TRIPLE-S MANAGEMENT CORP
Form 10-Q
November 07, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

þQUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

or

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

For the transition period from__to_____

COMMISSION FILE NUMBER: 001-33865

Triple-S Management Corporation

Puerto Rico (State or other jurisdiction of incorporation or organization)	66-0555678 (I.R.S. Employer Identification No.)
1441 F.D. Roosevelt Avenue San Juan, Puerto Rico (Address of principal executive offices)	00920 (Zip code)

(787) 749-4949
(Registrant's telephone number, including area code)

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
þ Yes ¨ No

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

Large accelerated filer ¨	Accelerated filer þ
Non-accelerated filer ¨	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title of each class	Outstanding at September 30, 2012
Common Stock Class A, $1.00 par value	9,042,809
Common Stock Class B, $1.00 par value	19,417,716

Triple-S Management Corporation

FORM 10-Q

For the Quarter Ended September 30, 2012

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Part I – Financial Information

Item 1. Financial Statements

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Triple-S Management Corporation
Consolidated Balance Sheets (Unaudited)
(Dollar amounts in thousands, except per share data)

	September 30, 2012	December 31, 2011
Assets		
Investments and cash:		
Securities available for sale, at fair value:		
Fixed maturities	$ 1,106,726	$ 988,894
Equity securities	191,623	144,408
Securities held to maturity, at amortized cost:		
Fixed maturities	4,128	13,684
Policy loans	6,223	6,307
Cash and cash equivalents	68,750	71,834
Total investments and cash	1,377,450	1,225,127
Premiums and other receivables, net	283,349	287,184
Deferred policy acquisition costs and value of business acquired	164,128	155,788
Property and equipment, net	96,818	81,872
Deferred tax asset	29,305	28,707
Goodwill	25,397	25,397
Other assets	74,691	76,502
Total assets	$ 2,051,138	$ 1,880,577
Liabilities and Stockholders' Equity		
Claim liabilities	$ 428,189	$ 391,259
Liability for future policy benefits	270,556	254,194
Unearned premiums	94,353	94,772
Policyholder deposits	106,385	76,753
Liability to Federal Employees' Health Benefits Program (FEHBP)	16,954	19,051
Accounts payable and accrued liabilities	167,801	151,052
Deferred tax liability	31,953	24,603
Short-term borrowings	11,200	-
Long-term borrowings	101,762	114,387
Liability for pension benefits	69,151	77,547
Total liabilities	1,298,304	1,203,618
Stockholders’ equity:		
Triple-S Management Corporation stockholders' equity		
Common stock Class A, $1 par value. Authorized 100,000,000 shares; issued and outstanding 9,042,809 at September 30, 2012 and December 31, 2011	9,043	9,043
Common stock Class B, $1 par value. Authorized 100,000,000 shares; issued and outstanding 19,417,716 and 19,321,524 shares at September 30, 2012 and December 31, 2011, respectively	19,418	19,322
Additional paid-in capital	145,493	144,302
Retained earnings	521,993	485,729
Accumulated other comprehensive income	56,580	18,563
Total Triple-S Management Corporation stockholders' equity	752,527	676,959
Noncontrolling interest in consolidated subsidiary	307	-
Total stockholders' equity	752,834	676,959
Total liabilities and stockholders’ equity	$ 2,051,138	$ 1,880,577

See accompanying notes to unaudited consolidated financial statements.

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Triple-S Management Corporation
Consolidated Statements of Earnings (Unaudited)
(Dollar amounts in thousands, except per share data)

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Revenues:				
Premiums earned, net	$565,607	$525,371	$1,695,157	$1,520,485
Administrative service fees	27,181	5,210	82,473	18,767
Net investment income	11,595	12,061	34,349	36,513
Other operating revenues	1,206	-	3,358	-
Total operating revenues	605,589	542,642	1,815,337	1,575,765
Net realized investment gains	21	5,569	2,157	18,457
Net unrealized investment loss on trading securities	-	(6,007)	-	(7,267)
Other income (expense), net	598	(169)	1,514	311
Total revenues	606,208	542,035	1,819,008	1,587,266
Benefits and expenses:				
Claims incurred	485,495	442,399	1,457,388	1,272,913
Operating expenses	104,604	83,623	309,378	252,216
Total operating costs	590,099	526,022	1,766,766	1,525,129
Interest expense	2,956	2,499	8,181	8,583
Total benefits and expenses	593,055	528,521	1,774,947	1,533,712
Income before taxes	13,153	13,514	44,061	53,554
Income tax expense (benefit):				
Current	1,344	1,161	8,116	3,155
Deferred	126	740	(254)	11,330
Total income taxes	1,470	1,901	7,862	14,485
Net income	11,683	11,613	36,199	39,069
Less: Net loss attributable to noncontrolling interest	32	-	65	-
Net income attributable to Triple-S Management Corporation	$11,715	$11,613	$36,264	$39,069
Earnings per share attributable to Triple-S Management Corporation				
Basic net income per share	$0.41	$0.40	$1.28	$1.36
Diluted net income per share	$0.41	$0.40	$1.27	$1.35

See accompanying notes to unaudited consolidated financial statements.

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Triple-S Management Corporation
Consolidated Statements of Comprehensive Income (Unaudited)
(Dollar amounts in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net income	$11,683	$11,613	$36,199	$39,069
Other comprehensive income (loss), net of tax:				
Net unrealized change in fair value of available for sale securities, net of taxes	14,838	20,508	35,008	25,109
Defined benefit pension plan:				
Actuarial loss, net	1,117	566	3,247	1,744
Prior service credit, net	(82)	(77)	(238)	(241)
Total other comprehensive income, net of tax	15,873	20,997	38,017	26,612
Comprehensive income	27,556	32,610	74,216	65,681
Comprehensive income attributable to noncontrolling interest	32	-	65	-
Comprehensive income attributable to Triple-S Management Corporation	$27,588	$32,610	$74,281	$65,681

See accompanying notes to unaudited consolidated financial statements.

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Triple-S Management Corporation
Consolidated Statements of Stockholders’ Equity (Unaudited)
(Dollar amounts in thousands, except per share data)

	2012	2011
Balance at January 1	$676,959	$617,272
Share-based compensation	1,876	1,489
Cash settlement of options granted under share-based compensation plan	-	(2,420)
Stock issued upon the exercise of stock options	3,001	914
Repurchase and retirement of common stock	(3,590)	(8,279)
Net current period change in comprehensive income	74,281	65,681
Total Triple-S Management Corporation stockholders' equity	752,527	674,657
Noncontrolling interest in consolidated subsididary	307	-
Balance at September 30	$752,834	$674,657

See accompanying notes to unaudited consolidated financial statements.

