

**Delta Dental of California and Subsidiaries**

Consolidated Financial Statements

December 31, 2016 and 2015



Confidential

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of  
Delta Dental of California  
San Francisco, California

We have audited the accompanying consolidated financial statements of Delta Dental of California and Subsidiaries (a non-profit California corporation), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income and expense and comprehensive income, general reserves and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**


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

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

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

### **Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Delta Dental of California and Subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

  
Armanino<sup>LLP</sup>  
San Francisco, California

April 7, 2017

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands)

	<b>December 31</b>	
	<b>2016</b>	<b>2015</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 803,486	\$ 602,965
Marketable securities	1,083,729	964,328
	<u>1,887,215</u>	<u>1,567,293</u>
Premiums and other receivables		
Premium receivables	348,052	321,704
Other receivables	36,122	33,312
	<u>384,174</u>	<u>355,016</u>
Property and equipment, net	179,579	201,294
Deferred compensation plans investments	34,508	35,716
Notes receivable	40,000	10,000
Other assets	36,822	34,352
	<u>36,822</u>	<u>34,352</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 2,562,298</u></b>	<b><u>\$ 2,203,671</u></b>
<b>LIABILITIES AND GENERAL RESERVES</b>		
<b>Liabilities</b>		
Unpaid claims and claims adjustment expenses	\$ 438,388	\$ 390,910
Accounts payable and accrued expenses	244,424	222,407
Deferred revenue	82,535	75,142
Refundable group balances	601,266	482,344
Deferred compensation plans	34,508	35,716
Accrued retirement benefits	71,283	72,714
Other liabilities	19,478	18,145
	<u>1,491,882</u>	<u>1,297,378</u>
<b>General reserves</b>		
General reserves	1,072,973	926,020
Accumulated other comprehensive loss	(2,557)	(19,727)
	<u>1,070,416</u>	<u>906,293</u>
<b>TOTAL LIABILITIES AND GENERAL RESERVES</b>	<b><u>\$ 2,562,298</u></b>	<b><u>\$ 2,203,671</u></b>

The accompanying notes are an integral part of these consolidated financial statements.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME AND EXPENSE**  
**AND COMPREHENSIVE INCOME**

(In thousands)

	<b>Years Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
<b>Premiums and other income</b>		
Commercial programs	\$ 5,637,417	\$ 5,354,482
State programs	1,004,643	927,957
Federal programs	825,570	765,982
	<u>7,467,630</u>	<u>7,048,421</u>
Administrative service contracts	(3,109,173)	(2,789,226)
	<u>4,358,457</u>	<u>4,259,195</u>
Investment income, net	17,258	23,156
Other income (expense), net	989	(9,886)
	<u>4,376,704</u>	<u>4,272,465</u>
<b>Claims and operating expenses</b>		
Claims incurred	6,535,514	6,189,805
Claims incurred on administrative service contracts	(3,109,173)	(2,789,226)
	<u>3,426,341</u>	<u>3,400,579</u>
Operating expenses	803,410	756,187
	<u>4,229,751</u>	<u>4,156,766</u>
<b>Net income</b>	<u>146,953</u>	<u>115,699</u>
Other comprehensive income (loss)		
Pension liability and post-retirement adjustments	3,566	(11,452)
Unrealized gains (losses) on securities	13,604	(3,449)
	<u>17,170</u>	<u>(14,901)</u>
<b>Comprehensive income</b>	<u>\$ 164,123</u>	<u>\$ 100,798</u>

The accompanying notes are an integral part of these consolidated financial statements.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF GENERAL RESERVES**  
(In thousands)

	<u>General Reserves</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total</u>
<b>BALANCE AT JANUARY 1, 2015</b>	\$ 810,321	\$ (4,826)	\$ 805,495
Net income	115,699	-	115,699
Pension liability and post-retirement adjustments	-	(11,452)	(11,452)
Net unrealized losses on securities	<u>-</u>	<u>(3,449)</u>	<u>(3,449)</u>
<b>BALANCE AT DECEMBER 31, 2015</b>	926,020	(19,727)	906,293
Net income	146,953	-	146,953
Pension liability and post-retirement adjustments	-	3,566	3,566
Net unrealized gains on securities	<u>-</u>	<u>13,604</u>	<u>13,604</u>
<b>BALANCE AT DECEMBER 31, 2016</b>	<u>\$ 1,072,973</u>	<u>\$ (2,557)</u>	<u>\$ 1,070,416</u>

The accompanying notes are an integral part of these consolidated financial statements.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	<b>Years Ended December 31</b>	
	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 146,953	\$ 115,699
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	25,939	27,860
Impairment of long-lived assets	35,424	33,995
Impairment of marketable securities	14,285	-
Impairment of goodwill	6,295	-
Bond amortization	11,622	10,186
Realized losses (gains) on securities	(1,140)	63
Allowance for notes receivable	-	10,000
Changes in operating assets and liabilities		
Premium receivables	(26,348)	81,687
Other receivables	(2,810)	12,321
Other assets	(8,765)	(3,406)
Unpaid claims and claims adjustment expenses	47,478	(586)
Accounts payable and accrued expenses	22,017	14,153
Deferred revenue	7,393	883
Refundable group balances	118,922	320,923
Accrued retirement benefits	2,135	(408)
Other liabilities	1,333	2,296
Net cash provided by operating activities	<u>400,733</u>	<u>625,666</u>
<b>Cash flows from investing activities</b>		
Purchases of marketable securities	(179,468)	(219,418)
Redemptions of marketable securities	48,904	31,466
Issuance of notes receivable	(30,000)	(20,000)
Development and purchases of computer software systems	(30,957)	(19,303)
Purchases of property and equipment	(8,691)	(8,680)
Net cash used in investing activities	<u>(200,212)</u>	<u>(235,935)</u>
Net increase in cash and cash equivalents	200,521	389,731
Cash and cash equivalents, beginning of year	<u>602,965</u>	<u>213,234</u>
<b>Cash and cash equivalents, end of year</b>	<u>\$ 803,486</u>	<u>\$ 602,965</u>
<b>Supplemental disclosure</b>		
Interest paid	<u>\$ 987</u>	<u>\$ 326</u>

The accompanying notes are an integral part of these consolidated financial statements.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**1. Nature of Organization**

Delta Dental of California (Delta, or with its subsidiaries, referred to as the Company), is a non-profit California corporation regulated by the Department of Managed Health Care (DMHC). Delta has ownership in the following companies listed in the table below:

<u>Company Name</u>	<u>% Ownership</u>
DDC Insurance Holdings, Inc. (DDCIH)	100.0%
Delta Dental of Puerto Rico, Inc. (DDPR)	63.9%
Celebration Dental Services (CDS)	100.0%
PaCa Management, LLC (PaCa)	50.0%

On January 1, 2012, Delta assigned all of its interests in certain subsidiaries to DDCIH in order for the subsidiaries to properly enter into a Federal Tax Sharing agreement for the preparation of a consolidated federal tax return. Those subsidiaries included:

<u>Company Name</u>	<u>% Ownership</u>
Delta Dental Insurance Company (DDIC)	91.1%
Dentegra Insurance Company (DIC)	80.0%
Dentegra Insurance Company of New England (DICNE)	100.0%
The Alphas:	
Alpha Dental Programs, Inc.	100.0%
Alpha Dental of Alabama, Inc.	100.0%
Alpha Dental of Arizona, Inc.	100.0%
Alpha Dental of Nevada, Inc.	100.0%
Alpha Dental of New Mexico, Inc.	100.0%
Alpha Dental of Utah, Inc.	100.0%

DDCIH also holds 100% of the preferred stock of DDIC.

