



May 20, 2014

Jack M. Stover, Esquire
Buchanan Ingersoll & Rooney PC
409 North Second Street
Suite 500
Harrisburg, PA 17101-1357

RE: Approval of Transaction Pursuant to Condition 11 of the Pennsylvania Insurance Department's Approving Determination and Order (Order No. ID-RC-13-06) (the "Order")¹ – West Penn Allegheny Health System entering into a \$700,000,000 term loan and the guaranty by Highmark Inc. of that term loan

Dear Mr. Stover:

On March 28, 2014, Highmark Inc. ("Highmark") filed, as a confidential document (the "March 28, 2014 Filing"), a request for approval of a Financial Commitment (as defined in the Order) relating to a \$700,000,000 syndicated bank term loan (the "Term Loan") (i) to West Penn Allegheny Health System, Inc., as the representative acting on behalf of itself and its affiliated obligated group members ("West Penn") (ii) from PNC Bank, National Association ("PNC"), acting as administrative agent for certain financial institutions, including PNC (collectively the "Lenders").

As provided in the March 28, 2014 Filing, as supplemented by additional information provided by or on behalf of Highmark, West Penn and their respective affiliates, the Financial Commitment contemplated by Term Loan transaction (the "Transaction") consists of the following:

1. A guaranty by Highmark of the obligations of West Penn under the Term Loan (the "Guarantee").
2. A pledge by Highmark of securities and cash in the aggregate maintenance value of not less than 100% of the outstanding Term Loan borrowings, to secure Highmark's obligation under the Guarantee (the "Highmark Collateral").
3. The obligations of West Penn in connection with the Term Loan will be further evidenced under a Master Note (the "Master Note"), issued pursuant to the Master Trust Indenture dated as of May 1, 2007 as amended (the "Indenture"), relating to the West Penn 2007A Series Bonds (as defined below) to PNC, for the benefit of each Lender and a provider of an interest rate hedging arrangement (the "Hedging Arrangement"). As a result, the obligations of West Penn in connection with the Term Loan will be secured by a first priority lien on the gross revenues and the mortgaged property granted by West Penn pursuant to the Indenture (the "Indenture Collateral"). The documents governing the Transaction will provide that Highmark will be subrogated to the rights of PNC upon payment in full under the Guarantee, and that PNC will assign the Master Note and the Indenture Collateral to Highmark following such payment.

¹ Any capitalized terms not defined in this letter shall have the meaning ascribed to them in Appendix 1 (Definitions) to the Order.

4. A lien on certain additional personal property of West Penn granted by West Penn to Highmark to secure West Penn's reimbursement obligations to Highmark arising in connection with Guarantee.

The March 28, 2014 Filing included a summary of the material terms and conditions of the Transaction (the "Term Sheet"). In addition to the March 28 Filing, Highmark provided additional information to the Department and its advisors. On May 7, 2014, at the request of the Department, Highmark made a non-confidential, public filing describing the Transaction (the "May 7 Filing").

As described by Highmark in the May 7 Filing, the proceeds from the Term Loan are intended to be used by West Penn (the "Proposed Use of Proceeds"): (a) to redeem or repurchase from Highmark all of the Health System Revenue Bonds (West Penn Allegheny Health System), Series 2007A (the "West Penn 2007A Series Bonds"), issued by the Allegheny County Hospital Development Authority, that are owned by Highmark for approximately \$580,916,875, representing Highmark's cost of acquiring the West Penn 2007A Series Bonds (the "Highmark Bonds"); (b) to pay to Highmark the accrued interest on the Highmark Bonds of approximately \$31,985,705; (c) to defease the remaining amount of the outstanding West Penn 2007A Series Bonds that are not owned by Highmark of approximately \$34,215,000; and (d) the balance, for transactional costs and for West Penn's operational needs, such as debt restructuring and/or capital projects. May 7 Filing, pp. 3, 5.

Highmark's request for approval of the Financial Commitment relating to Transaction was submitted to the Department for approval pursuant to Condition 11(C) of the Order, which states:

C. Transactions Requiring Department Approval. Without the Approval of the Department, no Domestic Insurer shall make or agree, directly or indirectly, to make any Financial Commitment if: (i) the amount thereof, together with all other Financial Commitments made or agreed to be made directly or indirectly by all of the Domestic Insurers within the immediately preceding consecutive twelve (12) months, equals or exceeds \$250,000,000; (ii) the amount thereof is made in connection with a Financial Commitment made or agreed to be made to a Person (including but not limited to any Affiliates), together with all other Financial Commitments between or among one or more of the UPE Entities, on the one hand, and such Person (including but not limited to any Affiliates), on the other hand, aggregate \$250,000,000 or more; or (iii) the RBC Rating of Highmark is, or as a result of the Financial Commitment is likely to be, 525% or below.