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Triple-S Management Corporation
Consolidated Statements of Cash Flows (Unaudited)
(Dollar amounts in thousands, except per share data)

	Nine months ended September 30, 2012	2011
Cash flows from operating activities:		
Net income	$36,199	$39,069
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,989	16,435
Net amortization of investments	4,566	398
Provision for doubtful receivables, net	1,321	5,807
Deferred tax expense (benefit)	(254)	11,330
Net realized investment gain on sale of securities	(2,157)	(18,457)
Net unrealized loss on trading securities	-	7,267
Share-based compensation	1,876	1,489
Proceeds from trading securities sold:		
Equity securities	-	53,066
Acquisition of securities in trading portfolio:		
Equity securities	-	(2,764)
(Increase) decrease in assets:		
Premium and other receivables, net	5,272	70,430
Deferred policy acquisition costs and value of business acquired	(8,340)	(1,729)
Other deferred taxes	200	(177)
Other assets	(4,364)	(13,703)
Increase (decrease) in liabilities:		
Claim liabilities	36,930	(8,808)
Liability for future policy benefits	16,362	11,415
Unearned premiums	(419)	65,859
Policyholder deposits	1,507	986
Liability to FEHBP	(2,097)	5,412
Accounts payable and accrued liabilities	7,503	(26,416)
Net cash provided by operating activities	112,094	216,909

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Triple-S Management Corporation
Consolidated Statements of Cash Flows (Unaudited)
(Dollar amounts in thousands, except per share data)

	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Cash flows from investing activities:		
Proceeds from investments sold or matured:		
Securities available for sale:		
Fixed maturities sold	$67,943	$225,060
Fixed maturities matured/called	115,649	76,786
Equity securities sold	50,016	31,253
Securities held to maturity:		
Fixed maturities matured/called	11,080	1,941
Acquisition of investments:		
Securities available for sale:		
Fixed maturities	(278,533)	(212,358)
Equity securities	(78,135)	(111,770)
Securities held to maturity:		
Fixed maturities	(1,067)	(755)
Other investments	18	-
Net inflows (outflows) from policy loans	84	(392)
Acquisition of business, net of cash acquired of $816 and $29,370 in the nine months ended September 30, 2012 and 2011, respectively	(2,685)	(54,058)
Net capital expenditures	(8,756)	(12,000)
Net cash used in investing activities	(124,386)	(56,293)
Cash flows from financing activities:		
Change in outstanding checks in excess of bank balances	(3,332)	(9,275)
Net change in short-term borrowings	11,200	(15,575)
Repayments of long-term borrowings	(26,464)	(51,230)
Repurchase and retirement of common stock	(637)	(7,554)
Cash settlements of stock options	-	(2,420)
Proceeds from exercise of stock options	316	189
Proceeds from policyholder deposits	32,946	20,725
Surrenders of policyholder deposits	(4,821)	(4,580)
Net cash provided by (used in) financing activities	9,208	(69,720)
Net increase (decrease) in cash and cash equivalents	(3,084)	90,896
Cash and cash equivalents:		
Beginning of period	71,834	45,021
End of period	$68,750	$135,917

See accompanying notes to unaudited consolidated financial statements.

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Triple-S Management Corporation
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share data)
(Unaudited)

(1) Basis of Presentation

The accompanying consolidated interim financial statements prepared by Triple-S Management Corporation and its subsidiaries are unaudited. In this filing, the "Corporation", the "Company", "TSM", "we", "us", and "our" refer to Triple-S Management Corporation and its subsidiaries. The consolidated interim financial statements do not include all of the information and the footnotes required by accounting principles generally accepted in the U.S. (GAAP) for complete financial statements. These consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011.

In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of such consolidated interim financial statements have been included. The results of operations for the three months and nine months ended September 30, 2012 are not necessarily indicative of the results for the full year ending December 31, 2012.

(2) Recent Accounting Standards

In October 2010 the FASB issued guidance to address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. This guidance specifies that the following costs incurred in the acquisition of new and renewal contracts should be capitalized: (1) Incremental direct costs of contract acquisition. Incremental direct costs are those costs that result directly from and are essential to the contract transaction and would not have been incurred by the insurance entity had the contract transaction not occurred. (2) Certain costs related directly to the following acquisition activities performed by the insurer for the contract: a. Underwriting, b. Policy issuance and processing, c. Medical and inspection, and d. Sales force contract selling. Advertising costs should be included in deferred acquisition costs only if the capitalization criteria in the direct-response advertising guidance in Subtopic 340-20, Other Assets and Deferred Costs— Capitalized Advertising Costs, are met. This guidance is effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2011. The Corporation adopted this guidance in January 1, 2012; there was no significant impact on our financial position or results of operations as a result of the adoption.

In June 2011, the FASB issued guidance to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The FASB decided to eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. This guidance is effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2011. The FASB required reclassification adjustments from accumulated other comprehensive income to be measured and presented by income statement line item in net income and also in other comprehensive income on the face of the financial statement. However, responding to concerns from financial statement preparers, the FASB decided to indefinitely defer that requirement pending further outreach. The Corporation adopted this guidance in January 1, 2012 electing to present the components of comprehensive income in two separate but consecutive financial statements.

In May 2011, the FASB issued guidance that changes the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements that result in common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards ("IFRS"). For many of the requirements, FASB does not intend the amendments in this guidance to result in a change in the application of the requirements in Topic 820. Some of the amendments clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The Corporation adopted this guidance in January 1, 2012, with no significant impact on our financial position or results of operations as a result of the adoption. However, we have added disclosure requirements related to fair value measurements in Note 7, "Fair Value Measurements".

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Triple-S Management Corporation
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share data)
(Unaudited)

In July 2011, the FASB issued guidance to address questions about how health insurers should recognize and classify in their income statements fees mandated by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act. A health insurer's portion of the annual fee becomes payable to the U.S. Treasury once the entity provides health insurance for any U.S. health risk for each applicable calendar year. The amendments specify that the liability for the fee should be estimated and recorded in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year that it is payable. This guidance is effective for calendar years beginning after December 31, 2013, when the fee initially becomes effective. We are currently evaluating the impact, if any, the adoption of this guidance will have on the financial position or results of operations.

In July 2012, the FASB issued guidance to establish a two-step analysis for impairment testing of indefinite-lived intangibles other than goodwill, which brings the accounting treatment for determining impairment charges on other intangible assets in to conformity with the treatment of goodwill. This guidance is effective for periods beginning after September 15, 2012. The adoption of this guidance has no impact on the financial statements disclosures.

In August 27, 2012 and October 1, 2012, the FASB issued guidance to make generally non-substantive technical corrections to certain codification topics, remove inconsistencies and outdated provisions, clarify the FASB's intent and amend or delete various Securities and Exchange Commission ("SEC") paragraphs. In particular, the updates consist of:

- Technical corrections and amendments as part of the FASB's standing agenda to review and improve the Accounting Standards Codification,
- Conforming amendments related to fair value measurements, in accordance with Topic 820,
- Reflect the issuance of the SEC's Staff Accounting Bulletin No. 114, Revisions and Rescissions of Portions of the Interpretative Guidance Included in the Codification of Staff Accounting Bulletins, and
- Reflect the issuance of the SEC Final Rulemaking Release No. 33-9250, Technical Amendments to Commission Rules and Forms Related to the FASB's Accounting Standards Codification.

This guidance is effective for fiscal periods beginning after December 15, 2012. The adoption of this guidance had no impact on the Corporation's financial position or results of operations.

Other than the accounting pronouncements disclosed above, there were no other new accounting pronouncements issued during the nine months ended September 30, 2012 that could have a material impact on the Corporation's financial position, operating results or financials statement disclosures.

(3) Segment Information

The operations of the Corporation are conducted principally through three business segments: Managed Care, Life Insurance, and Property and Casualty Insurance. The Corporation evaluates performance based primarily on the operating revenues and operating income of each segment. Operating revenues include premiums earned, net, administrative service fees and net investment income. Operating costs include claims incurred and operating expenses. The Corporation calculates operating income or loss as operating revenues less operating costs.

As discussed further in note 14, our Managed Care segment includes the results of operations and financial condition of Socios Mayores en Salud Holdings, Inc. (from now on referred to as “American Health” or “AH”) since February 1, 2011.

