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April 2, 2019

VIA HAND DELIVERY

Joseph DiMemmo, CPA
Deputy Insurance Commissioner
Office of Corporate and Financial Regulation
Pennsylvania Insurance Department
1345 Strawberry Square
Harrisburg, PA 17120

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Corporate & Financial Regulation

APR - 2 2019

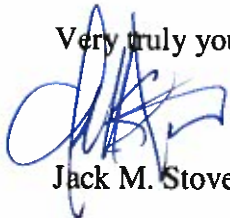
**Pennsylvania
Insurance Department**

**Re: Order # ID-RC-13-06
Highmark Health Consolidated Financial Statements**

Dear Deputy Commissioner DiMemmo:

In compliance with Condition 13 of the above-captioned Approving Determination dated April 29, 2013, Highmark Health is submitting the enclosed non-confidential consolidated financial statements for the period ending December 31, 2018. A copy has been forwarded to Mr. Beaser and Mr. DeLacey by email.

Very truly yours,



Jack M. Stover

JMS/jls
Enclosure

cc: Lawrence J. Beaser, Esq. (via email)
Patrick T. DeLacey (via email)

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Corporate & Financial Regulation

APR - 8 2019

Pennsylvania
Insurance Department

Highmark Health
Consolidated Financial Statements
December 31, 2018 and 2017

Highmark Health
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December 31, 2018 and 2017

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Report of Independent Auditors

To the Board of Directors of Highmark Health

We have audited the accompanying consolidated financial statements of Highmark Health and its subsidiaries and affiliates (the "Company"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the 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.

Auditors' Responsibility

Our responsibility is to express an opinion on the 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 our 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, we consider internal control relevant to the Company'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 Company'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 Highmark Health and its subsidiaries and affiliates as of December 31, 2018 and 2017, 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.

Other Matter

Accounting principles generally accepted in the United States of America require that the prior year incurred and paid claims development information, net of reinsurance, on pages 40 and 41 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PRICEWATERHOUSE COOPERS LLP

March 26, 2019

Highmark Health
Consolidated Balance Sheets
December 31, 2018 and 2017

(in thousands of dollars)

	2018	2017
Assets		
Cash and cash equivalents	\$ 886,043	\$ 2,354,426
Accounts receivable		
Insurance, less allowance for doubtful accounts of \$23,651 and \$38,979, respectively	2,256,778	2,207,252
Patient service, less allowance for doubtful accounts of \$54,884 and \$47,176, respectively	187,782	210,287
Other	224,847	175,060
Investments		
Debt securities, available-for-sale at fair value	4,002,940	2,923,676
Equity securities, available-for-sale at fair value	1,459,913	1,192,593
Board designated, restricted and other investments at fair value	844,076	837,041
Investment in affiliates	475,962	434,131
Other	240,137	195,265
Reinsurance recoverables	112,104	117,023
Securities lending invested collateral	320,052	112,429
Inventory, net	159,724	152,022
Income tax recoverable, net	97,997	18,221
Deferred income taxes, net	160,076	260,899
Property and equipment, net	1,984,883	1,820,033
Goodwill and other intangible assets, net	515,845	500,314
Prepaid pension plan assets	-	1,129
Other assets	544,510	601,205
Total assets	\$ 14,473,669	\$ 14,113,006
Liabilities and Net Assets		
Claims and claim adjustment expenses outstanding	\$ 2,580,284	\$ 2,571,476
Unearned revenue	218,101	214,281
Amounts held for others	595,410	654,088
Accrued salaries and benefits	429,973	374,504
Other payables and accrued expenses	1,234,407	1,052,612
Securities lending payable	320,053	112,423
Benefit plan liabilities	605,103	741,240
Debt	1,628,977	1,680,079
Other liabilities	209,826	247,399
Total liabilities	7,822,134	7,648,102
Net Assets		
Without donor restrictions - Highmark Health	6,242,973	6,029,140
Without donor restrictions - noncontrolling interest	120,995	127,370
Total net assets without donor restrictions	6,363,968	6,156,510
With donor restrictions	287,567	308,394
Total net assets	6,651,535	6,464,904
Total liabilities and net assets	\$ 14,473,669	\$ 14,113,006

The accompanying notes are an integral part of these Consolidated Financial Statements.

Highmark Health
Consolidated Statements of Operations
Years Ended December 31, 2018 and 2017

(in thousands of dollars)

	2018	2017
Revenue and other support		
Premium revenue, net	\$ 13,773,039	\$ 13,139,665
Net patient service revenue	2,383,303	2,241,318
Vision revenue	956,564	1,351,158
Service revenue	1,592,680	1,493,375
Affiliates income	65,460	31,213
Net assets released from restriction	5,367	4,203
Total revenue and other support	18,776,413	18,260,932
Expenses		
Claims and claim adjustment expenses	11,220,517	10,851,046
Salaries, wages and fringe benefits	3,916,910	3,775,617
Patient care supplies	663,366	606,405
Depreciation and amortization	324,479	302,500
Other operating expenses, net	2,125,273	2,109,688
Goodwill impairment	-	277,738
Total operating expenses	18,250,545	17,922,994
Operating gain	525,868	337,938
Net investment income, including net realized gains on investments	206,264	238,564
Interest expense	(66,906)	(69,335)
Gain on sale of subsidiary and consolidation of affiliate	-	609,465
Excess of revenue over expenses before income taxes	665,226	1,116,632
Income tax provision	95,870	51,585
Excess of revenue over expenses before noncontrolling interest	569,356	1,065,047
(Deficit) excess of revenue over expenses attributable to noncontrolling interest	(1,421)	2,306
Excess of revenue over expenses attributable to Highmark Health	\$ 570,777	\$ 1,062,741

The accompanying notes are an integral part of these Consolidated Financial Statements.