Delta, DDIC, DDPR and the Alphas underwrite and administer prepaid, cost reimbursement, and capitation dental care programs under agreements with various subscriber groups and individuals. DIC is a single license entity authorized to offer insurance products in fifty jurisdictions. DICNE is a single license entity authorized to do business in five jurisdictions. CDS operates dental offices in Celebration, Florida. PaCa assists affiliates of Delta Dental of Pennsylvania (DDP) in the administration of their programs.



**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**1. Nature of Organization (continued)**

PaCa was formed on January 1, 1998 with capital contributions from Delta Dental of Pennsylvania (DDP) and Delta. In accordance with the governing documents of PaCa, the term of PaCa is 30 years, unless terminated sooner pursuant to an affirmative vote of the members of PaCa. A vote was conducted on December 1, 2016 and passed to dissolve PaCa as of the close of business on December 31, 2016. DDP was appointed as the liquidating member as of the date of dissolution. The assets of PaCa have been liquidated and the settlement of affiliate receivables and payables will occur in January 2017. The remaining members' equity balance will be distributed pro-rata in accordance with their capital account balances.

The Company is a member of Dentegra Group Inc., a holding company with common management and control. These entities provide services to each other and charge fees for those services, and the Company's financial position and results of operations might be different if the entities operated as stand-alone entities.

**2. Summary of Significant Accounting Policies**

**Principles of consolidation and basis of presentation**

The consolidated financial statements include the accounts of Delta and all entities in which a controlling interest is held. All significant intercompany transactions and balances have been eliminated in consolidation.

**Revenue recognition**

The Company administers a variety of dental programs, with the major programs described as follows:

Retention/guaranteed administration

Under retention and guaranteed administration programs, the excess of subscriber premiums over dental claims and administrative fees is refundable to the subscriber group, whereas any excess of dental claims and administrative fees over subscriber premiums can be recovered from future premium rates or absorbed by the Company. Premium revenue is recognized during the coverage period.

Non-retention

Under non-retention programs, the Company retains any excess or absorbs any shortages incurred between subscriber premiums and dental claims incurred and administrative fees. Premium income is recognized during the coverage period.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**2. Summary of Significant Accounting Policies (continued)**

**Revenue recognition (continued)**

Administrative services contracts (ASC)

Under ASC programs, the Company receives revenues from subscriber groups on a cost reimbursement basis plus administrative fees. The cost of the dental fees for these groups is charged as incurred and administrative fees are charged to the subscriber group based on a percentage of claims paid or a specific fee per eligible subscriber.

Capitation

Under capitation programs, the Company receives premium revenues from groups and individuals, and contracts with certain providers for agreed upon procedures for enrollees. Capitation fees are paid to providers during the contract period and are expensed as incurred. Premium income is recognized during the coverage period.

**Cash and cash equivalents**

Cash and cash equivalents include demand deposits and short-term investments with original maturities of three months or less.

**Financial instruments and concentrations of credit risk**

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash, cash equivalents, marketable securities and premium receivables. Cash and cash equivalents are maintained with high-credit quality financial institutions and, at times, may exceed federally insured amounts. The Company has not incurred any losses in such accounts. All investments are managed within established guidelines that limit the amounts that may be invested with one issuer.

**Marketable securities**

The Company classifies investments in debt securities as held-to-maturity and, as such, they are carried at amortized cost. Premiums and discounts are amortized over the life of the related securities as an adjustment to yield using the scientific (constant yield) interest method. Such amortization is included in investment income. Equity securities are classified as available-for-sale and are carried at fair value. Realized gains and losses on debt and equity securities are included in investment income using the specific identification method for determining the cost of securities sold. Dividend and interest income is recognized when earned.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**2. Summary of Significant Accounting Policies (continued)**

**Marketable securities (continued)**

A decline in the fair value of held-to-maturity securities and/or common stock below cost that are deemed to be other-than-temporary results in a reduction in the carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. The Company performs regular analysis of its investments to determine the need to record an impairment. The Company recorded an impairment charge of \$14.3 million and \$1.1 million at December 31, 2016 and 2015, respectively, and is included in investment income on the consolidated statements of income and expense.

**Fair value measurements**

The Company applies the provisions of ASC No. 820, *Fair Value Measurements and Disclosures (ASC 820)*, which establishes a hierarchy for inputs used in measuring fair value, as follows:

Level 1 - Valuations are based on quoted market prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are readily and regularly available, valuation of Level 1 assets and liabilities does not require a significant degree of judgment. The Company considers U.S. Treasuries and equity securities as Level 1 assets.

Level 2 - Valuations are based on quoted prices for similar assets in active markets, or quoted prices in markets that are not active for which significant inputs are observable, either directly or indirectly. The Company considers U.S. Government agencies, municipal bonds, mortgage-backed securities, collateralized mortgage obligations, asset-backed securities, and corporate bonds as Level 2 assets. The Company currently does not own any assets measured as Level 2 assets.

Level 3 - Valuations are based on inputs that are unobservable and significant to the overall fair value measurement. Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model. The Company considers common stock that is not actively traded as Level 3 assets. Valuation is based on cost.

The Company's investments in fixed income and equity securities are valued through the use of nationally recognized pricing services by the custodian and investment managers. If the Company does not agree with the estimated price, the identified price will be verified by an independent pricing source or through performing independent valuations of inputs and assumptions similar to those used by the pricing service in order to determine prices represent a reasonable estimate of fair value. The Company made no significant adjustments to pricing as of December 31, 2016 or 2015.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**2. Summary of Significant Accounting Policies (continued)**

**Premiums and other receivables**

Premiums and other receivables are monitored by management on an on-going basis and are written off by the Company when it has been determined that all available collection avenues have been exhausted. The allowance for doubtful accounts at December 31, 2016 and 2015 was \$10.5 million and \$9.5 million, respectively.

**Property and equipment**

Property and equipment, including computer software systems, are carried at cost and depreciated by the straight-line method over the shorter of the estimated useful lives of the assets, ranging from three to ten years, or the lease term. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred; renewals, leasehold improvements and betterments are capitalized.

**Goodwill and other intangible assets**

Included in other assets are goodwill and intangible assets of \$1.3 million and \$7.6 million as of December 31, 2016 and 2015, respectively. These assets represent goodwill on Delta's capitation line of business and the excess of the purchase price of DIC, DICNE and CDS over the net assets acquired. Under accounting guidance, the Company does not amortize goodwill and other intangible assets with indefinite lives, however, Delta reviews the assets for impairment at least annually and more frequently if material changes in events or circumstances arise. Based on the reviews performed, the Company recorded an impairment charge of \$6.3 million to goodwill at December 31, 2016. There were no impairments at December 31, 2015.

**Long-lived assets**

The Company reviews long-lived assets held and used for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying value of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell. The Company recorded an impairment charge of \$35.4 million and \$34.0 million at December 31, 2016 and 2015, respectively.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**2. Summary of Significant Accounting Policies (continued)**

**Deferred compensation plans**

Delta provides deferred compensation plans, other than pension plans, for Delta dentists. Investments and liabilities related to these programs consist of participant contributions and investment income. Contributions to the dentists' plan were discontinued in 1992.