The following tables summarize the operations by major operating segment for the three months and nine months ended September 30, 2012 and 2011:

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Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share data)
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Operating revenues:				
Managed Care:				
Premiums earned, net	$ 508,152	$ 471,945	$ 1,531,703	$ 1,363,053
Administrative service fees	27,181	5,210	82,473	18,767
Intersegment premiums /service fees	1,489	1,644	4,622	4,584
Net investment income	3,999	4,474	11,783	13,475
Total managed care	540,821	483,273	1,630,581	1,399,879
Life Insurance:				
Premiums earned, net	31,654	28,651	92,190	83,410
Intersegment premiums	107	88	302	262
Net investment income	5,207	4,619	15,304	13,549
Total life insurance	36,968	33,358	107,796	97,221
Property and Casualty Insurance:				
Premiums earned, net	25,801	24,775	71,264	74,022
Intersegment premiums	153	153	460	460
Net investment income	2,210	2,482	6,707	7,065
Total property and casualty insurance	28,164	27,410	78,431	81,547
Other segments: *				
Intersegment service revenues	3,634	3,906	10,887	11,548
Operating revenues from external sources	1,207	-	3,361	4
Total other segments	4,841	3,906	14,248	11,552
Total business segments	610,794	547,947	1,831,056	1,590,199
TSM operating revenues from external sources	143	312	447	1,261
Elimination of intersegment premiums	(1,749)	(1,885)	(5,384)	(5,306)
Elimination of intersegment service fees	(3,634)	(3,906)	(10,887)	(11,548)
Other intersegment eliminations	35	174	105	1,159
Consolidated operating revenues	$ 605,589	$ 542,642	$ 1,815,337	$ 1,575,765

* Includes segments that are not required to be reported separately, primarily the data processing services organization and the health clinic.

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Triple-S Management Corporation
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share data)
(Unaudited)

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Operating income:				
Managed care	$7,329	$11,264	$33,320	$32,669
Life insurance	4,065	5,263	12,480	13,178
Property and casualty insurance	1,936	(1,046)	4,047	1,957
Other segments *	(349)	384	(188)	515
Total business segments	12,981	15,865	49,659	48,319
TSM operating revenues from external sources	143	308	447	1,261
TSM unallocated operating expenses	(111)	(1,783)	(8,405)	(6,810)
Elimination of TSM intersegment charges	2,477	2,230	6,870	7,866
Consolidated operating income	15,490	16,620	48,571	50,636
Consolidated net realized investment gains	21	5,569	2,157	18,457
Consolidated net unrealized loss on trading securities	-	(6,007)	-	(7,267)
Consolidated interest expense	(2,956)	(2,499)	(8,181)	(8,583)
Consolidated other income, net	598	(169)	1,514	311
Consolidated income before taxes	$13,153	$13,514	$44,061	$53,554
Depreciation and amortization expense:				
Managed care	$5,397	$5,137	$15,747	$14,196
Life insurance	219	162	547	487
Property and casualty insurance	136	371	434	1,148
Other segments*	221	-	622	-
Total business segments	5,973	5,670	17,350	15,831
TSM depreciation expense	215	200	639	604
Consolidated depreciation and amortization expense	$6,188	$5,870	$17,989	$16,435

* Includes segments that are not required to be reported separately, primarily the data processing services organization and the health clinic.

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Triple-S Management Corporation
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share data)
(Unaudited)

	September 30, 2012	December 31, 2011
Assets:		
Managed care	$ 933,021	$ 832,850
Life insurance	676,459	610,118
Property and casualty insurance	356,366	348,480
Other segments *	36,039	15,846
Total business segments	2,001,885	1,807,294
Unallocated amounts related to TSM:		
Cash, cash equivalents, and investments	44,349	53,172
Property and equipment, net	21,645	22,269
Other assets	27,451	27,794
	93,445	103,235
Elimination entries-intersegment receivables and others	(44,192)	(29,952)
Consolidated total assets	$ 2,051,138	$ 1,880,577

* Includes segments that are not required to be reported separately, primarily the data processing services organization and the health clinic.

(4) Investment in Securities

The amortized cost for debt securities and cost for equity securities, gross unrealized gains, gross unrealized losses, and estimated fair value for available-for-sale and held-to-maturity securities by major security type and class of security at September 30, 2012 and December 31, 2011, were as follows:

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Triple-S Management Corporation
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share data)
(Unaudited)

	September 30, 2012			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Securities available for sale:				
Fixed maturities:				
Obligations of government-sponsored enterprises	$61,971	$5,236	$-	$67,207
U.S. Treasury securities and obligations of U.S. government instrumentalities	39,411	2,033	-	41,444
Obligations of the Commonwealth of Puerto Rico and its instrumentalities	61,001	1,735	-	62,736
Municipal securities	510,364	58,208	(133)	568,439
Corporate bonds	106,976	24,556	-	131,532
Residential mortgage-backed securities	22,471	742	(4)	23,209
Collateralized mortgage obligations	207,643	5,075	(559)	212,159
Total fixed maturities	1,009,837	97,585	(696)	1,106,726
Equity securities:				
Common stocks	66	3,876	-	3,942
Mutual funds	166,825	20,884	(28)	187,681
Total equity securities	166,891	24,760	(28)	191,623
Total	$1,176,728	$122,345	$(724)	$1,298,349

	December 31, 2011			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Securities available for sale:				
Fixed maturities:				
Obligations of government-sponsored enterprises	$75,429	$5,392	$-	$80,821
U.S. Treasury securities and obligations of U.S. government instrumentalities	39,544	2,311	-	41,855
Obligations of the Commonwealth of Puerto Rico and its instrumentalities	83,685	2,584	(10)	86,259
Municipal securities	394,201	40,094	(116)	434,179
Corporate bonds	109,024	20,268	(148)	129,144
Residential mortgage-backed securities	8,367	748	-	9,115
Collateralized mortgage obligations	203,305	4,586	(370)	207,521
Total fixed maturities	913,555	75,983	(644)	988,894
Equity securities:				
Common stocks	66	3,257	-	3,323
Perpetual preferred stocks	1,000	-	(101)	899
Mutual funds	137,101	5,453	(2,368)	140,186
Total equity securities	138,167	8,710	(2,469)	144,408
Total	$1,051,722	$84,693	$(3,113)	$1,133,302

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Triple-S Management Corporation
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share data)
(Unaudited)

	September 30, 2012			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Securities held to maturity:				
Obligations of government-sponsored enterprises	$1,793	$133	$-	$1,926
U.S. Treasury securities and obligations of U.S.government instrumentalities	624	235	-	859
Residential mortgage-backed securities	449	43	-	492
Certificates of deposit	1,262	-	-	1,262
Total	$4,128	$411	$-	$4,539

	December 31, 2011			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Securities held to maturity:				
Obligations of government- sponsored enterprises	$1,793	$173	$-	$1,966
U.S. Treasury securities and obligations of U.S. government instrumentalities	624	223	-	847
Corporate bonds	9,839	130	-	9,969
Residential mortgage-backed securities	479	42	-	521
Certificates of deposit	949	-	-	949
Total	$13,684	$568	$-	$14,252

Gross unrealized losses on investment securities and the estimated fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2012 and December 31, 2011 were as follows:

	September 30, 2012								
	Less than 12 months			12 months or longer			Total		
	Estimated Fair Value	Gross Unrealized Loss	Number of Securities	Estimated Fair Value	Gross Unrealized Loss	Number of Securities	Estimated Fair Value	Gross Unrealized Loss	Number of Securities
Securites available for sale:									
Fixed maturities:									
Municipal securities	$ 24,191	$ (133)	8	$ -	$ -	-	$ 24,191	$ (133)	8
Residential mortgage-backed securities	3,821	(4)	1	-	-	-	3,821	(4)	1

Collateralized mortgage obligations	57,219	(543)	12	7,424	(16)	1	64,643	(559)	13
Total fixed maturities	85,231	(680)	21	7,424	(16)	1	92,655	(696)	22
Equity securities:									
Mutual funds	-	-	-	2,477	(28)	1	2,477	(28)	1
Total equity securities	-	-	-	2,477	(28)	1	2,477	(28)	1
Total for securities available for sale	$ 85,231	$ (680)	21	$ 9,901	$ (44)	2	$ 95,132	$ (724)	23