Highmark Health
Consolidated Statements of Changes in Net Assets
Years Ended December 31, 2018 and 2017

(in thousands of dollars)

	2018	2017
Net assets without donor restrictions - Highmark Health		
Excess of revenue over expenses	\$ 570,777	\$ 1,062,741
Unrealized net holding (losses) gains on available-for-sale securities, net of tax of \$49,515 and (\$70,822), respectively	(218,137)	123,515
Reclassification for net gains on available-for-sale securities included in income, net of tax of \$8,990 and \$10,631, respectively	(33,819)	(19,745)
Benefit plan asset and liability changes, net of tax of \$160 and \$13,462, respectively	(108,339)	(17,459)
Net assets released from restriction for acquisition of equipment	1,152	809
Other, net	2,199	1,464
	<u>213,833</u>	<u>1,151,325</u>
Increase in net assets without donor restrictions - Highmark Health	213,833	1,151,325
Net assets without donor restrictions - noncontrolling interest		
(Deficit) excess of revenue over expenses	(1,421)	2,306
Dividends paid	(5,013)	-
Recognition of noncontrolling interest	-	109,836
Other	59	292
	<u>(6,375)</u>	<u>112,434</u>
(Decrease) increase in net assets without donor restrictions - noncontrolling interest	(6,375)	112,434
Net assets with donor restrictions		
Contributions	10,206	3,485
Net investment (loss) income	(14,427)	38,908
Net assets released from restrictions used for:		
Operations	(5,367)	(4,203)
Acquisition of equipment	(1,152)	(809)
Transfer out of trusts to net investment income	(9,226)	(9,047)
Other, net	(861)	(1,005)
	<u>(20,827)</u>	<u>27,329</u>
(Decrease) increase in net assets with donor restrictions	(20,827)	27,329
Increase in net assets	186,631	1,291,088
Net assets		
Beginning of the year	<u>6,464,904</u>	<u>5,173,816</u>
End of the year	<u>\$ 6,651,535</u>	<u>\$ 6,464,904</u>

The accompanying notes are an integral part of these Consolidated Financial Statements.

Highmark Health

Consolidated Statements of Cash Flows

Years Ended December 31, 2018 and 2017

(in thousands of dollars)

	2018	2017
Cash flows from operating activities		
Increase in net assets	\$ 186,631	\$ 1,291,088
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Bad debt expense	84,360	53,622
Depreciation and amortization, including investments	337,499	322,474
Partial sale of subsidiary and consolidation of affiliate	-	(109,836)
Gain on sale of subsidiary and consolidation of affiliate	-	(609,465)
Goodwill impairment	-	277,738
Net realized gains on investments	(44,972)	(58,526)
Net unrealized losses (gains) on investments	285,262	(112,802)
Dividends received from affiliates	4,518	4,869
Undistributed gain of affiliates	(64,602)	(36,751)
Beneficial interest in perpetual trusts	22,911	(26,772)
Benefit plan asset and liability changes	108,339	17,459
Deferred income tax provision (benefit)	155,902	(122,650)
Restricted contributions	(10,206)	(3,485)
(Decrease) increase due to change in		
Accounts receivable	(78,514)	13,797
Reinsurance recoverables	4,919	245,995
Pharmacy rebates receivable	13,514	(69,098)
Other assets	(55,609)	(17,593)
Claims and claim adjustment expenses	8,808	(262,335)
Amounts held for others	(58,678)	(44,858)
Benefit plan liabilities, net	(244,316)	(199,386)
Other liabilities	152,245	125,776
Net cash provided by operating activities	<u>808,011</u>	<u>679,261</u>
Cash flows from investing activities		
Purchases of investments	(5,299,090)	(2,796,355)
Proceeds from sales of investments	3,193,973	2,146,785
Proceeds from maturities of investments	382,318	291,282
Net collection of notes receivable	-	25,837
Purchases of property and equipment, net	(471,969)	(311,879)
Change in securities lending invested collateral	(207,630)	51,100
Proceeds from sale of subsidiary and noncontrolling interest of subsidiary, net of cash included and transaction costs	-	853,569
Cash obtained in consolidation of affiliate	-	55,085
Net cash (used in) provided by investing activities	<u>(2,402,398)</u>	<u>315,424</u>
Cash flows from financing activities		
Restricted contributions	10,206	3,485
Change in book overdrafts	23,693	10,388
Receipts from contract deposits	174,068	317,563
Withdrawals from contract deposits	(256,732)	(280,131)
Change in securities lending payable	207,630	(51,100)
Proceeds from issuance of debt	1,005,085	1,019,196
Repayment of debt	(1,032,933)	(1,170,431)
Noncontrolling interest dividends paid	(5,013)	-
Net cash provided by (used in) financing activities	<u>126,004</u>	<u>(151,030)</u>
(Decrease) increase in cash and cash equivalents	(1,468,383)	843,655
Cash and cash equivalents		
Beginning of year	2,354,426	1,510,771
End of year	<u>\$ 886,043</u>	<u>\$ 2,354,426</u>

The accompanying notes are an integral part of these Consolidated Financial Statements.

Highmark Health
Consolidated Statements of Cash Flows
Years Ended December 31, 2018 and 2017

(in thousands of dollars)

	2018	2017
Supplemental disclosure of cash flow information		
Interest paid, net	\$ 62,355	\$ 71,224
Income taxes paid, net	\$ 19,717	\$ 138,918
Supplemental disclosure of noncash investing and financing		
Assets acquired through other payables	\$ 41,409	\$ 21,816
Capital lease (cancellations) acquisitions, net	\$ (29,706)	\$ 50,308

The accompanying notes are an integral part of these Consolidated Financial Statements.

Highmark Health

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(in thousands of dollars)

1. Nature of Operations

Highmark Health is incorporated as a nonprofit corporation in the Commonwealth of Pennsylvania and is federally recognized as a 501(c)(3). Highmark Health, through its affiliates, Highmark Inc. and its subsidiaries and affiliates (collectively "Highmark"), HM Health Solutions ("HMHS"), HM Health Holding Company ("HHCO"), and Allegheny Health Network and its subsidiaries and affiliates (collectively "AHN"), is a diversified health and wellness enterprise based in Pittsburgh, Pennsylvania. Highmark Health, Highmark, HMHS, HHCO and AHN are herein referred to as the "Corporation".

Highmark Inc. is incorporated as a nonprofit corporation and operates as a hospital plan corporation and a professional health services plan in the Commonwealth of Pennsylvania. Highmark Inc.'s affiliates, Highmark West Virginia Inc. ("Highmark WV") and Highmark BCBSA Inc. ("Highmark DE"), are nonprofit health services corporations and operate in the states of West Virginia and Delaware, respectively. As a licensee of the Blue Cross Blue Shield Association ("BCBSA"), Highmark underwrites various indemnity and managed care health insurance products for national accounts (groups headquartered in Pennsylvania, West Virginia and Delaware that have operations in other locations), regional accounts and individual accounts. In addition, Highmark also underwrites Medicaid, Medicare Advantage, Medicare Part D prescription drug and Medicare supplemental insurance products.