**Liability for unpaid claims and claims adjustment expenses**

Liability for unpaid claims represents estimated unpaid dental services rendered and reported to the Company, as well as a provision for dental claims incurred but not reported prior to the end of the year. The provision is actuarially determined based upon claims experience. The provision for claims incurred but not reported amounted to \$342.9 million and \$251.9 million at December 31, 2016 and 2015, respectively. Claims adjustment expenses related to unpaid claims are accrued based on an estimate of expenses to adjudicate and pay such claims. Claims adjustment expenses are reflected in operating expenses.

While management believes that the liability for unpaid claims and claims adjustment expenses at December 31, 2016 and 2015 is adequate to cover the ultimate net cost of claims, the liability is based on estimates and the amount ultimately paid may be more or less than the estimates. Adjustments and changes resulting from revisions of these estimates are reported in the period in which the revisions are made.

**Deferred revenue**

Premiums received in advance for the unexpired contractual coverage periods are reflected in the accompanying consolidated balance sheets as deferred revenue.

**Refundable group balances**

Certain contracts provide that dues received in excess of claims incurred and administrative fees are either refundable to the groups at the expiration of the agreements or applied against future dues payments.

**Pension and other post-retirement benefits**

The Company provides a range of benefits to eligible and retired employees, including pensions and post-retirement healthcare. The Company records annual amounts relating to these plans based on calculations which include various actuarial assumptions such as discount rates, expected rates of return on plan assets, compensation increases, turnover rates and healthcare cost trend rates. The Company reviews its actuarial assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when appropriate. As required, the effect of the modifications is generally amortized over future periods.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**2. Summary of Significant Accounting Policies (continued)**

**Income tax status**

Delta is a tax-exempt organization organized under Section 501(c)(4) of the Internal Revenue Code and, as such, no provision for income taxes has been made in the financial statements.

Subsidiaries of DDCIH are included in a consolidated federal income tax return with DDCIH. A Federal Tax Sharing agreement sets forth the manner in which the total combined federal income tax is allocated to each entity which is party to the consolidation. Pursuant to this agreement each party has an enforceable right to recoup federal income taxes paid in prior years in the event of future net losses, which it may incur, or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes. In accordance with accounting guidance, current and deferred taxes are allocated to members of the consolidated group using the separate return allocation method. Income tax expense for the years ended December 31, 2016 and 2015 was \$19.1 million and \$13.6 million, respectively, and is included in operating expenses on the consolidated statements of income and expense.

For subsidiaries of DDCIH, deferred tax provisions and benefits are calculated for certain transactions and events because of differing treatments between generally accepted accounting principles and the currently enacted tax laws. The effects of these differences on a cumulative basis result in the recognition and measurement of the deferred tax assets and liabilities. Net deferred tax assets in the amount of \$2.2 million and \$1.3 million at December 31, 2016 and 2015, respectively, are included in other assets on the consolidated balance sheets. Deferred tax liabilities in the amount of \$2.2 million and \$1.8 million at December 31, 2016 and 2015, respectively, are included in accounts payable and accrued expenses on the consolidated balance sheets.

Current accounting guidance clarifies how uncertainties in tax positions are recognized in an entity's financial statements. The guidance prescribes a recognition threshold and measurement process for tax positions taken or expected to be taken in a tax return. Positions include those with respect to Delta's tax exempt status and with respect to income taxes on unrelated business income. The Company has determined that such tax positions do not result in uncertainties requiring recognition.

**Estimates and assumptions**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as revenues and expenses reported for the periods presented. The Company regularly assesses these estimates and, while actual results may differ, management believes these estimates are reasonable.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**2. Summary of Significant Accounting Policies (continued)**

**Comprehensive income (loss)**

Accumulated other comprehensive income (loss) of the Company consists of net unrealized gains or losses on equity securities and adjustments to pension and other post-retirement benefit plans.

**Business concentration**

PaCa receives all of its operating income from the following sources: (1) administrative fee income ceded from DDNY and DDDC; (2) administrative fee income earned on the state of Maryland programs ceded from DDP; and (3) contractual income from DDP in an amount equal to the portion of Delta Reinsurance Corporation (DRC) net profits attributable to the reinsurance of DDNY and DDDC risk-based programs if DDP receives a dividend from DRC.

Additionally, PaCa receives contractual income from DDP for the settlement of underwriting results on the state of Maryland programs. The Maryland contractual income was \$1.7 million and \$1.2 million for the periods ending December 31, 2016 and 2015, respectively.

**Subsequent events**

The Company has evaluated subsequent events through April 7, 2017, the date the consolidated financial statements were available to be issued. As of April 7, 2017, the Company did not have any subsequent events that require recognition or disclosure.





**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**3. Marketable Securities (continued)**

The contractual maturities of debt securities at December 31, 2016 are summarized in the table (in thousands) below:

	<u>Amortized Cost</u>	<u>Fair Value</u>
Due within one year	\$ 28,167	\$ 28,325
Due after one year through five years	468,155	471,600
Due after five years through ten years	392,186	392,047
Due after ten years	<u>100</u>	<u>100</u>
	<u>\$ 888,608</u>	<u>\$ 892,072</u>

**4. Fair Value**

The following table (in thousands) reflects the major categories of assets measured at fair value on a recurring basis during the years ended December 31, 2016 and 2015. The Company currently does not own assets measured by significant other inputs (Level 2):

	<u>Level 1: Quoted For Identical Assets</u>	<u>Level 3: Significant Unobservable Inputs</u>	<u>Total at December 31, 2016</u>
Available-for-sale securities	<u>\$ 178,621</u>	<u>\$ 16,500</u>	<u>\$ 195,121</u>

	<u>Level 1: Quoted For Identical Assets</u>	<u>Level 3: Significant Unobservable Inputs</u>	<u>Total at December 31, 2015</u>
Available-for-sale securities	<u>\$ 149,602</u>	<u>\$ 20,000</u>	<u>\$ 169,602</u>

Realized gains and losses included in earnings for the year ended December 31, 2016 and 2015 are reported in investment income as follows (in thousands):

	<u>2016</u>	<u>2015</u>
Realized gains (losses), net	<u>\$ 1,140</u>	<u>\$ (63)</u>

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**5. Property and Equipment**

Property and equipment as of December 31 are summarized in the table (in thousands) below:

	<u>2016</u>	<u>2015</u>
Leasehold improvements	\$ 35,736	\$ 36,086
Computer equipment and office furniture	97,260	93,196
Computer software systems	<u>388,863</u>	<u>398,817</u>
	521,859	528,099
Less accumulated depreciation and amortization	<u>(342,280)</u>	<u>(326,805)</u>
Property and equipment, net	<u>\$ 179,579</u>	<u>\$ 201,294</u>

Depreciation and amortization expense for 2016 and 2015 was \$25.9 million and \$27.9 million, respectively.

**6. State and Federal Programs and Reinsurance**

On August 4, 2011, the State of California awarded Delta a five-year Medi-Cal dental risk contract (Denti-Cal) with the option of four one-year extensions. This contract was to begin on July 1, 2012. On July 26, 2012, the State of California Department of Health Care Services (DHCS) informed Delta of their intent to suspend the new contract and extend the old contract for twelve months through June 30, 2013. On July 1, 2013, an additional two-year extension was granted through June 30, 2015. On July 27, 2015, an additional one-year extension was granted through June 30, 2016. On October 10, 2016, an additional extension was granted through September 30, 2018.