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	December 31, 2011								
	Less than 12 months			12 months or longer			Total		
	Estimated Fair Value	Gross Unrealized Loss	Number of Securities	Estimated Fair Value	Gross Unrealized Loss	Number of Securities	Estimated Fair Value	Gross Unrealized Loss	Number of Securities
Securites available for sale:									
Fixed maturities:									
Obligations of government-Commonwealth of Puerto Rico and its instrumentalities	$ 6,073	$ (10)	3	$ -	$ -	-	$ 6,073	$ (10)	3
Municipal securities	16,726	(116)	5	-	-	-	16,726	(116)	5
Corporate bonds	3,790	(85)	3	800	(63)	1	4,590	(148)	4
Collateralized mortgage obligations	29,813	(274)	7	1,611	(96)	1	31,424	(370)	8
Total fixed maturities	56,402	(485)	18	2,411	(159)	2	58,813	(644)	20
Equity securities:									
Perpetual preferred stocks	-	-	-	899	(101)	1	899	(101)	1
Mutual funds	37,943	(2,270)	18	1,917	(98)	1	39,860	(2,368)	19
Total equity securities	37,943	(2,270)	18	2,816	(199)	2	40,759	(2,469)	20
Total for securities available for sale	$ 94,345	$ (2,755)	36	$ 5,227	$ (358)	4	$ 99,572	$ (3,113)	40

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

The Corporation's process for identifying and reviewing invested assets for other-than temporary impairments during any quarter includes the following:

Identification and evaluation of securities that have possible indications of other-than-temporary impairment, which includes an analysis of all investments with gross unrealized investment losses that represent 20% or more of their cost and all investments with an unrealized loss greater than $50.

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

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

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

The Corporation continually reviews its investment portfolios under the Corporation's impairment review policy. Given the current market conditions and the significant judgments involved, there is a continuing risk that further declines in fair value may occur and additional material other-than-temporary impairments may be recorded in future periods.

Municipal securities: The unrealized losses of these securities were principally caused by fluctuations in interest rates and general market conditions. The Corporation does not consider these investments other-than-temporarily impaired because the decline in estimated fair value is principally attributable to changes in interest rates, the Corporation does not intend to sell the investments and its is more likely than not that the Corporation will not be required to sell the investments before recovery of their amortized cost basis, which may be maturity, and because the Corporation expects to collect all contractual cash flows.

Residential mortgage-backed securities and Collateralized mortgage obligations: The unrealized losses on investments in residential mortgage-backed securities and collateralized mortgage obligations ("CMOs") were mostly caused by fluctuations in interest rates and credit spreads. The contractual cash flows of these securities, other than private CMOs, are guaranteed by a U.S. government-sponsored enterprise. Any loss in these securities is determined according to the seniority level of each tranche, with the least senior (or most junior), typically the unrated residual tranche, taking any initial loss. The investment grade credit rating of our securities reflects the seniority of the securities that the Corporation owns. The Corporation does not consider these investments other-than-temporarily impaired because the decline in fair value is attributable to changes in interest rates and not credit quality, the Corporation does not intend to sell the investments and it is more likely than not that the Corporation will not be required to sell the investments before recovery of their amortized cost basis, which may be maturity, and because the Corporation expects to collect all contractual cash flows.

Mutual Funds: The unrealized loss of the security included in the twelve months or longer category has improved since December 31, 2011. This position is not considered other-than-temporarily impaired because the Corporation does not have the intent to sell this position, and the Corporation has the ability and intent to hold the investment until a market price recovery.

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Maturities of investment securities classified as available for sale and held to maturity at September 30, 2012 were as follows:

	September 30, 2012	
	Amortized cost	Estimated fair value
Securities available for sale:		
Due in one year or less	$16,164	$16,264
Due after one year through five years	169,817	178,922
Due after five years through ten years	170,044	188,586
Due after ten years	423,698	487,586
Residential mortgage-backed securities	22,471	23,209
Collateralized mortgage obligations	207,643	212,159
	$1,009,837	$1,106,726
Securities held to maturity:		
Due in one year or less	$1,262	$1,262
Due after five years through ten years	1,793	1,926
Due after ten years	624	859
Residential mortgage-backed securities	449	492
	$4,128	$4,539

Expected maturities may differ from contractual maturities because some issuers have the right to call or prepay obligations with or without call or prepayment penalties.

Information regarding realized and unrealized gains and losses from investments for the three months and nine months ended September 30, 2012 and 2011 is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Realized gains (losses):				
Fixed maturity securities:				
Securities available for sale:				
Gross gains from sales	$99	$3,792	$1,731	$10,941
Gross losses from sales	-	(13)	(189)	(248)
Total debt securities	99	3,779	1,542	10,693
Equity securities:				
Trading securities:				
Gross gains from sales	-	7,329	-	11,195
Gross losses from sales	-	(4,298)	-	(4,726)
	-	3,031	-	6,469
Securities available for sale:				
Gross gains from sales	388	686	1,850	3,317
Gross losses from sales	(466)	(1,927)	(1,235)	(2,022)

	(78)	(1,241)	615	1,295
Total equity securities	(78)	1,790	615	7,764
Net realized gains on securities	$21	$5,569	$2,157	$18,457

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	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Changes in net unrealized gains (losses):				
Recognized in income:				
Equity securities – trading	$-	$(6,007)	$-	$(7,267)
Recognized in accumulated other comprehensive income:				
Fixed maturities – available for sale	8,493	39,441	21,550	44,913
Equity securities – available for sale	8,964	(13,943)	18,491	(13,699)
	$17,457	$25,498	$40,041	$31,214
Not recognized in the consolidated financial statements:				
Fixed maturities – held to maturity	$(6)	$(50)	$(157)	$(172)

The deferred tax liability/asset related to unrealized gains and losses, respectively, recognized in accumulated other comprehensive income during the nine months ended September 30, 2012 and 2011 aggregated to $5,033 and $6,105, respectively.

As of September 30, 2012 and December 31, 2011, no individual investment in securities exceeded 10% of stockholders' equity.

Components of net investment income were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Fixed maturities	$9,481	$10,645	$28,828	$33,224
Equity securities	1,760	1,083	4,453	1,997
Policy loans	117	116	348	336
Cash equivalents and interest-bearing deposits	34	101	88	386
Other	203	116	632	570
Total	$11,595	$12,061	$34,349	$36,513

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(5) Premiums and Other Receivables, Net

Premiums and other receivables, net as of September 30, 2012 and December 31, 2011 were as follows:

	September 30, 2012	December 31, 2011
Premiums	$ 99,854	$ 105,177
Self-funded group receivables	65,279	64,053
FEHBP	11,578	11,062
Agent balances	34,488	37,421
Accrued interest	10,223	10,788
Reinsurance recoverable	49,459	48,828
Other	37,655	33,721
	308,536	311,050
Less allowance for doubtful receivables:		
Premiums	16,682	14,299
Other	8,505	9,567
	25,187	23,866
Total premiums and other receivables, net	$ 283,349	$ 287,184

(6) Claim Liabilities

The activity in the total claim liabilities for the three months and nine months ended September 30, 2012 and 2011 is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Claim liabilities at beginning of period	$421,894	$398,708	$391,259	$360,210
Reinsurance recoverable on claim liabilities	(37,124)	(31,854)	(37,234)	(31,449)
Net claim liabilities at beginning of period	384,770	366,854	354,025	328,761
Claim liabilities acquired from American Health	-	-	-	41,666
Incurred claims and loss-adjustment expenses:				
Current period insured events	476,450	435,953	1,451,254	1,274,432
Prior period insured events	3,138	2,515	(10,504)	(11,552)
Total	479,588	438,468	1,440,750	1,262,880
Payments of losses and loss-adjustment expenses:				
Current period insured events	452,411	386,457	1,129,384	956,934
Prior period insured events	21,068	59,899	274,512	317,407
Total	473,479	446,356	1,403,896	1,274,341
Net claim liabilities at end of period	390,879	358,966	390,879	358,966
Reinsurance recoverable on claim liabilities	37,310	35,657	37,310	35,657
Claim liabilities at end of period	$428,189	$394,623	$428,189	$394,623

The amount included as incurred claims for prior period insured events results from differences between actual claims and estimates of insured but not reported events presented in prior periods.