Highmark's diversified health business includes vision, dental and stop-loss business. Highmark Inc.'s wholly owned for-profit subsidiary, HVHC LLC ("HVHC"), operates a retail vision business, Visionworks of America, Inc. ("Visionworks"), and operated a managed vision care business, Davis Vision, Inc. ("Davis Vision"), through November 2017 (see Note 3). The retail line of business operates specialty optical retail stores, and the managed vision care line of business provides fully integrated eye care services. Highmark Inc.'s wholly owned for-profit subsidiary, United Concordia Companies, Inc. ("UCCI") and its subsidiaries, provide dental services through preferred provider and managed care networks as well as third party administrative services. Highmark Inc.'s other for-profit subsidiaries, including HM Insurance Group, LLC ("HMIG"), offer stop-loss insurance and other services.

HMHS is a for-profit corporation that provides health plan platform services, infrastructure management, data center hosting and print management.

HHCO, a holding company, currently has one subsidiary that performs utilization management and care coordination services. Operations are primarily intercompany.

AHN is incorporated as a nonprofit corporation in the Commonwealth of Pennsylvania and is federally recognized as a 501(c)(3). AHN's subsidiaries and consolidated affiliates primarily are nonprofit health care providers offering routine and tertiary healthcare services, clinical support and healthcare education in Western Pennsylvania. Additionally, AHN's other for-profit and nonprofit subsidiaries manage and develop outpatient medical facilities, which offer a variety of services including pharmacies, primary care, imaging, and group hospital purchasing services.

Highmark Health

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(in thousands of dollars)

2. Acquisition

On July 1, 2017, Highmark WV exercised a warrant to purchase up to 60% voting interest in West Virginia Family Health ("WVFH") for an exercise price of \$0.001 per share. Through the exercise of the warrant Highmark WV obtained an additional 85,000 shares of preferred stock. For accounting purposes, as control was obtained through the transaction, the transaction was treated as an acquisition. The results of WVFH's operations have been included in the combined financial statements since the date of the warrant exercise. As less than 100 percent interest is acquired, the Corporation recognized the non-controlling interest at fair value. In addition, in conjunction with the transaction, a WVFH surplus note held by Highmark WV was adjusted to the determined fair value of the note and accrued interest.

The following table summarizes the value of the assets acquired and liabilities assumed at the acquisition date.

Recognized amounts of identifiable assets acquired and liabilities assumed:

Cash and cash equivalents	\$ 55,085
Accounts receivable	21,483
Pharmacy rebates receivables	959
Intangibles	30,300
Goodwill	14,880
Claims outstanding	(44,203)
Other payables and accrued expenses	(16,647)
Surplus note	(25,500)
Deferred income taxes, net	(11,885)
Total identifiable net assets	<u>24,472</u>
Noncontrolling interest	(9,786)
Fair value adjustment for surplus note and related interest receivable held by Highmark WV	<u>30,830</u>
Gain on transaction	<u>\$ 45,516</u>

The fair value of the equity interest in WVFH held by the Corporation immediately before the acquisition was \$10,523.

The fair value of the acquired intangible assets of \$30,300 was determined by a third party valuation expert. The intangible assets that make up that amount include member relationships of \$17,700 (18-year useful life), provider contracts of \$8,700 (15-year useful life), and a trademark/tradename of \$3,900 (8-year useful life).

Effective April 1, 2018, Highmark WV converted the WVFH surplus note and accrued interest into Class A Common Stock. Highmark WV increased its majority ownership from 60% to 83%. The fair market value of the Class A Common Stock was determined by a valuation of WVFH conducted by a third party valuation firm.

Highmark Health

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(in thousands of dollars)

3. Divestitures

Effective December 1, 2017, HVHC finalized the sale of Davis Vision to a third party ("the Buyer"). In addition, HVHC sold a 20 percent non-controlling interest in Visionworks and included options for the Buyer to acquire the remainder of the company over seven years. The Buyer also has the option to require HVHC to repurchase its initial interest in Visionworks at its purchase price within a three year period following the effective date of the transaction. Davis Vision was combined with the Buyer's existing managed care business and the Corporation acquired a non-controlling interest in the newly formed company in the amount of \$21,496, which is recorded in Other Investments in the Consolidated Balance Sheets. The gain on the sale of \$563,949 incorporates the fair value of consideration received less fair value of consideration given, and was recorded within gain on sale of subsidiary and consolidation of affiliate in the Consolidated Statements of Operations. The fair value of the Buyer's interest in Visionworks of \$100,050, which includes the value of the options, was recorded as a non-controlling interest.

As a part of the sale of Davis Vision and the non-controlling interest in Visionworks, HVHC agreed to indemnify the Buyer from certain losses and settle any purchase price adjustments as described in the Davis Vision and Visionworks Stock Purchase Agreement. Highmark Inc. agreed to guarantee HVHC's indemnification obligations, the payment of any purchase price adjustments and the Buyer's option to have HVHC repurchase its initial interest in Visionworks at its purchase price.

On January 1, 2017, HMIG sold 100% of the outstanding shares of its subsidiary, HM Casualty Insurance Company, which underwrote workers' compensation business. The loss on the transaction of approximately \$4,327 was included within operating expenses and incorporates the loss on the settlement of the policy assets and liabilities partially offset by the proceeds from the renewal rights and sale of the subsidiary. Effective February 1, 2017, HMIG finalized the workers' compensation divestiture and novated the policies to a third party through a novation and assumption reinsurance agreement.

4. Summary of Significant Accounting Policies

Basis of Financial Presentation

The accompanying Consolidated Financial Statements include the accounts of the Corporation.

The Consolidated Financial Statements are presented on the accrual basis of accounting, in accordance with accounting principles generally accepted in the United States of America ("GAAP").

All significant intercompany balances and transactions have been eliminated from the Consolidated Financial Statements.

The Corporation uses the equity method of accounting for 50% or less owned affiliates or those affiliates for which the Corporation does not hold a controlling financial interest but may influence operating or financial decisions.

Reclassifications

The Company has reclassified certain amounts relating to its prior period results to conform to its current period presentation. These reclassifications have not changed the results of operations of prior periods.

Highmark Health

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(in thousands of dollars)

New Accounting Pronouncements

Implemented

In January 2017, Financial Accounting Standards Board ("FASB") issued new guidance eliminating Step 2 from the goodwill impairment test. The new guidance is effective for fiscal years beginning after December 15, 2021. The Corporation elected to early adopt the guidance at December 31, 2017, which was permitted. The early adoption of this new guidance did not materially impact the financial position, results of operations and cash flows of the Corporation.