The terms of the Denti-Cal contract, including extensions, limit Delta's annual underwriting gain or loss to \$4.65 million. Delta is also required to maintain a minimum tangible net equity balance, as defined in the contract, of \$143.6 million and \$142.0 million for 2016 and 2015, respectively. Delta is also required to maintain segregated investments of \$39.9 million and \$37.1 million for 2016 and 2015, respectively, and a letter of credit of \$5.0 million. Delta was in compliance with these contract requirements during 2016 and 2015. Denti-Cal revenues, included in State programs, were \$989.9 million and \$915.5 million and incurred claims were \$893.4 million and \$822.7 million for the years ended December 31, 2016 and 2015, respectively.

On October 14, 2016, the State of California awarded Delta the Medi-Cal dental administrative services only contract. The contract is for the period January 10, 2017 through November 30, 2019.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**6. State and Federal Programs and Reinsurance (continued)**

Delta also provides dental services to multiple county programs within the State of California with varying contract terms. The combined program revenues included in State programs were \$1.1 million and \$2.0 million and incurred claims were \$0.6 million and \$1.3 million for the years ended December 31, 2016 and 2015, respectively.

DDIC and the State of Utah Department of Health entered into a dental services contract to provide insurance under the Utah Medicaid Dental Services program through June 30, 2015, with two one-year extension options. In December 2015, the contract was extended through August 31, 2018. DDIC entered into a quota share reinsurance agreement with Delta. Under this agreement, 90% of the risk associated with the underwriting of the Utah Medicaid Dental Services contract was ceded to Delta. Utah Medicaid revenues, included in State programs, were \$13.7 million and \$11.1 million and incurred claims were \$13.8 million and \$11.9 million for the years ended December 31, 2016 and 2015, respectively.

Delta contracts with the United States Department of Defense (DOD) to provide dental benefits to retirees of the uniformed services and their dependents through a five-year contract expiring on December 31, 2018. The contract is underwritten and administered by Delta through risk sharing and administrative agreements. The Company maintains risk sharing agreements with Federal Marketing Group partners (Delta Dental Plan Association members). Under these agreements, the Company records 100% of the contract activity, retains 40.36% of the risk and provisions the remaining 59.64% of the risk to non-enterprise risk-share partners. The program revenues included in Federal programs were \$552.5 million and \$528.5 million and incurred claims were \$512.6 million and \$498.0 million for the years ended December 31, 2016 and 2015, respectively.

The Company has a multi-state dental contract with the AARP Dental Insurance Trust to provide dental insurance for AARP members. The contract covers all fifty states, Puerto Rico and the U.S. Virgin Islands and expires on December 31, 2019. Direct underwriting by selective state is assigned among DDIC, DIC and DICNE with Delta providing operational and administrative services for this contract. Delta has also entered into a 56% quota share reinsurance agreement with DDIC, DIC and DICNE. In addition, DDIC, DIC, and DICNE have each entered into a 33% and 10% quota share reinsurance agreement with Hannover Life and Reassurance Company of America (HLRC) and Renaissance Life and Health Insurance Company of America (RLHIC), respectively. As part of this agreement, Delta maintains a trust account balance for the purpose of collateralization of the reinsurance credit. The AARP program revenues included in Federal programs were \$187.3 million and \$176.0 million and incurred claims of \$86.7 million and \$82.1 million for the years ended December 31, 2016 and 2015, respectively.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**6. State and Federal Programs and Reinsurance (continued)**

DDIC and DIC entered into separate contracts with the United States Office of Personnel Management (OPM) to offer benefits in the Federal Employees Dental and Vision Insurance Program (FEDVIP) and with the United States Department of Veteran Affairs (VA) to provide dental benefits in the Veteran Affairs Dental Insurance Program (VADIP). The FEDVIP and VADIP contracts expire on December 31, 2020 and January 31, 2017, respectively. Direct underwriting by selective states and territories is assigned among DDIC and DIC. Delta provides operational and administrative services for these contracts. DDIC and DIC entered into reinsurance agreements with Delta to cede 100% of the risk associated with the underwriting for these programs. Delta entered into risk sharing agreements with Federal Marketing Group partners. Under this contract, Delta records 100% of the contract activity, retains 33.82% of the risk and provisions the remaining 66.18% of the risk to non-enterprise risk-share partners. FEDVIP program revenues, included in Federal programs, were \$56.9 million and \$35.9 million and incurred claims of \$47.7 million and \$30.2 million for the years ended December 31, 2016 and 2015, respectively. VADIP program revenues, included in Federal programs, were \$21.5 million and \$17.5 million and incurred claims of \$16.7 million and \$13.4 million, for the years ended December 31, 2016 and 2015, respectively.

On January 1, 2015, DDIC entered into a contract through December 31, 2015 with nine one-year renewal options with the Office of the Comptroller of the Currency (OCC) to offer benefits to the employees, retirees and their eligible dependents. OCC has exercised two of the one-year renewal options extending the contract through December 31, 2017. DDIC entered into a reinsurance agreement to cede 100% of premiums earned less administrative fees and claims incurred to Delta. OCC program revenues, included in Federal programs, were \$4.3 million and \$4.2 million and incurred claims of \$3.9 million for both years ended December 31, 2016 and 2015, respectively.

DDIC maintains a quota share reinsurance agreement with DRC of which DDIC owns a 5.93% minority share. Under the terms of this agreement, DDIC cedes 90% of all premiums earned less administrative fees and claims incurred for business written in the State of New York and the District of Columbia. Ceded premiums were \$10.9 million and \$11.0 million and ceded claims were \$10.8 million and \$11.5 million, for the years ended December 31, 2016 and 2015, respectively.

Additionally, DDIC has a reinsurance deposit in the amount of \$1.0 million from DRC for the maintenance of a statutory net credit for unauthorized reinsurance. The deposit bears interest at the lesser of the Prime Rate on the applicable date or the same rate payable on the first six-month U.S. Treasury Bill issued during each quarter. Interest paid to DRC was minimal in 2016 and 2015. The deposit amount is included in other liabilities.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**6. State and Federal Programs and Reinsurance (continued)**

Amounts ceded by reinsurance contracts do not relieve the underwriting company from its obligations to policy holders. Failure of reinsurers to honor their obligations could result in losses to the company. Each company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities and economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

**7. Liability for Unpaid Claims and Claims Adjustment Expenses**

Activity in the liability for unpaid claims and claims adjustment expenses is summarized in the table below (in thousands):

	<u>2016</u>	<u>2015</u>
Balance, January 1	\$ 383,693	\$ 382,051
Incurred related to:		
Current year	6,533,264	6,237,023
Prior years	<u>2,250</u>	<u>(47,218)</u>
	<u>6,535,514</u>	<u>6,189,805</u>
Paid related to:		
Current year	6,102,575	5,853,330
Prior years	<u>385,943</u>	<u>334,833</u>
	<u>6,488,518</u>	<u>6,188,163</u>
Balance, December 31	430,689	383,693
Unpaid claims adjustment expenses	<u>7,699</u>	<u>7,217</u>
Total unpaid claims and claims adjustment expenses	438,388	390,910
Ceded claims unpaid	<u>5,802</u>	<u>4,896</u>
Gross unpaid claims and claims adjustment expenses	<u>\$ 444,190</u>	<u>\$ 395,806</u>

As a result of actual claims of prior years' experience differing from estimated amounts of insured events provided for at the beginning of the respective years, the liability for unpaid claims increased by \$2.3 million and decreased by \$47.2 million in 2016 and 2015, respectively. The Company retains the risk and received the benefit of \$7.0 million and \$14.4 million from these reserve changes for December 31, 2016 and 2015, respectively.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**8. Commitments and Contingencies**

The Company has operating leases for office facilities, equipment and computer hardware. Future minimum lease payments required under these agreements are summarized in the table below (in thousands):

<u>Year Ending December 31</u>		
2017	\$	24,222
2018	\$	17,672
2019	\$	9,099
2020	\$	8,897
2021	\$	1,914
Thereafter	\$	1,478

Rental expense, including software licensing fees, was \$26.9 million and \$30.0 million in 2016 and 2015, respectively.