The additional incurred claims and loss-adjustment expenses for prior period insured events for the three months ended September 30, 2012 and 2011 is due primarily to higher than anticipated utilization trends. The credit in the incurred claims and loss-adjustment expenses for prior period insured events for the nine months ended September 30, 2012 and 2011 is due primarily to better than expected utilization trends.

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Reinsurance recoverable on unpaid claims is reported within the premium and other receivables, net in the accompanying consolidated financial statements. The claims incurred disclosed in this table exclude the change in the liability for future policy benefits expense, which amounted to $5,907 and $16,638, during the three months and nine months ended September 30, 2012, respectively. The change in the liability for future policy benefits during the three months and nine months ended September 30, 2011 amount to $3,931 and $10,033, respectively.

(7) Fair Value Measurements

Assets recorded at fair value in the consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Level inputs, as defined by current accounting guidance for fair value measurements and disclosures, are as follows:

Level Input:	Input Definition:
Level 1	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level 2	Inputs other than quoted prices included in Level 1 that are observable for the asset or liability through corroboration with market data at the measurement date.
Level 3	Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The Corporation uses observable inputs when available. Fair value is based upon quoted market prices when available. If market prices are not available, the Corporation employs internally-developed models that primarily use market-based inputs including yield curves, interest rates, volatilities, and credit curves, among others. The Corporation limits valuation adjustments to those deemed necessary to ensure that the security or derivative's fair value adequately represents the price that would be received or paid in the marketplace. Valuation adjustments may include consideration of counterparty credit quality and liquidity as well as other criteria. The estimated fair value amounts are subjective in nature and may involve uncertainties and matters of significant judgment for certain financial instruments. Changes in the underlying assumptions used in estimating fair value could affect the Corporation's results. The fair value measurement levels are not indicative of risk of investment.

The fair value information of financial instruments in the accompanying consolidated financial statements was determined as follows:

(i) Investment in Securities

The fair value of investment securities is estimated based on quoted market prices for those or similar investments. Additional information pertinent to the estimated fair value of investment in securities is included in note 4.

(ii) Derivative Instruments

Current market pricing models were used to estimate fair value of structured note agreements. Fair values were determined using market quotations provided by outside securities consultants or prices provided by market makers using observable inputs. The derivative instrument held by the Corporation matured in May 25, 2012.

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The following tables summarize fair value measurements by level at September 30, 2012 and December 31, 2011 for assets measured at fair value on a recurring basis:

	September 30, 2012			
	Level 1	Level 2	Level 3	Total
Securities available for sale:				
Fixed maturity securities				
Obligations of government-sponsored enterprises	$-	$67,207	$-	$67,207
U.S. Treasury securities and obligations of U.S government instrumentalities	41,444	-	-	41,444
Obligations of the Commonwealth of Puerto Rico and its instrumentalities	-	62,736	-	62,736
Municipal securities	-	568,439	-	568,439
Corporate bonds	-	131,532	-	131,532
Residential agency mortgage-backed securities	-	23,209	-	23,209
Collateralized mortgage obligations	-	212,159	-	212,159
Total fixed maturities	41,444	1,065,282	-	1,106,726
Equity securities				
Common stocks	3,942	-	-	3,942
Mutual funds	115,259	60,935	11,487	187,681
Total equity securities	119,201	60,935	11,487	191,623
Total	$160,645	$1,126,217	$11,487	$1,298,349

	December 31, 2011			
	Level 1	Level 2	Level 3	Total
Securities available for sale:				
Fixed maturity securities				
Obligations of government-sponsored enterprises	$-	$80,821	$-	$80,821
U.S. Treasury securities and obligations of U.S government instrumentalities	41,855	-	-	41,855
Obligations of the Commonwealth of Puerto Rico and its instrumentalities	-	86,259	-	86,259
Municipal securities	-	434,179	-	434,179
Corporate bonds	-	129,144	-	129,144
Residential agency mortgage-backed securities	-	9,115	-	9,115
Collateralized mortgage obligations	-	207,521	-	207,521
Total fixed maturities	41,855	947,039	-	988,894
Equity securities				
Common stocks	3,323	-	-	3,323
Perpetual preferred stocks	899	-	-	899
Mutual funds	120,651	12,441	7,094	140,186
Total equity securities	124,873	12,441	7,094	144,408
Derivatives (reported within other assets in the consolidated balance sheets)	-	7	-	7

Total	$166,728	$959,487	$7,094	$1,133,309

The fair value of fixed maturity and equity securities included in the Level 2 category were based on market values obtained from independent pricing services, which utilize evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information and for structured securities, cash flow and when available loan performance data. Because many fixed income securities do not trade on a daily basis, the models used by independent pricing service providers to prepare evaluations apply available information, such as benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. For certain equity securities, quoted market prices for the identical security are not always available and the fair value is estimated by reference to similar securities for which quoted prices are available. The independent pricing service providers monitor market indicators, industry and economic events, and for broker-quoted only securities, obtain quotes from market makers or broker-dealers that they recognize to be market participants.

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Transfers into or out of the Level 3 category occur when unobservable inputs, such as the Company's best estimate of what a market participant would use to determine a current transaction price, become more or less significant to the fair value measurement. Transfers between levels, if any, are recorded as of the actual date of the event or change in circumstance that caused the transfer. There were no transfers between Levels 1 and 2 during the three months and nine months ended September 30, 2012 and 2011.

A reconciliation of the beginning and ending balances of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months and nine months ended September 30, 2012 and 2011 is as follows:

	Three months ended					
	September 30, 2012			September 30, 2011		
	Fixed Maturity Securities	Equity Securities	Total	Fixed Maturity Securities	Equity Securities	Total
Beginning balance	$-	$9,014	$9,014	$-	$1,338	$1,338
Total gains or losses:						
Unrealized in other accumulated comprehensive income	-	473	473	-	54	54
Purchases	-	2,000	2,000	-	525	525
Transfers in and/or out of Level 3	-	-	-	-	3,169	3,169
Ending balance	$-	$11,487	$11,487	$-	$5,086	$5,086

	Nine months ended					
	September 30, 2012			September 30, 2011		
	Fixed Maturity Securities	Equity Securities	Total	Fixed Maturity Securities	Equity Securities	Total
Beginning balance	$-	$7,094	$7,094	$-	$1,044	$1,044
Total gains or losses:						
Unrealized in other accumulated comprehensive income	-	884	884	-	126	126
Purchases	-	4,579	4,579	-	747	747
Transfers in and/or out of Level 3	-	(1,070)	(1,070)	-	3,169	3,169
Ending balance	$-	$11,487	$11,487	$-	$5,086	$5,086

In addition to the preceding disclosures on assets recorded at fair value in the consolidated balance sheets, FASB guidance also requires the disclosure of fair values for certain other financial instruments for which it is practicable to estimate fair value, whether or not such values are recognized in the consolidated balance sheets.