In August 2016, FASB issued new guidance regarding the presentation of financial statements of not-for-profit entities. The new guidance replaces the currently required three classes of net assets with two classes: net assets with donor restrictions and net assets without donor restrictions, eliminates the requirement to present or disclose the indirect method reconciliation if using the direct method on the cash flow statement, and requires enhanced disclosures about governing board designations and appropriations, composition of net assets with donor restrictions, management of liquidity, expenses, methods of cost allocation, and underwater endowment funds. The new guidance is effective for fiscal years beginning after December 15, 2017. The Corporation adopted this new guidance and has included the changes within the Consolidated Financial Statements and related disclosures.

Under Evaluation

In March 2017, FASB issued new guidance regarding the presentation of net periodic pension and postretirement benefit costs. The new guidance requires an entity to disaggregate the service cost component from the other components of net benefit cost, and is effective for fiscal years beginning after December 15, 2018. The adoption of this guidance is expected to impact the operating gain, as other components of net benefit costs will be reclassified below the operating indicator. There will be no net impact to excess of revenue over expenses.

In November 2016, FASB issued new guidance that requires that a statement of cash flows to reconcile total of cash including cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The guidance is effective for annual periods beginning after December 15, 2018. The Corporation is evaluating the impact of the adoption of this new guidance on its Consolidated Statements of Cash Flows.

In October 2016, FASB issued new guidance that requires an entity to recognize the income tax effect of intercompany sales and transfers of assets other than inventory at the time that the transfer occurs rather than when the asset is sold to a third party. The guidance is effective for annual periods beginning after December 15, 2018. The Corporation is evaluating the impact of this standard on its financial position, results of operations and cash flows.

In August 2016, FASB issued new guidance which clarifies the classification of certain cash receipts and cash payments in our Consolidated Statements of Cash Flows. The guidance is effective for annual periods beginning after December 15, 2018. The Corporation is evaluating the impact of the adoption of this new guidance on its Consolidated Statements of Cash Flows.

Highmark Health

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(In thousands of dollars)

In February 2016, FASB issued new guidance regarding the recognition of leases. The new guidance requires lessees to recognize a lease liability and a lease asset for all leases, including operating leases, with a term greater than 12 months on its balance sheet. The guidance also expands the required quantitative and qualitative disclosures surrounding leases. The new guidance is effective for fiscal years beginning after December 15, 2019. The Corporation is evaluating the impact of the new guidance on its financial position, results of operations and cash flows.

In January 2016, FASB issued new guidance requiring all equity investments, other than those accounted for under the equity method or those that result in the consolidation of the investee, to be measured at fair value with changes in the fair value recognized through net income. The new guidance also eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for non-public business entities. The new guidance is effective for fiscal years beginning after December 15, 2018. The Corporation evaluated the impact of the new guidance on its financial position and determined a cumulative effect adjustment will be recorded in 2019.

In May 2014, FASB issued new guidance related to revenue recognition for contracts with customers. This new guidance removes most industry-specific revenue recognition requirements and requires that an entity recognize revenue for the transfer of goods or services to a customer at an amount that reflects the consideration to which an entity expects to be entitled in exchange for the goods or services. Insurance contracts are not covered by this guidance. The new guidance also requires additional disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts. The new guidance is effective for fiscal years beginning after December 15, 2018. The Corporation is evaluating the impact of the adoption of this new guidance on the financial position, results of operations and cash flows.

Use of Estimates

The preparation of the Corporation's Consolidated Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Corporation considers all highly liquid investments with maturities of three months or less when purchased, excluding assets limited or restricted as to use, to be cash equivalents.

Accounts Receivable

In the normal course of business, the Corporation grants credit to its customers under various contractual arrangements. The Corporation carries its accounts receivable at estimated net realizable value, which reflects the impact of potential credit losses.

Insurance accounts receivable is specific to Highmark business and includes amounts related to health, dental, vision, stop-loss and government business accounts receivable.

Patient service accounts receivable is specific to AHN business and includes amounts receivable from patients, third-party payors and others for services as they are rendered.

Highmark Health

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(in thousands of dollars)

Other accounts receivable primarily includes receivables from affiliates, accrued interest revenue, receivables from securities sold and other receivables not associated with the Corporation's core business.

An allowance for doubtful accounts is based on a number of factors, including economic experience, past history, trends, coverage type and other indicators. When it is determined an accounts receivable balance is not collectible, it is written off.

Concentrations of credit risk, excluding government payors, are limited due to the large number of Highmark Health customers.

Investments

Debt and equity securities classified as available-for-sale are carried at fair value (based on quoted or estimated market prices), except for certain available-for-sale investments which are valued at net asset value (NAV) as a practical expedient to fair value. Unrealized gains and losses are reported in net assets without donor restrictions, net of deferred income taxes. Derivatives embedded within convertible debt securities are bifurcated, with changes in fair value included in earnings; any remaining unrealized gains or losses of the convertible bonds are reported in net assets without donor restrictions, net of deferred income taxes. Premiums and discounts are amortized using the effective interest method. Realized gains and losses on debt securities are based on amortized cost. Realized gains and losses on equity securities are based on cost (specific identification method). Realized gains and losses on available-for-sale debt and equity securities are reported in net investment income in the Consolidated Statements of Operations.

The Corporation monitors its available-for-sale investments portfolio for unrealized losses that appear to be other-than-temporary. At the time an equity security is determined to be other-than-temporarily impaired, the Corporation reduces the book value of the security to the current market value and records a realized loss in net investment income in the Consolidated Statements of Operations.

In determining if an available-for-sale debt security is other-than-temporarily impaired, the Corporation considers whether it has intent to sell the available-for-sale debt security or whether it is more likely than not that the Corporation will be required to sell the available-for-sale debt security before recovery of its amortized cost basis, which may be at maturity. If the Corporation intends to sell the debt security or it is more likely than not that the Corporation will be required to sell the debt security before recovery of its amortized cost basis, an other-than-temporary impairment is recorded as a realized loss in net investment income in the Consolidated Statements of Operations for the difference between fair value and amortized cost.

