth into net benefit expense.

Actuarial assumptions used were as follows:

	2018	2017
Discount rate at January 1 for calculating benefit expense	3.85%	4.55%
Discount rate for calculating December 31 PBO	N/A	3.85%
Salary scale for calculating pension expense	4.40%	4.40%
Salary scale for calculating December 31 PBO	N/A	4.40%
Expected long-term rate of return on designated investments for calculating benefit expense	7.00%	7.00%

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

2018	$	199
2019		218
2020		239
2021		263
2022		286
2023–2027		1,744

(17) Commitments and Contingencies

(a) Lease and Purchase Commitments

Health Plans and Hospitals leases primarily office space, medical facilities, and equipment under various leases that expire through 2048. Certain leases contain rent escalation clauses and renewal options for additional periods.

At December 31, 2017, minimum commitments under noncancelable leases extending beyond one year were as follows (in millions):

2018	$	329
2019		320
2020		284
2021		231
2022		186
Thereafter		599
Total	$	1,949

Minimum payments above have not been reduced by minimum sublease rentals of $2 million due in the future under noncancelable subleases.

For the nine months ended September 30, 2018 and 2017, total lease expense for all leases was $385 million and $369 million, respectively.

At December 31, 2017, minimum purchase commitments extending beyond one year were as follows (in millions):

2018	$	324
2019		220
2020		96
2021		38
2022		33
Thereafter		8
Total	$	719

During the nine months ended September 30, 2018 and 2017, Health Plans and Hospitals' total purchases under contracts with minimum purchase commitments were $421 million and $369 million, respectively.

(b) Surety Instruments and Standby Letters of Credit

In the normal course of business, Health Plans and Hospitals contracts to perform certain financial obligations that require a guarantee from a third party. This guarantee creates a contingent liability to the entity that provides that guarantee. At September 30, 2018 and December 31, 2017, Health Plans and Hospitals had entered into surety instruments and standby letters of credit that totaled $124 million and $128 million, respectively.

Health Plan, Inc. and Hospitals also guarantee payment of workers' compensation liabilities of certain Medical Groups under self-insurance programs. The majority of such liabilities are recorded as other long-term liabilities of Health Plan, Inc., as payment is provided for under the applicable medical service agreements. In addition to amounts accrued, at September 30, 2018 and December 31, 2017, pursuant to such guarantees, Health Plan, Inc. and Hospitals are contingently liable for approximately $150 million and $140 million, respectively, of certain Medical Groups' self-insured workers' compensation liabilities.

(c) Regulatory

Health Plans is required to periodically file financial statements with regulatory agencies in accordance with statutory accounting and reporting practices. Health Plans must comply with the various states' minimum regulatory net worth requirements generally under the regulation of the California Department of Managed Health Care and various state departments of insurance. Such requirements are generally based on tangible net equity or risk-based capital, and for California are calculated on the basis of combined net worth of Health Plans and Hospitals. At September 30, 2018 and December 31, 2017, the regulatory net worth, so defined, exceeded the aggregate regulatory minimum requirements by approximately $29 billion and $26 billion, respectively.

Health Plans' regulated subsidiaries maintain investments in various states where they are licensed. At September 30, 2018 and December 31, 2017, $6 million and $7 million, respectively, in securities were held to satisfy various state regulatory requirements.

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

In the ordinary course of business operations, Health Plans and Hospitals is subject to periodic reviews, investigations, and audits by various federal, state, and local regulatory agencies and accreditation agencies, including, without limitation, CMS, Department of Managed Health Care, USOPM, Occupational Safety and Health Administration, Drug Enforcement Administration, State Boards of Pharmacy, Food and Drug Administration, IRS, National Committee for Quality Assurance, and state departments of insurance.

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

(d) Litigation

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

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

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

Pursuant to civil subpoenas, Health Plans and Hospitals has provided documents and information to the Department of Justice and Department of Health and Human Services – Office of Inspector General relating to Medicare Part C risk adjustment practices, policies, and programs. These matters could result in False Claims Act litigation, in which an unfavorable outcome could have a material adverse effect. No significant reserves have been provided related to these matters.

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