Non-financial instruments such as property and equipment, other assets, deferred income taxes and intangible assets, and certain financial instruments such as claim liabilities are excluded from the fair value disclosures. Therefore, the fair value amounts cannot be aggregated to determine our underlying economic value.

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, receivables, accounts payable and accrued liabilities, and short-term borrowings approximate fair value because of the short term nature of these items. These assets and liabilities are not listed in the table below.

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

(i) Policy Loans

Policy loans have no stated maturity dates and are part of the related insurance contract. The carrying amount of policy loans approximates fair value because their interest rate is reset periodically in accordance with current market rates.

(ii) Policyholder Deposits

The fair value of policyholder deposits is the amount payable on demand at the reporting date, and accordingly, the carrying value amount approximates fair value.

(iii) Long-term Borrowings

The carrying amount of the loans payable to bank – variable approximates fair value due to its floating interest-rate structure. The fair value of the loans payable to bank – fixed and senior unsecured notes payable was determined using broker quotations.

(iv) Repurchase Agreement

The value of the repurchase agreement with a long term maturity is based on the discontinued value of the contractual cash flows using current estimated market discount rates for instruments with similar terms.

A summary of the carrying value and fair value by level of financial instruments not recorded at fair value on our consolidated balance sheet at September 30, 2012 are as follows:

	Carrying Value	Fair Value Level 1	Level 2	Level 3	Total
Assets:					
Policy loans	$6,223	$-	$6,223	$-	$6,223
Liabilities:					
Policyholder deposits	$106,385	$-	$106,385	$-	$106,385
Long-term borrowings:					
Loans payable to bank - variable	18,157	-	18,157	-	18,157
Loans payable to bank - fixed	13,605	-	13,605	-	13,605
6.6% senior unsecured notes payable	35,000	-	34,563	-	34,563
6.7% senior unsecured notes payable	10,000	-	9,950	-	9,950
Repurchase agreement	25,000	-	26,018	-	26,018
Total long-term borrowings	101,762	-	102,293	-	102,293
Total liabilities	$208,147	$-	$208,678	$-	$208,678

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A summary of the carrying value and fair value of financial instruments not recorded at fair value on our consolidated balance sheet at December 31, 2011 are as follows:

	December 31, 2011	
	Carrying amount	Fair value
Assets:		
Policy loans	$6,307	$6,307
Liabilities:		
Policyholder deposits	$76,753	$76,753
Long-term borrowings:		
Loans payable to bank - variable	19,387	19,387
6.6% senior unsecured notes payable	35,000	34,475
6.7% senior unsecured notes payable	35,000	34,650
Repurchase agreement	25,000	25,739
Total long-term borrowings	114,387	114,251
Total liabilities	$191,140	$191,004

(8) Share-Based Compensation

Share-based compensation expense recorded during the three months and nine months ended September 30, 2012 was $517 and $1,876, respectively. Share-based compensation expense recorded during the three months and nine months ended September 30, 2011 was $398 and $1,489, respectively. During the nine months ended September 30, 2012 and 2011 cash received from stock option exercises was $316 and $189, respectively. The impact of these cash receipts is included within the cash flows from financing activities in the accompanying consolidated statement of cash flows. During the nine months ended September 30, 2012 and 2011, 140,666 and 32,776 shares, respectively, were repurchased and retired as a result of a non-cash exercise of stock options. Also, during the nine months ended September 30, 2011, 432,567 options were cash-settled for $2,420 at its fair value at time of settlement. No options were cash-settled during the nine months ended September 30, 2012.

(9) Comprehensive Income

The accumulated balances for each classification of other comprehensive income, net of tax, are as follows:

	Net unrealized gain on securities	Liability for pension benefits	Accumulated other comprehensive income
Balance at January 1	$ 68,137	$ (49,574)	$ 18,563
Net current period change	35,008	3,009	38,017
Balance at September 30	$ 103,145	$ (46,565)	$ 56,580

(10) Income Taxes

Under Puerto Rico income tax law, the Corporation is not allowed to file consolidated tax returns with its subsidiaries. The Corporation and its subsidiaries are subject to Puerto Rico income taxes. The Corporation's insurance subsidiaries are also subject to U.S. federal income taxes for foreign source dividend income. As of September 30, 2012, tax years 2007 through 2011 for the Corporation and its subsidiaries are subject to examination by Puerto Rico taxing authorities.

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Managed Care and Property and Casualty corporations are taxed essentially the same as other corporations, with taxable income primarily determined on the basis of the statutory annual statements filed with the insurance regulatory authorities. Also, operations are subject to an alternative minimum income tax, which is calculated based on the formula established by existing tax laws. Any alternative minimum income tax paid may be used as a credit against the excess, if any, of regular income tax over the alternative minimum income tax in future years.

The Life Insurance corporation operates as a qualified domestic life insurance company and is subject to the alternative minimum tax and taxes on its capital gains.

All other corporations within the group are subject to Puerto Rico income taxes as a regular corporation, as defined in the P.R. Internal Revenue Code, as amended. The holding company within the AH group of companies is a U.S.-based corporation and is subject to U.S. federal income taxes. This U.S-based corporation within our group has not provided U.S. deferred taxes on an outside basis difference created as a result of the business combination of AH and cumulative earnings of its Puerto Rico-based subsidiaries that are considered to be indefinitely reinvested. The total outside basis difference at December 31, 2011 is estimated at $57 million. We do not intend to repatriate earnings to fund U.S. and Puerto Rico operations nor do any transaction that would cause a reversal of that outside basis difference. Because of the availability of U.S. foreign tax credits, it is not practicable to determine the U.S. federal income tax liability if such outside basis difference was reversed.

On January 31, 2011 the Government of Puerto Rico approved a reduction of the maximum corporate income tax rate from 40.95% to approximately 30%, including the elimination of a 5% additional special tax over the tax obligation imposed for corporations, as well as adding several tax credits and deductions, among other tax reliefs and changes. One of the companies acquired in the AH transaction elected to continue filing its tax returns at the 39% statutory tax rate, following the previous Puerto Rico tax code. This selection was made according the provisions of the newly enacted Puerto Rico tax code in order to maximize the use of net operating losses carryforward. As a result of this income tax rate reduction, the consolidated net deferred tax assets were decreased through a one-time charge to the consolidated deferred tax expense of approximately $6,400 during the nine months ended September 30, 2011.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the consolidated statements of earnings in the period that includes the enactment date. Quarterly income taxes are calculated using the effective tax rate determined based on the income forecasted for the full fiscal year.

(11) Pension Plan

The components of net periodic benefit cost for the three months and nine months ended September 30, 2012 and 2011 were as follows:

	Three months ended September 30,	Nine months ended September 30,

	2012	2011	2012	2011
Components of net periodic benefit cost:				
Service cost	$1,438	$1,406	$4,184	$2,926
Interest cost	1,963	1,624	5,688	5,125
Expected return on assets	(1,639)	(1,270)	(4,712)	(3,997)
Amortization of prior service benefit	(117)	(109)	(340)	(344)
Amortization of actuarial loss	1,597	809	4,639	2,492
Net periodic benefit cost	$3,242	$2,460	$9,459	$6,202

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Employer contributions: The Corporation disclosed in its audited consolidated financial statements for the year ended December 31, 2011 that it expected to contribute $13,000 to its pension program in 2012. As of September 30, 2012, the Corporation has contributed $14,235 to the pension program.