If the Corporation does not have the intent to sell and it does not believe that it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost, the Corporation performs a detailed review to determine the underlying cause of the unrealized loss and whether an other-than-temporary impairment is warranted. At the time a debt security is determined to be other-than-temporarily impaired, the credit component of the other-than-temporary impairment is recognized in income in the Consolidated Statements of Operations and the non-credit component of the other-than-temporary investment is recognized in the Consolidated Statement of Changes in Net Assets, net of deferred income taxes.

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Board designated, restricted and other investments include assets whose use is contractually limited by external parties and assets set aside by the Board of Directors for future capital improvements or liquidity, over which the Board retains control and may, at its discretion, subsequently use for other purposes, as well as assets held by trustees under indenture agreements. Other investments consist primarily of marketable debt and equity securities and marketable securities maintained in a master trust fund. Investment income or loss (including realized gains and losses, interest and dividends, and unrealized gains and losses) is recorded in net investment income in the Consolidated Statements of Operations unless restricted by donor or law. Investment income related to restricted gifts is recorded based on donor restriction as part of net assets with donor restrictions in the Consolidated Statements of Changes in Net Assets.

Other investments include investments in private limited partnerships, real estate trusts and limited liability companies. Private limited partnerships are accounted for under the equity method. The Corporation has committed \$229,571 and \$132,852 to various private limited partnership investments at December 31, 2018 and 2017, respectively. These commitments are due upon capital calls by the general partners of the partnerships. Generally, limited liability companies are accounted for under the cost or equity method, dependent on certain factors including ownership. Fair values of real estate investment trusts are approximated based on trustee estimates. Certain other investments are valued at NAV as a practical expedient to fair value. The Corporation monitors its other investments for unrealized losses that appear to be other-than-temporary. At the time an investment is determined to be other-than-temporarily impaired, the Corporation reduces the book value to the current market value and records a realized loss in net investment income in the Consolidated Statements of Operations.

The Corporation participates in securities lending transactions, which are accounted for as secured borrowings. The Corporation utilizes a custodian as a lending agent, maintains effective control over the loaned securities and requires collateral initially equal to at least 102% of loaned domestic securities and 105% of loaned international securities at the loan date. Collateral received consists of cash and fixed-income securities. Non-cash collateral is not recorded in the Consolidated Balance Sheets, as the Corporation does not have the right to sell, pledge or otherwise reinvest the non-cash collateral. Cash collateral is invested in short-term debt securities and is carried at fair value. Changes in fair value are reported as unrealized gains and losses within net assets without donor restrictions.

The fair value of securities held as invested collateral was \$320,052 and \$112,429 at December 31, 2018 and 2017, respectively. The corresponding liability that represents the Corporation's obligation to return the collateral was \$320,053 and \$112,423 at December 31, 2018 and 2017, respectively.

The potential risks associated with the transactions include counterparty credit risk, non-cash collateral security risk, lending agent operational risk, and cash collateral reinvestment risk, including the risk that the reinvested collateral would be illiquid, insufficient to repay borrowers, would differ in maturity, or be otherwise unavailable to return the cash collateral to counterparties.

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The Corporation and its lending agent mitigate those risks by limiting the amount of investments available for loan, limiting the amount of borrowings by any one counterparty, maintaining effective control over loaned securities, evaluating the credit of counterparties, maintaining a list of approved borrowers, requiring overcollateralization, placing limitations, including duration and credit quality, on the investment of cash collateral, conducting daily mark-to-market pricing of securities, collateral and invested collateral, and maintaining a written agreement with the lending agent that includes certain protections.

The Corporation's assets are invested in a variety of financial instruments. Accordingly, the related values as presented in the Consolidated Financial Statements are subject to various market fluctuations, which include changes in the interest rate environment, equity markets and general economic conditions.

Reinsurance

In the normal course of business, the Corporation seeks to reduce losses that may arise from risks or occurrences of an unexpected nature that may cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers. Reinsurance premiums and benefits paid or provided are accounted for in a manner consistent with the original policies issued and the terms of the reinsurance contracts. The Corporation also assumes risks from other insurance companies. Such assumed reinsurance activity is recorded principally on the basis of reports received from the ceding companies.

Inventory, Net

Inventory consists primarily of vision related eyewear components and health care delivery related drugs, medical supplies and surgical supplies. Vision related eyewear components include frames, lenses and cases, contact lenses and solutions, laboratory supplies, and packaging materials. Inventory is stated at the lower of cost or market. Vision related inventory cost is determined using the weighted average or first-in first-out basis. Health care delivery related inventory cost is determined using the first-in first-out basis. Obsolescence reserves were \$8,856 and \$8,621 at December 31, 2018 and 2017, respectively.

Property and Equipment, Net

Property and equipment is recorded at cost, net of accumulated depreciation and amortization. If a donor contributes property and equipment, it is recorded at the fair market value on the date contributed. Maintenance, repairs and minor improvements are expensed as incurred. Certain costs related to the internal development of software or software purchased for internal use are capitalized. Gains or losses on sales or disposals of property and equipment are included in operations.

Depreciation is computed under the straight-line method by annual charges to expense over the estimated useful lives of the various asset types as follows: buildings and building or land improvements, up to 40 years; leasehold improvements, lesser of lease term or useful life; office furniture and equipment, 3 to 30 years; and capitalized software, 3 to 10 years.

Property and equipment is reviewed for impairment whenever changes in circumstances indicate that the carrying value of the assets may not be recoverable. Impairment losses are recognized to the extent the carrying amount of an asset exceeds the undiscounted future cash flows expected to result from the use of the asset and its eventual disposal. Impairment losses of \$8,615 and \$10,984 were recorded in 2018 and 2017, respectively. These impairment losses are reflected in operating expenses in the Consolidated Statements of Operations.

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Goodwill and Other Intangible Assets, Net

Intangible assets with definite lives are amortized using the straight-line method over their estimated lives, which range from 3 to 25 years. Intangible assets with indefinite useful lives, including goodwill, are not amortized, but are tested for impairment at least annually and more frequently if events or changes in circumstances indicate that an asset may be impaired. If fair value is less than carrying value, the asset is adjusted to the fair value and an impairment loss is recorded in the Consolidated Statements of Operations. Management tested goodwill and other intangible assets with indefinite lives for impairment and concluded that no goodwill impairment existed at December 31, 2018, while a goodwill impairment did exist at December 31, 2017 (see Note 9).

Other Assets

Other assets primarily include prepaid expenses, pharmacy rebates receivable, insurance recoveries associated with medical malpractice, notes receivable and cash surrender values of corporate-owned life insurance policies held in grantor trusts.