"Financial commitment" is defined in Appendix 1 to the Order as follows:

"Financial Commitment" means any direct or indirect payment or transfer of any cash or other property, any Donation, provision of services, encumbrance upon or granting of any security interest in or to any assets or properties, or the direct or indirect guaranty or incurrence of any contractual obligation or liability. The term "Financial Commitment" includes, but is not limited to, the acquisition of any assets or properties of or interests in, the merger, consolidation or affiliation with, or the entering into of any financial or contractual relationship with, any Person, except for: (i) any Financial Commitment made in the ordinary and usual course of the UPE Entity's business; or (ii) any amounts expressly required to be paid without any further consent of any Person and pursuant to the current provisions of the Affiliation Agreement, JRMC Affiliation Agreement and/or any affiliation agreement between Highmark and SVHS acceptable to the Department. Without limiting the generality of the foregoing, (i) until June 30, 2017, a Financial Commitment shall include but is not limited to (A) any advance payment by a Domestic Insurer to a WPAHS Entity pursuant to or in connection with a contract or arrangement for the payment or reimbursement for Health Care Services; or (B) an increase in contractual rates pursuant to or in connection with a contract or

arrangement for the payment or reimbursement for Health Care Services between or among any Domestic Insurer and any WPAHS Entity in excess of the level of increase set forth in the Base Case Financial Projections; and (ii) in no event shall any Financial Commitment relating to the acquisition of any assets or properties of or interests in, the merger, consolidation or affiliation with, or any Donation to or investment in, any Person in connection with the IDN Strategy, as it may be renamed, modified or replaced, be considered to be in the ordinary course of business.

West Penn has advanced in support of this approval that the Transaction will “. . . achieve interest rate savings, thus resulting in a financially stronger health system that can benefit its stakeholders and the community.” May 7 Filing, p. 5. Highmark delivered projections as to the following financial benefits on West Penn: (i) estimated annual interest savings to West Penn of \$16-\$19 million; (ii) the Term Loan will permit the payment of approximately \$33 million of accrued interest due to Highmark; (iii) the Term Loan will “[g]enerate additional funds for operational needs such as debt restructuring and/or capital projects within [West Penn].” *Id.*

The Department understands that Highmark supports approval of the Transaction “. . . because the transaction will improve the quality of [Highmark’s] investment portfolio and reduce its financial leverage. Specifically, Highmark projected the following impacts from approval of the Transaction: (a) reduction of the amount of non-investment grade investments by approximately \$581 million; (b) reduction of Highmark’s debt and related debt service obligations as a result of repayment of its current loan, which was entered into and used to purchase the Highmark Bonds; (c) improvement in the average quality of the Highmark fixed income investment portfolio from the current Baa1 to Aa3 once the Highmark Bonds are removed from Highmark’s portfolio; and (d) “[e]nhanced reputation in the market and community from a stronger [West Penn] network, increasing Highmark’s ability to retain membership and attract customers to Highmark’s Community Blue product, which is a lower cost market alternative.” *Id.* at 5-6. In addition, Highmark has estimated that the value of the Guarantee is approximately \$100 million. *Id.* at 6.

In issuing this letter the Department has assumed that the information provided by or on behalf of Highmark, West Penn and their respective Affiliates in connection with the filing is true, accurate and complete. Based on the Department’s review of the March 28 Filing, the May 7 Filing and the additional information provided to the Department and its advisors by or for Highmark, West Penn and its and their affiliates, the Department approves the Financial Commitment relating to the Transaction under Condition 11(C) of the Order, subject to the following:

1. The Department is only approving the current Financial Commitment relating to the \$700,000,000 Term Loan, including the Master Note, Indenture Collateral, the Guarantee, the Highmark Collateral and the Additional Collateral provided that the proceeds are used in accordance with Proposed Use of Proceeds.
2. The Department is not approving any other loan, guarantee or other Financial Commitment that may be entered into or obtained, whether or not relating the Term Loan and whether or not arising pursuant to any amendment or modification of the Master Note, Indenture Collateral, the Guarantee, the Highmark Collateral, the Additional Collateral and/or any other document.
3. The terms and conditions of all agreements, documents and instruments entered into or to be entered into in connection with the Transaction, including without limitation, the form of the

Master Note, Indenture Collateral, the Guarantee, the Highmark Collateral and the Additional Collateral, shall be substantially the same as the terms and conditions set forth in the Term Sheet.

4. This letter constitutes an approval of the Hedging Arrangement only to the extent that (i) the Hedging Arrangement relates solely to the Term Loan, is entered into on customary terms and is not speculative in nature; (ii) the principal amount of obligations subject to the Hedging Arrangement do not exceed a total of \$700,000,000; and (iii) any costs or expenditures in connection with the Hedging Arrangement are included in and are expended in accordance with the Proposed Use of Proceeds.
5. Highmark will record the \$97.5 million cost of the guarantee for statutory accounting purposes upon consummation of the transaction and will update such amount as required to comply with all applicable statutory accounting guidance and principles.
6. The value of the Financial Commitment made by Highmark in connection with Highmark entering into the Guarantee shall be \$97,500,000 for purposes of calculating the amount of the Financial Commitment made by Highmark pursuant to Condition 11(C) of the Order.
7. Highmark shall deliver, or cause to be delivered, promptly following receipt thereof, copies of all material notices (including, without limitation, any notice of default, acceleration or enforcement) received by Highmark or West Penn under or in connection with the documents governing the Transaction.

Sincerely,



Stephen J. Johnson, CPA
Deputy Insurance Commissioner
Office of Corporate and Financial Regulation