Lease payments for Dentegra Seguros Dentales S.A. (DSD) and Servicios Dentales Dentegra S.A. de C.V. (SDD), Mexican corporations and subsidiaries of DIC, are guaranteed by DDP. Future minimum lease payments and the term of the guarantee agreements are summarized in the table below (in thousands):

<u>Lessee</u>	<u>End of Guarantee</u>	<u>Term</u>	<u>Annual Rent</u>
DSD	7/31/2019	5 years	\$ 900
DSD	1/1/2021	5 years	\$ 228
SDD	12/31/2022	6 years	\$ 84
SDD	1/1/2026	10 years	\$ 96

These guarantees shall remain in full force and effect until the earliest date on which: (i) the term of the lease; (ii) all of the guaranteed obligations have been completely performed and paid in full, or (iii) a replacement guarantor shall have assumed all the rights and obligations of guarantor under this guaranty with prior written consent from lessor. DSD and SDD are current in all lease payments at December 31, 2016 and 2015.

Delta maintained a \$50.0 million unsecured revolving bank line of credit with applicable interest rate indexed to one month LIBOR plus 1.50% per annum. DDIC maintained a \$10.0 million unsecured revolving bank line of credit with an interest rate indexed to one month LIBOR plus 1.50% per annum. There were no outstanding balances at December 31, 2016 and 2015. Celebration maintained a \$1.0 million bank line of credit with an interest rate indexed to one month LIBOR plus 2.00% per annum. These lines of credit are used for periodic short-term cash flow requirements. The outstanding balances were \$0.6 million at December 31, 2016 and 2015.

In addition to the \$5.0 million unsecured letter of credit maintained for the Denti-Cal contract (Note 6), Delta maintained credit facilities (unsecured letters of credit) of \$24.0 with \$7.3 million and \$8.2 million outstanding at December 31, 2016 and 2015, respectively.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**9. Notes Receivable**

On November 15, 2015, Delta issued a \$20.0 million note receivable to Moda, Inc. (Moda), an affiliate of Oregon Dental Services (a Delta Dental Plan Association member) with an interest rate of 6.5% per annum payable within thirty calendar days of the close of the prior calendar year. All unpaid principal together with accrued and unpaid interest are due on November 15, 2020 unless Delta agrees to a later maturity date. Due to the uncertainty regarding the status of Moda's cash position and certain requirements placed on Moda by the Oregon Department of Insurance, a \$10.0 million allowance as of December 31, 2015 was established.

On May 16, 2016, Delta issued an additional \$30.0 million note receivable to Moda with an interest rate of 15.0% per annum with a maturity date of May 16, 2019 or earlier. Accrued interest shall be due and payable on the first day of each calendar month. Unpaid interest shall be added to the then-outstanding principal balance of the note and shall thereafter bear interest as noted above.

**10. Related Party Transactions**

DDP performs claims processing functions for Delta and DDIC under administrative services agreement. The Company paid DDP \$8.7 million and \$9.2 million for processing functions for 2016 and 2015, respectively.

In accordance with an administrative services agreement for the AARP contract, Delta reimburses DDP for 100% of the pooled administrative costs incurred by DDP. For each of the years ended 2016 and 2015, Delta paid DDP \$2.9 million.

The amounts payable to affiliates for administrative services at December 31, 2016 and 2015 was \$2.1 million and \$1.2 million, respectively.

The Company performs certain computer and other administrative support services under the administrative services agreements with DDP and its affiliates. The Company recorded \$13.3 million and \$11.8 million in cost reimbursements in 2016 and 2015, respectively. The amounts receivable from affiliates for these administrative services at December 31, 2016 and 2015 was \$4.1 million and \$3.6 million, respectively.

Pursuant to an administrative services agreement, DDP charges administrative expenses and interest expense to PaCa, based on an allocation of actual expenses, for the performance of certain functions for PaCa, DDNY, DDDC, and the state of Maryland programs. Administrative expenses and interest expense charged by DDP, included within operating expenses, were \$33.1 million and \$31.6 million, for the years ended December 31, 2016 and 2015, respectively.

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**10. Related Party Transactions (continued)**

In addition to the allocation of expenses from DDP, PaCa covers certain direct costs incurred by DDNY and DDDC. The amounts incurred included within operating expenses, were \$0.6 million and \$0.7 million in 2016 and 2015, respectively.

The amount receivable from affiliates for PaCa activity at December 31, 2016 and 2015 was \$2.7 million and \$3.1 million, respectively. The amount payable to affiliates related to PaCa activity was \$2.4 million at December 31, 2016 and 2015.

Receivables from affiliates are included in other receivables and payables to affiliates are included in accounts payable and accrued expenses on the consolidated balance sheets. Related party (affiliate) transactions are settled on a monthly basis through intercompany cash transfers.

**11. Minimum Tangible Net Equity and Capital and Surplus Requirements**

Under the requirements of the DMHC, Delta is required to maintain a minimum tangible net equity balance, as defined by the DMHC, of \$113.1 million and \$113.0 million at December 31, 2016 and 2015, respectively. Delta's tangible net equity balance was \$898.4 million and \$776.8 million at December 31, 2016 and 2015, respectively, and exceeded the DMHC's requirements.

At December 31, 2016 and 2015, Delta's subsidiaries exceed minimum capital and surplus requirements under the insurance code respective to the state where they are domiciled.

**12. Employee Benefit Plans**

The Company sponsors various plans for their employees. These plans include a qualified cash balance defined benefit pension plan and a post-retirement health benefit plan. The Company also maintains a non-qualified, defined benefit plan, Executive Supplemental Pension Plan (ESPP), for certain members of management. The ESPP is unfunded, however the Company has established a rabbi trust which protects the interest of the plan participants.

The Company's post-retirement health benefit plan is offered to eligible retired employees and their survivors. The plan is unfunded and claims are paid from Company funds.

The Company recognized an accumulated other comprehensive income and loss of \$3.6 million and \$11.5 million for the years ended December 31, 2016 and 2015, respectively, due to pension and post-retirement adjustments.



**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**12. Employee Benefit Plans (continued)**

The Company participates in a 401(k) Plan (the Plan) that is available to all employees. Employees may contribute up to 50% of compensation to the Plan up to the maximum allowed by law and the Company will match 50% of the employees' contributions to the Plan up to 6% of eligible compensation, which is limited to \$265,000 for the years ended December 31, 2016 and 2015. The annual expense for the Plan was \$3.4 million and \$3.9 million, respectively, for the years ended December 31, 2016 and 2015. The Company may elect to make discretionary contributions to the Plan. The Company elected to reserve for a discretionary contribution in the amount of \$10.7 million and \$0 at December 31, 2016 and 2015, respectively.