Pharmacy rebates receivable, and the related customer liabilities, is an actuarial estimate based on prescriptions filled and terms of rebate contracts. The actuarial estimates are continually reviewed and any resulting adjustments are included in current operations. The Corporation carries its notes receivable at estimated net realizable value, which reflects the impact of potential credit losses. Changes in cash surrender value are reported in net investment income in the Consolidated Statements of Operations.

Claims and Claim Adjustment Expenses Outstanding

Claims and claim adjustment expenses outstanding include claims reported and adjudicated but unpaid as well as an estimate of incurred but not reported ("IBNR") claims. The liability for IBNR claims is an actuarial estimate based on historical claims paid data, modified for current conditions and coverage changes. The methods to determine the estimate of IBNR claims use past experience adjusted for current trends. The methods and assumptions are continually reviewed and any resulting adjustments are included in current operations. Corresponding administrative costs to process outstanding claims are estimated and accrued and are also included in claims and claim adjustment expenses outstanding.

The Corporation records certain non-risk administrative arrangements in claims liabilities. The non-risk administrative receivable is included in insurance accounts receivable and the corresponding provider liability is included in claims and claim adjustment expenses outstanding in the Consolidated Balance Sheets.

Amounts Held for Others

Amounts held for others include reserves for refunds and deposits received from groups for non-risk administrative arrangements. Amounts held for others also include amounts related to the BlueCard program, which allows the Highmark members to access other Blue Cross and Blue Shield plans' provider networks.

Other Liabilities

Other liabilities include medical malpractice reserves, deferred grant revenue, asset retirement obligations, book overdraft and interest rate swap liabilities.

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The provision for medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported, including costs associated with litigating or settling claims. Anticipated insurance recoveries associated with reported and unreported claims are reported in other assets in the Consolidated Balance Sheets at net realizable value.

The Corporation records deferred grant revenue for grant monies received until the revenue is earned or related costs have been incurred. Governmental grant monies received for the acquisition of property and equipment are deferred until the asset is provided or until depreciation expense is recognized.

Net Assets Without Donor Restrictions

Net assets without donor restrictions include investments and board designated assets set aside by the Corporation for future capital improvements or liquidity, over which the Corporation retains control and may at its discretion subsequently use for other purposes.

Net assets without donor restrictions for the years ended December 31, 2018 and 2017 include:

	2018	2017
Undesignated - Highmark Health	\$ 6,209,776	\$ 5,993,805
Undesignated - Noncontrolling interest	120,995	127,370
Board designated assets:		
Capital improvements	<u>33,197</u>	<u>35,335</u>
Total net assets without donor restrictions	<u>\$ 6,363,968</u>	<u>\$ 6,156,510</u>

Net Assets With Donor Restrictions

Net assets with donor restrictions include those whose use is limited by donor-imposed stipulations, including some that either expire with the passage of time or can be fulfilled and removed by actions of the Corporation pursuant to those stipulations. Additionally, net assets with donor restrictions include those whose use is limited by donor-imposed stipulations that neither expire with the passage of time nor can be fulfilled or otherwise removed by the actions of the Corporation. Investment earnings from net assets with donor restrictions may be donor restricted for capital or operating needs depending upon the original intent of the donor.

Net assets are released from donor restrictions by incurring expenses satisfying the restricted purposes of being placed-in-service, incurred, or by occurrence of other events specified by donors. Net assets released from restrictions and used for operations are recorded in net assets released from restriction. Net assets released from restriction and used for capital purposes are recorded as change in net assets without donor restrictions in the Consolidated Statements of Changes in Net Assets.

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Insurance Revenue Recognition

Highmark's business consists of at-risk insurance arrangements and non-risk administrative arrangements. Risk business includes all insurance contracts. Premiums are generally billed in advance of the contractual coverage periods and are included in premium revenue as they are earned during the coverage period. The unearned portion of premiums collected is reflected in the Consolidated Balance Sheets as unearned revenue. Premium revenue is received from the federal government and certain states according to government specified payment rates and various contractual terms. Changes in revenues from Medicare, ACA and Medicaid products resulting from the periodic changes in risk-adjustment scores derived from medical diagnoses for the Highmark's membership are recognized when the amounts become determinable and the collectability is reasonably assured.

Service Revenue

The administrative fees received under non-risk administrative arrangements are included in service revenue and recognized in the period in which the related services are performed. This also includes fees for management of medical services, claims processing and access to provider networks. Under non-risk administrative arrangements, the customer assumes the risk of funding claims. The Corporation does not record premium revenue or claims incurred on non-risk administrative arrangements. The expenses associated with administering the risk and non-risk business are included in salaries, wages and fringe benefits and other operating expenses in the Consolidated Statements of Operations.

Service revenue also includes pharmacy rebates retained in lieu of fees charged for non-risk administrative arrangements, grants, contributions, physician stipends, Medicare and Medicaid electronic health record incentive payments and other ancillary hospital services revenue such as parking, cafeteria, tuition and rent.

Revenue related to health plan platform services, infrastructure management, data centering hosting, and print management is also included in service revenue.

Vision Revenue

Vision revenue includes sales from optical retail stores, and fully integrated eye care services through November 2017. Revenue is recognized based upon services rendered. Sales are recognized when title and the risk of loss transfer to the customer, there is evidence of a contractual arrangement and collectability of the resulting receivable is reasonably assured.

Net Patient Service Revenue

Net patient service revenue is comprised of gross patient service revenues less contractual allowances, charity care and provision for doubtful accounts. Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors and others for services rendered at the time the service is performed and includes estimated retroactive revenue adjustments due to future audits, reviews and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews and investigations.

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AHN has agreements with third-party payors that provide for payments to AHN at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, per diem payments and contracted amounts. AHN recognizes patient service revenues associated with services provided to patients who have third-party payor coverage on the basis of established rates for services rendered. AHN provides discounts to uninsured patients who do not qualify for medical assistance or charity care.