(12) Net Income Available to Stockholders and Net Income per Share

The following table sets forth the computation of basic and diluted earnings per share for the three months and nine months ended September 30, 2012 and 2011:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Numerator for earnings per share:				
Net income attributable to TSM available to stockholders	$11,715	$11,613	$36,264	$39,069
Denominator for basic earnings per share:				
Weighted average of common shares	28,348,097	28,736,762	28,343,550	28,776,279
Effect of dilutive securities	105,946	113,485	129,193	180,415
Denominator for diluted earnings per share	28,454,043	28,850,247	28,472,743	28,956,694
Basic net income per share attributable to TSM	$0.41	$0.40	$1.28	$1.36
Diluted net income per share attributable to TSM	$0.41	$0.40	$1.27	$1.35

During the three months and nine months ended September 30, 2011, the weighted average of stock option shares of approximately 4,032 was excluded from the denominator for the diluted earnings per share computation because the stock options were anti-dilutive. There were no anti-dilutive stock options during the three months and nine months ended September 30, 2012.

(13) Contingencies

As of September 30, 2012, the Corporation is a defendant in various lawsuits arising in the ordinary course of business. We are also defendants in various other claims and proceedings, some of which are described below. Furthermore, the Commissioner of Insurance, as well as other Federal and Puerto Rico government authorities, regularly make inquiries and conduct audits concerning the Corporation's compliance with applicable insurance and other laws and regulations.

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

Additionally, we may face various potential litigation claims that have not been asserted to date, including claims from persons purporting to have contractual rights to have contractual rights to acquire shares of the Corporation on favorable terms ("Share Acquisition Agreements") or to have inherited such shares notwithstanding applicable transfer and ownership restrictions. See the disclosures included in Item 1A of Part 1 of our Annual Report on Form 10-K for the year ended December 31, 2011 under the caption "Risks Relating to our Capital Stock".

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

On April 24, 2002, Octavio Jordán, Agripino Lugo, Ramón Vidal, and others filed a suit against the Corporation, the Corporation's subsidiary TSS and others in the Court of First Instance for San Juan, Superior Section (the "Court of First Instance"), alleging, among other things, violations by the defendants of provisions of the Puerto Rico Insurance Code, antitrust violations, unfair business practices, RICO violations, breach of contract with providers, and damages in the amount of $12 million. Following years of complaint amendments, motions practice and interim appeals up to the level of the Puerto Rico Supreme Court, the plaintiffs amended their complaint on June 20, 2008 to allege with particularity the same claims initially asserted but on behalf of a more limited group of plaintiffs, and increase their claim for damages to approximately $207 million. Plaintiffs amended their complaint for the third time in December 2010 and dropped all claims predicated on violations of the antitrust and RICO laws and the Puerto Rico Insurance Code. In addition, the plaintiffs voluntarily dismissed with prejudice any and all claims against officers of the Corporation and TSS. Two of the original plaintiffs were also eliminated from the Third Amended Complaint ("TAC"). The TAC alleges breach of six Share Acquisition Agreements, breach of the provider contract by way of discriminatory audits and improper payment of services rendered. Plaintiffs also allege a claim for libel and slander against a former President of TSM. In January 2011, we filed our response and a counterclaim for malicious prosecution and abuse of process. Discovery has been substantially completed. On April 13, 2012 the Corporation filed a motion to dismiss and for summary judgment, seeking the dismissal of the TAC, which the plaintiffs opposed. The Court set oral argument on the dispositive motion for November 1, 2012. The Corporation is vigorously defending this claim.

Dentists Association Litigation

On February 11, 2009, the Puerto Rico Dentists Association (Colegio de Cirujanos Dentistas de Puerto Rico) filed a complaint in the Court of First Instance against 24 health plans operating in Puerto Rico that offer dental health coverage. The Corporation and two of its subsidiaries, TSS and Triple-C, Inc. ("TCI"), were included as defendants. This litigation purports to be a class action filed on behalf of Puerto Rico dentists who are similarly situated.

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

Two codefendant plans, whose main operations are outside Puerto Rico, removed the case to federal court in Florida, which the plaintiffs and the other codefendants, including the Corporation, opposed. Following months of jurisdictional proceedings in the federal court system, the federal district court in Puerto Rico decided to retain jurisdiction on February 8, 2011. The defendants filed a joint motion to dismiss the case on the merits, because the complaint fails to state a claim upon which relief can be granted. On August 31, 2011, the District Court dismissed all of plaintiffs' claims except for its breach of contract claim, and ordered the parties to brief the issue of whether the court still has federal jurisdiction under the Class Action Fairness Act of 2005. Plaintiffs moved the court to reconsider its August 31, 2011 decision and the defendants did the same, arguing that the breach of contract claim failed to state a claim upon which relief can be granted. On May 2, 2012, the court denied the plaintiffs' motion. On May 31, 2012, plaintiffs appealed the District Court's dismissal of their complaint and the denial of plaintiffs' motion for reconsideration. The Court of Appeals for the First Circuit dismissed the appeal for lack of jurisdiction. On September 25, 2012 the District Court denied without prejudice the defendants’ motion for reconsideration. On October 10, 2012 the parties filed their briefs with respect to class certification and are waiting for the court’s decision.

Claims by Heirs of Former Shareholders

The Corporation and TSS are defending four individual lawsuits, all filed in state court, from persons who claim to have inherited a total of 69 shares of the Corporation or one of its predecessors or affiliates (before giving effect to the 3,000-for-one stock split). While each case presents unique facts and allegations, the lawsuits generally allege that the redemption of the shares by the Corporation pursuant to transfer and ownership restrictions contained in the Corporation's (or its predecessors' or affiliates') articles of incorporation and bylaws was improper.

In one of these cases, the plaintiffs argued that the redemption of shares was fraudulent and was not subject to the two year statute of limitations contained in the local securities law. The Court of First Instance determined that the plaintiffs' claims are time barred under the local securities law. The plaintiffs appealed, and in January 2012, the Puerto Rico Court of Appeals upheld the dismissal, holding that even if the plaintiffs could have survived the securities law's two year statute of limitations, their complaint was time-barred under the Civil Code's four year statute of limitations on claims of fraud. On March 28, 2012 the plaintiffs filed a petition for writ of certiorari before the Puerto Rico Supreme Court that was granted on May 31, 2012. We filed our respondent’s brief on October 5, 2012. The parties are waiting for the Supreme Court’s decision.

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In the second case, the Puerto Rico Court of First Instance granted our motion to dismiss on grounds that the complaint was time-barred under the two year statute of limitations contained in the securities law, and the Puerto Rico Court of Appeals confirmed. Plaintiffs filed a petition for certiorari before the Puerto Rico Supreme Court that was granted on January 20, 2012. Plaintiffs filed the Petitioners' brief with the Supreme Court on April 26, 2012. Defendants filed their Respondents' brief on May 29, 2012. The parties are waiting for the Supreme Court's decision.

In the third case, the court of First Instance denied our motion for summary judgment based on its determination that there are material issues of fact in controversy. In response to our appeal, the Puerto Rico Court of Appeals confirmed the decision of the Court of First Instance. Our request for reconsideration was denied in December 2011. The case is again before the Court of First Instance, which held a pretrial hearing on September 27. 2012. The court set another pretrial hearing for February 28, 2013.

The fourth case was filed in November 2011. On August 9, 2012, plaintiffs filed a petition to amend their allegation, which included an amended complaint; the petition was granted. On October 15, 2012, we filed a motion to dismiss on the grounds that the claim is time barred under the local securities law's two year statue of limitations. The court has not ruled on our motion.

Management believes all these claims are time barred under one or more statutes of limitations and is vigorously defending the claims on these and other grounds.