The Company participates in a qualified cash balance defined benefit plan (the Cash Balance Plan). On January 1, 2013 (for non-union employees) and January 31, 2014 (for union employees), the Cash Balance Plan was frozen to new contributions and replaced with a 6% contribution to the 401(k) Plan with contributions of \$11.9 million for each of the years ended December 31, 2016 and 2015.

The following tables (in thousands) set forth the combined plans' total projected benefit obligations, weighted average assumptions used to determine the benefit obligation, fair value of plan assets, and the funded status as of the measurement date of September 30.

	Pension		Post-Retirement Health	
	2016	2015	2016	2015
<b>Change in benefit obligation</b>				
Benefit obligation, beginning of year	\$ 178,583	\$ 205,245	\$ 27,148	\$ 28,452
Service cost	760	1,168	813	1,054
Interest cost	5,717	6,230	1,197	1,161
Actuarial (gain)/loss	746	1,853	509	(2,705)
Gross benefits paid	(251)	(176)	(888)	(814)
Administrative expenses paid	(118)	(775)	-	-
Plan change	-	4,030	-	-
Settlements	(11,160)	(38,992)	-	-
Benefit obligation, end of year	<u>\$ 174,277</u>	<u>\$ 178,583</u>	<u>\$ 28,779</u>	<u>\$ 27,148</u>
Accumulated benefit obligation, end of year	<u>\$ 163,390</u>	<u>\$ 167,343</u>	<u>N/A</u>	<u>N/A</u>

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**12. Employee Benefit Plans (continued)**

	Pension		Post-Retirement Health	
	2016	2015	2016	2015
<b>Weighted-average assumptions used to determine benefit obligation at end of year:</b>				
Qualified plan				
- Discount rate	3.47%	3.55%	4.09%	4.35%
- Rate of compensation increase	N/A	N/A	N/A	N/A
Non-qualified plan				
- Discount rate	2.85%	3.04%	N/A	N/A
- Rate of compensation increase	Various	4.50%	N/A	N/A
Cash balance interest credit rate	0.58%	0.33%	N/A	N/A
Health care cost trend rate				
- Initial rate	N/A	N/A	7.00%	7.25%
- Ultimate rate	N/A	N/A	5.00%	5.00%
- Years to ultimate	N/A	N/A	8	8
Effect of one-percentage point change in assumed health care cost trend rate on post retirement obligation				
- Increase	N/A	N/A	\$ 194	\$ 110
- Decrease	N/A	N/A	\$ (159)	\$ (95)
<b>Change in plan assets</b>				
Fair value of plan assets,				
beginning of year	\$ 133,016	\$ 172,028	\$ -	\$ -
Actual return on plan assets	10,223	851	-	-
Employer contributions	63	81	(888)	814
Gross benefits paid	(251)	(176)	888	(814)
Settlements	(11,160)	(38,992)	-	-
Administrative expenses paid	(118)	(775)	-	-
Fair value of plan assets, end of year	<u>\$ 131,773</u>	<u>\$ 133,017</u>	<u>\$ -</u>	<u>\$ -</u>

The following tables (in thousands) provide the amounts recognized in the consolidated balance sheets as of December 31:

	Pension		Post-Retirement Health	
	2016	2015	2016	2015
<b>Funded status, end of year</b>				
Fair value of plan assets	\$ 131,773	\$ 133,017	\$ -	\$ -
Benefit obligations	<u>(174,277)</u>	<u>(178,583)</u>	<u>(28,779)</u>	<u>(27,148)</u>
Funded status	<u>\$ (42,504)</u>	<u>\$ (45,566)</u>	<u>\$ (28,779)</u>	<u>\$ (27,148)</u>

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**12. Employee Benefit Plans (continued)**

	Pension		Post-Retirement Health	
	2016	2015	2016	2015
<b>Amounts recognized in the consolidated balance sheets:</b>				
Current liability	\$ (140)	\$ (142)	\$ (917)	\$ (870)
Noncurrent liability	(42,364)	(45,424)	(27,862)	(26,278)
	<u>\$ (42,504)</u>	<u>\$ (45,566)</u>	<u>\$ (28,779)</u>	<u>\$ (27,148)</u>
<b>Accumulated other comprehensive loss:</b>				
Prior service cost/(credit)	\$ 1,243	\$ 411	\$ (4,076)	\$ (7,311)
Unamortized net loss	44,999	52,655	8,107	8,084
Accumulated other comprehensive loss	<u>\$ 46,242</u>	<u>\$ 53,066</u>	<u>\$ 4,031</u>	<u>\$ 773</u>

The following table provides the asset allocation by asset category for the years ending December 31, along with the target allocation:

	Target Allocation		Actual Allocation	
	2016	2015	2016	2015
Equity securities	50%	50%	53%	50%
Debt securities	46%	48%	43%	46%
Real estate	4%	2%	4%	4%

The following tables (in thousands) provide the components of net periodic cost (benefit) and the weighted-average assumptions used to determine net periodic cost (benefit) for the years ending December 31:

	Pension		Post-Retirement Health	
	2016	2015	2016	2015
<b>Components of net periodic cost (benefit):</b>				
Service cost	\$ 760	\$ 1,168	\$ 813	\$ 1,054
Interest cost	5,717	6,230	1,197	1,161
Expected return on plan assets	(9,031)	(11,264)	-	-
Amortization:				
Actuarial loss	5,286	3,765	486	848
Prior service credit	(831)	(1,555)	(3,234)	(3,244)
Settlement loss	1,925	2,327	-	-
Net periodic cost (benefit)	<u>\$ 3,826</u>	<u>\$ 671</u>	<u>\$ (738)</u>	<u>\$ (181)</u>

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**12. Employee Benefit Plans (continued)**

	Pension		Post-Retirement Health	
	2016	2015	2016	2015
<b>Weighted-average assumptions used to determine net periodic cost (benefit):</b>				
Qualified plan				
- Discount rate	3.55%	3.47%	4.35%	3.99%
- Rate of compensation increase	N/A	N/A	N/A	N/A
Non-qualified plan				
- Discount rate	3.04%	2.97%	N/A	N/A
- Rate of compensation increase	4.50%	4.50%	N/A	N/A
Expected long-term rate of return on plan assets				
	7.50%	7.50%	N/A	N/A
Cash balance interest credit rate:				
Minimum balance	2.86%	3.03%	N/A	N/A
Ongoing balance	0.58%	0.33%	N/A	N/A
Health care cost trend rate				
- Initial rate	N/A	N/A	7.25%	7.50%
- Ultimate rate	N/A	N/A	5.00%	5.00%
- Year of ultimate trend rate	N/A	N/A	2024	2024
Effect of one-percentage point change in assumed health care cost trend rate on aggregate service and interest cost (in thousands)				
- Increase	N/A	N/A	\$ 5	\$ 6
- Decrease	N/A	N/A	\$ (4)	\$ (6)

The following table (in thousands) provides information about the expected cash flows for the years ending December 31:

	Post-Retirement	
	Pension	Health
<b>Expected cash flows:</b>		
Expected employer contributions	\$ 142	\$ 935
Expected benefits payments		
2017	\$ 29,197	\$ 935
2018	\$ 12,245	\$ 992
2019	\$ 12,071	\$ 1,068
2020	\$ 10,689	\$ 1,136
2021	\$ 10,664	\$ 1,218
2022 to 2026	\$ 92,104	\$ 7,518

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2016 and 2015

**13. Mexico Operations**

In order to meet the need for cross border access to dental care, Delta has been authorized by its Board to fund the formation of a Mexican specialized health insurer in an amount not to exceed \$26.0 million less any amount funded by DDP. To date, funding of \$20.5 million has been provided. DIC holds a 100% interest in Dentegra Insurance Holdings, LLC (DIH), a Delaware limited liability corporation. DIC also holds a 99% interest in DSD with the remaining 1% held by DIH. DSD underwrites and administers dental insurance contracts in Mexico. DIC also has a 98% interest in SDD. SDD provides administrative services to DSD and is located in Mexico City, Mexico. DIH holds the remaining 2% of SDD.