Net patient service revenue, by major payor in 2018 and 2017 was as follows:

	2018	2017
Medicare	\$ 1,087,758	\$ 999,830
Medical assistance	225,940	225,962
Blue Cross Blue Shield payors	528,544	540,806
Other third-party payors	586,651	481,269
Patients and residents	<u>32,984</u>	<u>44,118</u>
Total patient service revenue, net of contractual allowances and discounts	2,461,877	2,291,985
Less: Provision for doubtful accounts	<u>(78,574)</u>	<u>(50,667)</u>
Total net patient service revenue	<u>\$ 2,383,303</u>	<u>\$ 2,241,318</u>

In 2018, revenue from Medicare and Medical Assistance programs accounted for 44% and 9%, respectively, of patient service revenue, net of contractual allowances and discounts. In 2017, revenue from Medicare and Medical Assistance programs accounted for 44% and 10%, respectively, of patient service revenue, net of contractual allowances and discounts. Laws and regulations governing Medicare and Medical Assistance programs are complex and subject to interpretation and there is at least a reasonable possibility that actual results could differ from revenue recognized.

Charity Care

AHN hospitals provide services to all patients regardless of ability to pay. AHN hospitals each have a charity care policy under which they provide care to patients at no charge or at discounted rates, provided the patients meet the eligibility requirements stipulated in their policies. AHN does not pursue collection of amounts determined to qualify for charity care; therefore, charity care amounts are not recorded as revenue or deducted from gross patient service revenue in arriving at net patient service revenue.

Affiliates Income

Affiliate income includes the Corporation's proportionate share of affiliate earnings.

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Contributions with Donor Restrictions

Unconditional promises to give cash and other assets to the Corporation are reported at fair value at the date the promise is received as unrestricted gifts within service revenue in the Consolidated Statements of Operations. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the Consolidated Statements of Operations as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year are reported as net assets released from restriction in the accompanying Consolidated Financial Statements.

Income Taxes

Highmark Health and certain of the entities within AHN are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code ("IRC") and are exempt from federal income taxes on exempt purpose income. These tax-exempt organizations are subject to federal taxes on unrelated business income under section 511 of the IRC.

Highmark Inc., Highmark WV and Highmark DE are subject to federal income taxes, although they remain exempt from state and local taxes. Highmark Inc., Highmark WV and Highmark DE file separate consolidated federal income tax returns. Non-insurance subsidiaries and health maintenance organizations of Highmark Inc., Highmark WV and Highmark DE are subject to state income taxes. Certain insurance subsidiaries are subject to state premium taxes. Provisions for the applicable tax liabilities have been made in the Consolidated Financial Statements.

Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using tax rates and laws that are expected to be in effect when the difference is reversed. The Corporation records a valuation allowance against its deferred tax assets when it determines that it is more likely than not that some portion or all of the deferred tax asset will not be realized.

Excess of Revenue Over Expenses

The Consolidated Statements of Operations include an excess of revenue over expenses. Changes in net assets without donor restrictions which are excluded from the excess of revenue over expenses, consistent with industry practice, include unrealized gains and losses on available-for-sale securities, benefit plan asset and liability changes, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets) and certain tax benefits.

Subsequent Events

In connection with the preparation of the Consolidated Financial Statements, the Corporation evaluated events subsequent to the balance sheet date of December 31, 2018 through March 26, 2019, which is also the date the financial statements were available to be issued, and has determined that all material transactions have been recorded and disclosed properly.

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5. Insurance Regulation

Highmark and its insurance subsidiaries and affiliates file financial statements with insurance departments in their states of domicile. These financial statements are prepared in accordance with statutory accounting principles prescribed by such regulatory authorities. Prescribed statutory accounting principles include state laws, regulations and general administrative rules, as well as a variety of publications of the National Association of Insurance Commissioners ("NAIC"). Permitted statutory accounting practices encompass all accounting practices not prescribed.

Financial statements prepared for state insurance departments in accordance with statutory accounting principles differ from the Combined Financial Statements prepared in accordance with GAAP. The principal differences in statutory accounting are: (1) certain assets, such as accounts receivable aged more than 90 days, office furniture and equipment, non-operating software, certain provider advances, certain intangible assets and certain prepaid expenses, are excluded from statutory reserves; (2) pharmaceutical rebates receivable are limited based on the timing of billing and collection activities; (3) bonds are carried at amortized cost or fair value, not fair value as required under GAAP; (4) equity income or loss of subsidiaries, affiliates and limited partnerships is recorded directly to reserves rather than in results of operations as required under GAAP, with dividends or distributions recognized in statutory net income when declared; (5) investments in, and earnings from, the Corporation's controlled affiliates, Highmark DE and Highmark WV, are not recognized; (6) certain assets and liabilities pertaining to reinsurance transactions are reported net of reinsurance; (7) deferred tax asset recognition is limited; (8) changes in deferred taxes are recorded directly to reserves rather than in results of operations as required under GAAP; (9) uncertain tax positions are fully recognized if the probability is greater than 50%; (10) the amount of expense recognized for pension and postretirement plans differs from GAAP primarily due to the required timing of the recognition of certain inputs for statutory accounting; (11) noncontrolling interest consolidated for GAAP purposes is not recognized; (12) mergers are accounted for at historical statutory amounts, as if the merger occurred at the beginning of the earliest presented fiscal year; and (13) certain equity transfers to affiliates are expensed.

As a result of the foregoing, statutory reserves at December 31, 2018 and 2017 and statutory net loss for the years then ended was:

	2018	2017
Highmark (excluding Highmark WV and Highmark DE)		
Statutory reserves	\$ 3,704,173	\$ 3,798,960
Statutory net income	\$ 163,308	\$ 660,075
Highmark WV		
Statutory reserves	\$ 473,265	\$ 421,870
Statutory net income	\$ 95,011	\$ 72,347
Highmark DE		
Statutory reserves	\$ 304,194	\$ 253,909
Statutory net income	\$ 85,197	\$ 58,438

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Highmark and its insurance subsidiaries and affiliate are subject to minimum risk-based capital ("RBC") requirements that were developed by the NAIC and adopted by various state legislatures. The formula for determining the amount of RBC specifies various weighting factors that are applied to financial balances and various levels of activity based on perceived degrees of risk.

The RBC ratios of Highmark and its insurance subsidiaries and affiliates are compared to authorized control levels established by the NAIC. Companies below specific ratio thresholds may be required to take specific corrective actions. At December 31, 2018 and 2017, Highmark and its insurance subsidiaries and affiliates exceeded their respective minimum RBC requirements.