ACODESE Investigation

During April 2010, each of the Company's wholly-owned insurance subsidiaries received subpoenas for documents from the U.S. Attorney for the Commonwealth of Puerto Rico (the "U.S. Attorney") and the Puerto Rico Department of Justice ("PRDOJ") requesting information principally related to the Asociación de Compañías de Seguros de Puerto Rico, Inc. ("ACODESE" by its Spanish acronym). Also in April 2010, the Company's insurance subsidiaries received a request for information from the Office of the Commissioner of Insurance of Puerto Rico ("OCI") related principally to ACODESE. The Company's insurance subsidiaries are members of ACODESE, an insurance trade association established in Puerto Rico since 1975, and their current presidents have participated over the years on ACODESE's board of directors.

The Company believes similar subpoenas and information requests were issued to other member companies of ACODESE in connection with the investigation of alleged payments by the former Executive Vice President of ACODESE to members of the Puerto Rico Legislative Assembly beginning in 2005. The Company, however, was not informed of the specific subject matter of the investigations conducted by the U.S. Attorney, the PRDOJ or the OCI. The Company fully complied with the subpoenas and requests for information and cooperated with each of the government investigations. The Company has been advised that these investigations have concluded and will not be further pursued with respect to the Company’s insurance subsidiaries.

Intrusions into Triple-C, Inc. Internet IPA Database

On September 21, 2010, we learned from a competitor that a specific internet database managed by our subsidiary TCI containing information pertaining to individuals previously insured by TSS under the Government of Puerto

Rico's Health Insurance Plan ("HIP") and to independent practice associations ("IPAs") that provided services to those individuals, had been accessed without authorization by certain of our competitor's employees from September 9 to September 15, 2010. TCI served as a third-party administrator for TSS in the administration of its HIP contracts until September 30, 2010. We conducted a thorough investigation with the assistance of external resources and identified the information that was accessed and downloaded into the competitor's system. The September 2010 intrusions may have potentially compromised protected health information of approximately 398,000 beneficiaries in the North and Metro-North regions of the HIP. Our investigation also revealed that protected health information of approximately 5,500 HIP beneficiaries, 2,500 Medicare beneficiaries and IPA data from all three HIP regions previously serviced by TSS was accessed through multiple, separate intrusions into the TCI IPA database from October 2008 to August 2010. We have no evidence indicating that the stolen information included Social Security numbers. We attempted to notify by mail all beneficiaries whose information may have been compromised by these intrusions. We also established a toll-free call center to address inquiries and complaints from the individuals to whom notice was provided. We received a total of approximately 1,530 inquiries and no complaints from these individuals.

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Our investigation revealed that the security breaches were the result of unauthorized use of one or more active user IDs and passwords specific to the TCI IPA database, and not the result of breaches of TCI's, TSS's or the Corporation's system security features. Nonetheless, we took measures to strengthen TCI's server security and credentials management procedures and conducted an assessment of our system-wide data and facility security to prevent the occurrence of a similar incident in the future.

We were unable to determine the purpose of these breaches and do not know the extent of any fraudulent use of the information or its impact on the potentially affected individuals and IPAs. According to representations made by our competitor, however, the target was financial information related to IPAs and management of the HIP, rather than the beneficiaries' information.

We notified the appropriate Puerto Rico and federal government agencies of these events, and gave public notice of the breaches as required under Puerto Rico and federal law. We received a number of inquiries and requests for information related to these events from these government agencies and are cooperating with them. The Puerto Rico government agency that oversees the HIP levied a fine of $100 on TSS in connection with these incidents, but following our request for reconsideration, the agency withdrew the fine until the pertinent federal authorities conclude their investigations of this matter. On August 16, 2011, the Office for Civil Rights of the U.S. Department of Health and Human Services initiated a review of TSS's and TCI's compliance with the security and privacy rules promulgated under the Health Insurance Portability and Accountability Act of 1996, in connection with these data breaches. The Company at this time cannot reasonably assess the impact of these investigations on the Company.

Joint Underwriting Association Litigations

On August 19, 2011, plaintiffs, purportedly a class of motor vehicle owners, filed an action in the United States District Court for the District of Puerto Rico against the Puerto Rico Joint Underwriting Association ("JUA") and 18 other defendants, including Triple-S Propiedad, Inc. ("TSP"), alleging violations under the Puerto Rico Insurance Code, the Puerto Rico Civil Code, the Racketeer Influenced and Corrupt Organizations Act ("RICO") and the local statute against organized crime and money laundering. JUA is a private association created by law to administer a compulsory public liability insurance program for motor vehicles in Puerto Rico ("CLI"). As required by its enabling act, JUA is composed of all the insurers that underwrite private motor vehicle insurance in Puerto Rico and exceed the minimum underwriting percentage established in such act. TSP is a member of JUA.

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In this lawsuit, entitled Noemí Torres Ronda, et al v. Joint Underwriting Association, et al., plaintiffs allege that the defendants illegally charged and misappropriated a portion of the CLI premiums paid by motor vehicle owners in violation of the Puerto Rico Insurance Code. Specifically, they claim that because the defendants did not incur acquisition or administration costs allegedly totaling 12% of the premium dollar, charging for such costs constitutes the illegal traffic of premiums. Plaintiffs also claim that the defendants, as members of JUA, violated RICO through various inappropriate actions designed to defraud motor vehicle owners located in Puerto Rico and embezzle a portion of the CLI premiums for their benefit.

Plaintiffs seek the reimbursement of funds for the class amounting to $406.6 million, treble damages under RICO, and equitable relief, including a permanent injunction and declaratory judgment barring defendants from their alleged conduct and practices, along with costs and attorneys' fees.

On December 30, 2011, TSP and other insurance companies filed a joint motion to dismiss, arguing that plaintiffs' claims are barred by the filed rate doctrine, inasmuch a suit cannot be brought, even under RICO, to amend the compulsory liability insurance rates that were approved by the Puerto Rico Legislature and the Commissioner of Insurance. The motion also argues that since RICO is not a federal statute that specifically relates to the business of insurance, and its application in the claims at issue would frustrate state policy and interfere with Puerto Rico's insurance administrative regime, the McCarran-Ferguson Act precludes plaintiffs' claims. Finally, TSP argued that plaintiffs failed to allege the necessary elements of an actionable RICO claim, or, in the alternative, their damages claim is time barred.

On February 17, 2012, plaintiffs filed their opposition. On April 4, 2012, TSP filed a reply in support of our motion to dismiss. The court denied our motion to dismiss. On October 2, 2012, the court issued an order certifying the class. On October 12, 2012, several defendants, including TSP, filed an appeal before the U.S. Court of Appeals for the First District, requesting the court to vacate the District Court’s certification order.

A similar case entitled Maria Margarita Collazo Burgos, et al. v. La Asociación de Suscripcion Conjunta del Seguro de Responsabilidad Obligatorio ("JUA"), et al., was filed against JUA and its members, including TSP, in the Puerto Rico Court of First Instance, San Juan Part on January 28, 2010. This litigation is a putative class action lawsuit brought on behalf of motor vehicle owners in Puerto Rico. Plaintiffs in this lawsuit allege that each of the defendants engaged in similar activities and conduct as those alleged in the Torres Ronda litigation and claim the recovery of $225 million for the class pertaining to the acquisition and administration costs of the CLI, allegedly charged in violation of the Puerto Rico Insurance Code's provisions prohibiting the illegal traffic of premiums. TSP is vigorously contesting this action.

Given the early stage of these cases, the Corporation cannot assess the probability of an adverse outcome, or the reasonable financial impact that any such outcome may have on the Corporation. The Corporation intends to vigorously defend these lawsuits.

(14) Business Combination

2012 Acquisition

On January 18, 2012, TSM completed the acquisition of 90.8% of the outstanding capital stock of a health clinic in Puerto Rico. The cost of this acquisition was approximately $3,501, funded with unrestricted cash. The following table summarizes the net assets acquired as a result of this acquisition:

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