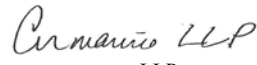
**SUPPLEMENTARY INFORMATION**



INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION

To the Board of Directors of  
Delta Dental of California  
San Francisco, California

We have audited the consolidated financial statements of Delta Dental of California, as of and for the years ended December 31, 2016 and 2015, and our report thereon dated April 7, 2017, which expressed an unmodified opinion on those financial statements, appears on page 1. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, and results of operations of the individual companies, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

  
Armanino<sup>LLP</sup>  
San Francisco, California

April 7, 2017

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATING BALANCE SHEETS**  
(In thousands)

	December 31, 2016									December 31,	
	DDC	DDIC	DIC	DICNE	Alphas	DDPR	CDS	PACA	Eliminations	Consolidated	2015
											Consolidated
<b>ASSETS</b>											
Cash and cash equivalents	\$ 652,472	\$ 61,448	\$ 47,362	\$ 4,954	\$ 15,776	\$ 13,914	\$ 155	\$ 7,405	\$ -	\$ 803,486	\$ 602,965
Marketable securities	936,871	120,938	5,553	1,284	10,579	8,504	-	-	-	1,083,729	964,328
	<u>1,589,343</u>	<u>182,386</u>	<u>52,915</u>	<u>6,238</u>	<u>26,355</u>	<u>22,418</u>	<u>155</u>	<u>7,405</u>	<u>-</u>	<u>1,887,215</u>	<u>1,567,293</u>
Premiums and other receivables											
Premium receivables	239,235	94,282	10,441	21	991	3,082	-	-	-	348,052	321,704
Other receivables	60,168	11,258	14,438	360	2,315	260	254	2,694	(55,625)	36,122	33,312
	<u>299,403</u>	<u>105,540</u>	<u>24,879</u>	<u>381</u>	<u>3,306</u>	<u>3,342</u>	<u>254</u>	<u>2,694</u>	<u>(55,625)</u>	<u>384,174</u>	<u>355,016</u>
Property and equipment, net	175,369	1,700	1,745	-	-	172	593	-	-	179,579	201,294
Deferred compensation plans investments	34,508	-	-	-	-	-	-	-	-	34,508	35,716
Notes receivable	135,750	-	-	-	-	-	-	-	(95,750)	40,000	10,000
Other assets	151,963	4,799	896	480	71	355	138	-	(121,880)	36,822	34,352
<b>TOTAL ASSETS</b>	<u>\$ 2,386,336</u>	<u>\$ 294,425</u>	<u>\$ 80,435</u>	<u>\$ 7,099</u>	<u>\$ 29,732</u>	<u>\$ 26,287</u>	<u>\$ 1,140</u>	<u>\$ 10,099</u>	<u>\$ (273,255)</u>	<u>\$ 2,562,298</u>	<u>\$ 2,203,671</u>
<b>LIABILITIES AND GENERAL RESERVES</b>											
<b>Liabilities</b>											
Unpaid claims and claims adjustment expenses	\$ 343,583	\$ 89,525	\$ 1,443	\$ 5	\$ 2,222	\$ 1,610	\$ -	\$ -	\$ -	\$ 438,388	\$ 390,910
Accounts payable and accrued expenses	176,829	73,885	27,694	505	3,597	1,488	891	2,351	(42,816)	244,424	222,407
Deferred revenue	76,204	3,681	592	9	1,882	167	-	-	-	82,535	75,142
Refundable group balances	601,081	165	20	-	-	-	-	-	-	601,266	482,344
Deferred compensation plans	34,508	-	-	-	-	-	-	-	-	34,508	35,716
Accrued retirement benefits	71,283	-	-	-	-	-	-	-	-	71,283	72,714
Notes payable	-	45,750	50,000	-	-	-	-	-	(95,750)	-	-
Other liabilities	12,432	4,145	-	-	-	2,320	581	-	-	19,478	18,145
	<u>1,315,920</u>	<u>217,151</u>	<u>79,749</u>	<u>519</u>	<u>7,701</u>	<u>5,585</u>	<u>1,472</u>	<u>2,351</u>	<u>(138,566)</u>	<u>1,491,882</u>	<u>1,297,378</u>
<b>Capital and general reserves</b>											
General reserves	1,072,973	54,292	(23,610)	130	17,673	3,632	(782)	(10,403)	(40,932)	1,072,973	926,020
Accumulated other comprehensive income (loss)	(2,557)	3,537	(5,231)	-	-	69	-	-	1,625	(2,557)	(19,727)
Preferred stock	-	10,500	-	-	-	-	-	-	(10,500)	-	-
Common stock	-	1,647	2,600	2,000	33	8,000	450	-	(14,730)	-	-
Additional paid-in capital	-	7,298	26,927	4,450	4,325	9,001	-	18,151	(70,152)	-	-
	<u>1,070,416</u>	<u>77,274</u>	<u>686</u>	<u>6,580</u>	<u>22,031</u>	<u>20,702</u>	<u>(332)</u>	<u>7,748</u>	<u>(134,689)</u>	<u>1,070,416</u>	<u>906,293</u>
<b>TOTAL LIABILITIES AND GENERAL RESERVES</b>	<u>\$ 2,386,336</u>	<u>\$ 294,425</u>	<u>\$ 80,435</u>	<u>\$ 7,099</u>	<u>\$ 29,732</u>	<u>\$ 26,287</u>	<u>\$ 1,140</u>	<u>\$ 10,099</u>	<u>\$ (273,255)</u>	<u>\$ 2,562,298</u>	<u>\$ 2,203,671</u>



**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATING STATEMENTS OF INCOME AND EXPENSE AND COMPREHENSIVE INCOME (LOSS)**  
(In thousands)

	Year Ended December 31, 2016									Year Ended December 31, 2015	
	<u>DDC</u>	<u>DDIC</u>	<u>DIC</u>	<u>DICNE</u>	<u>Alphas</u>	<u>DDPR</u>	<u>CDS</u>	<u>PACA</u>	<u>Eliminations</u>	<u>Consolidated</u>	<u>Consolidated</u>
<b>Premiums and other income</b>											
Commercial programs	\$ 4,066,538	\$ 1,487,983	\$ 23,200	\$ 88	\$ 36,379	\$ 34,838	\$ -	\$ -	\$ (11,609)	\$ 5,637,417	\$ 5,354,482
State programs	1,001,212	3,431	-	-	-	-	-	-	-	1,004,643	927,957
Federal programs	794,949	16,172	14,211	238	-	-	-	-	-	825,570	765,982
	5,862,699	1,507,586	37,411	326	36,379	34,838	-	-	(11,609)	7,467,630	7,048,421
Administrative service contracts	(2,271,258)	(816,142)	-	-	-	(21,773)	-	-	-	(3,109,173)	(2,789,226)
	3,591,441	691,444	37,411	326	36,379	13,065	-	-	(11,609)	4,358,457	4,259,195
Investment income, net	15,462	3,192	857	16	223	33	-	455	(2,980)	17,258	23,156
Other income (expense), net	(19,799)	(1,243)	1,461	-	(261)	195	6,686	32,941	(18,991)	989	(9,886)
	3,587,104	693,393	39,729	342	36,341	13,293	6,686	33,396	(33,580)	4,376,704	4,272,465
<b>Claims and operating expenses</b>											
Claims incurred	5,166,140	1,308,395	9,866	53	24,036	27,024	-	-	-	6,535,514	6,189,805
Claims incurred on administrative service contracts	(2,271,258)	(816,142)	-	-	-	(21,773)	-	-	-	(3,109,173)	(2,789,226)
	2,894,882	492,253	9,866	53	24,036	5,251	-	-	-	3,426,341	3,400,579
Operating expenses	545,269	183,340	34,044	282	8,767	7,038	7,237	33,733	(16,300)	803,410	756,187
	3,440,151	675,593	43,910	335	32,803	12,289	7,237	33,733	(16,300)	4,229,751	4,156,766
<b>Net income (loss)</b>	<u>146,953</u>	<u>17,800</u>	<u>(4,181)</u>	<u>7</u>	<u>3,538</u>	<u>1,004</u>	<u>(551)</u>	<u>(337)</u>	<u>(17,280)</u>	<u>146,953</u>	<u>115,699</u>
Other comprehensive income (loss)											
Pension liability and post-retirement adjustments	3,566	-	-	-	-	-	-	-	-	3,566	(11,452)
Unrealized gains (losses) on securities	13,604	1,151	-	-	-	51	-	(294)	(908)	13,604	(3,449)
Loss on foreign currency translation	-	-	(2,152)	-	-	-	-	-	2,152	-	-
	17,170	1,151	(2,152)	-	-	51	-	(294)	1,244	17,170	(14,901)
<b>Comprehensive income (loss)</b>	<u>\$ 164,123</u>	<u>\$ 18,951</u>	<u>\$ (6,333)</u>	<u>\$ 7</u>	<u>\$ 3,538</u>	<u>\$ 1,055</u>	<u>\$ (551)</u>	<u>\$ (631)</u>	<u>\$ (16,036)</u>	<u>\$ 164,123</u>	<u>\$ 100,798</u>

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATING BALANCE SHEETS- ALPHAS**

(In thousands)

	December 31, 2016						December 31,	
	Alpha Dental Programs, Inc.	Alpha Dental Alabama	Alpha Dental of Arizona	Alpha Dental of Nevada	Alpha Dental of New Mexico	Alpha Dental of Utah	2015	
						Total	Total	
<b>ASSETS</b>								
Cash and cash equivalents	\$ 12,821	\$ 138	\$ 270	\$ 1,397	\$ 238	\$ 912	\$ 15,776	\$ 11,567
Marketable securities	7,439	446	555	1,113	209	817	10,579	10,953
	<u>20,260</u>	<u>584</u>	<u>825</u>	<u>2,510</u>	<u>447</u>	<u>1,729</u>	<u>26,355</u>	<u>22,520</u>
Premiums and other receivables								
Premium receivables	898	-	49	24	1	19	991	1,329
Other receivables	1,458	152	466	145	22	72	2,315	1,318
	<u>2,356</u>	<u>152</u>	<u>515</u>	<u>169</u>	<u>23</u>	<u>91</u>	<u>3,306</u>	<u>2,647</u>
Other assets	57	1	5	3	2	3	71	40
<b>TOTAL ASSETS</b>	<u>\$ 22,673</u>	<u>\$ 737</u>	<u>\$ 1,345</u>	<u>\$ 2,682</u>	<u>\$ 472</u>	<u>\$ 1,823</u>	<u>\$ 29,732</u>	<u>\$ 25,207</u>
<b>LIABILITIES AND GENERAL RESERVES</b>								
<b>Liabilities</b>								
Unpaid claims and claims adjustment expenses	\$ 1,873	\$ 11	\$ 95	\$ 146	\$ 32	\$ 65	\$ 2,222	\$ 1,344
Accounts payable and accrued expenses	2,787	28	238	282	67	195	3,597	3,947
Deferred revenue	1,738	-	-	76	-	68	1,882	1,423
	<u>6,398</u>	<u>39</u>	<u>333</u>	<u>504</u>	<u>99</u>	<u>328</u>	<u>7,701</u>	<u>6,714</u>
<b>Capital and general reserves</b>								
General reserves	15,581	497	715	496	19	365	17,673	14,135
Common stock	1	1	-	20	1	10	33	33
Additional paid-in capital	693	200	297	1,662	353	1,120	4,325	4,325
	<u>16,275</u>	<u>698</u>	<u>1,012</u>	<u>2,178</u>	<u>373</u>	<u>1,495</u>	<u>22,031</u>	<u>18,493</u>
<b>TOTAL LIABILITIES AND GENERAL RESERVES</b>	<u>\$ 22,673</u>	<u>\$ 737</u>	<u>\$ 1,345</u>	<u>\$ 2,682</u>	<u>\$ 472</u>	<u>\$ 1,823</u>	<u>\$ 29,732</u>	<u>\$ 25,207</u>

**DELTA DENTAL OF CALIFORNIA AND SUBSIDIARIES**  
**CONSOLIDATING STATEMENTS OF INCOME AND EXPENSE- ALPHAS**  
(In thousands)

	Year Ended December 31, 2016						Year Ended December 31, 2015	
	<u>Alpha Dental Programs, Inc.</u>	<u>Alpha Dental Alabama</u>	<u>Alpha Dental of Arizona</u>	<u>Alpha Dental of Nevada</u>	<u>Alpha Dental of New Mexico</u>	<u>Alpha Dental of Utah</u>	<u>Total</u>	<u>Total</u>
<b>Premiums and other income</b>								
Commercial programs	\$ 29,973	\$ 150	\$ 2,193	\$ 2,526	\$ 298	\$ 1,239	\$ 36,379	\$ 30,914
Investment income, net	157	10	13	20	5	18	223	158
Other income (expense), net	(240)	(1)	(13)	(3)	-	(4)	(261)	23
	<u>29,890</u>	<u>159</u>	<u>2,193</u>	<u>2,543</u>	<u>303</u>	<u>1,253</u>	<u>36,341</u>	<u>31,095</u>
<b>Claims and operating expenses</b>								
Claims incurred	19,685	77	1,557	1,737	218	762	24,036	18,312
Operating expenses	7,399	52	421	548	69	278	8,767	7,950
	<u>27,084</u>	<u>129</u>	<u>1,978</u>	<u>2,285</u>	<u>287</u>	<u>1,040</u>	<u>32,803</u>	<u>26,262</u>
<b>Net income</b>	<u>\$ 2,806</u>	<u>\$ 30</u>	<u>\$ 215</u>	<u>\$ 258</u>	<u>\$ 16</u>	<u>\$ 213</u>	<u>\$ 3,538</u>	<u>\$ 4,833</u>