The Pennsylvania Insurance Commissioner has determined that an appropriate sufficient operating surplus range for Highmark is 550% - 750% of the health RBC ratio or the Department's consolidated risk factor ratio, whichever is lower. As long as Highmark operates above the 550% ratio, it is not permitted to include a risk and contingency factor in its filed premium rates. If Highmark's ratio exceeds 750%, it will be required to justify its surplus level and could be required to submit a plan to bring its surplus within the designated appropriate sufficient operating surplus range. At December 31, 2018 and 2017, Highmark's health RBC ratio was within the appropriate sufficient operating surplus range determined by the Department.

The ACA enacted significant reforms to various aspects of the U.S. health insurance industry. Certain of these reforms became effective January 1, 2014, including the establishment of federally-facilitated or state-based exchanges which provide individuals and small businesses access to affordable and quality health insurance. The Corporation participates in the Pennsylvania, West Virginia and Delaware markets.

The ACA imposes an annual premium-based fee on health insurers for each calendar year beginning on or after January 1, 2014, which is not deductible for tax purposes. The Consolidated Appropriations Act, 2016, enacted on December 18, 2015, included a one year suspension in 2017 of the health insurer fee. The health insurer fee resumed for 2018. The aggregate annual fee for all insurers was \$14,300,000 for 2018. This amount was apportioned among all insurers based on a ratio designated to reflect relative market share of U.S. health insurance business. The fee is based on the ratio of the Corporation's applicable net written premium to total applicable net premiums for all such issuers. The Corporation is required to estimate a liability for the health insurer fee and record it in full once qualifying insurance coverage is provided in the applicable calendar year in which the fee is payable with a corresponding deferred cost that is amortized ratably to expense over the same calendar year. In September 2018, the Corporation paid the federal government \$153,545 for its portion of the health insurer fee.

The ACA also established three premium stabilization programs effective January 1, 2014. These risk spreading programs are applicable to certain commercial medical insurance products. In the aggregate, the Corporation's commercial medical insurance products subject to the premium stabilization programs represented approximately 8% of the total premiums for the years ending December 31, 2018 and 2017. These programs, commonly referred to as the "3Rs", include a permanent risk adjustment program, a temporary risk corridor program and a transitional reinsurance program designed to more evenly spread the financial risk borne by issuers and to mitigate the risk that issuers would have mispriced products. The transitional reinsurance and risk corridor programs were available for years 2014 through 2016.

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The permanent risk adjustment program adjusts the premiums that commercial individual and small group health insurance issuers receive based on the demographic factors and health status of each member as derived from current year medical diagnosis as reported throughout the year. This program transfers funds from lower risk plans to higher risk plans in the same state. The risk adjustment program is applicable to commercial individual and small group health plans (except certain exempt, grandfathered and grandmothered plans) operating both inside and outside of the health insurance exchanges established under the ACA. Under the risk adjustment program, a risk score is assigned to each covered member to determine an average risk score at the individual and small group level by legal entity in a particular market in a state. Additionally, an average risk score is determined for the entire subject population for each market in each state. Settlement amounts are determined by utilizing the Centers for Medicare and Medicaid Services ("CMS") risk transfer formula which averages all risk scores in risk adjustment covered plans and uses the plan average risk scores combined with other factors to calculate the settlement. Settlements are determined on a net basis by legal entity and state.

The estimate of amounts receivable or payable under the risk adjustment program is based on an estimate of both the Corporation's and the state average risk scores. Assumptions used in these estimates include but are not limited to historical market experience, member demographics including age and gender, pricing models, membership data, the mix of previously underwritten membership as compared to new members in plans compliant with the ACA, published third party studies and other publicly available data including regulatory plan filings. The Corporation generally relies on providers to appropriately document all medical data, including the diagnosis data submitted with claims, as the basis for risk scores under the program.

For the permanent risk adjustment program, the Corporation records receivables or payables as adjustments to premium revenue based on year-to-date experience when the amounts are reasonably estimable and collection is reasonably assured. Final revenue adjustments are determined by CMS in the year following the policy year. Under the risk adjustment program, the Corporation received net payments of \$54,251 in 2018 to settle the 2017 plan year and \$47,998 in 2017 to settle the 2016 plan year.

The temporary risk corridor program applied to qualifying individual and small group Qualified Health Plans, as defined by CMS, operating both inside and outside of the exchanges. The risk corridor provisions limited issuer gains and losses by comparing allowable medical costs to a target amount, defined by CMS, and sharing the risk for allowable costs with the federal government. Allowable medical costs are adjusted for risk adjustment settlements, transitional reinsurance recoveries and cost sharing reductions received from CMS. Variances from the target exceeding certain thresholds may result in CMS making additional payments to the Corporation or require the Corporation to refund CMS a portion of the premiums received.

For the temporary risk corridor program, the Corporation records receivables upon communication by CMS of funds available that it intends to pay. Highmark recorded premium revenue of \$1,939 for the 2014 benefit year risk corridor for the year ended December 31, 2017. Highmark did not record any additional risk corridor premium revenue for the 2014 to 2016 benefit years as collection is not reasonably assured. However, the Corporation continues to believe that CMS has a binding obligation to satisfy the risk corridor receivable.

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The 3Rs receivable and payable amounts at December 31, 2018 were as follows:

	Risk Adjustment	Risk Corridor	Reinsurance	Total
Accounts receivable, insurance	\$ -	\$ (10)	\$ -	\$ (10)
Reinsurance recoverables	-	-	159	159
Other payables and accrued expenses	(18,579)	-	-	(18,579)
Net payable	<u>\$ (18,579)</u>	<u>\$ (10)</u>	<u>\$ 159</u>	<u>\$ (18,430)</u>

The 3Rs receivable and payable amounts at December 31, 2017 were as follows:

	Risk Adjustment	Risk Corridor	Reinsurance	Total
Accounts receivable, insurance	\$ -	\$ 1,939	\$ -	\$ 1,939
Reinsurance recoverables	-	-	12,194	12,194
Other payables and accrued expenses	(1,707)	-	(6,189)	(7,896)
Net receivable	<u>\$ (1,707)</u>	<u>\$ 1,939</u>	<u>\$ 6,005</u>	<u>\$ 6,237</u>

In addition to the 3Rs ACA established a cost-sharing reduction ("CSR") program that requires Qualified Health Plans to provide reduced cost sharing for essential health benefits to eligible enrollees. Under the CSR program issuers must ensure eligible enrollees pay only the cost sharing required for applicable covered services. Issuers are then required to notify CMS of cost-sharing reductions provided on behalf of eligible enrollees. Monthly, CMS makes payments estimated to be the value of cost-sharing reductions provided by the issuers. In the subsequent benefit year, CMS reconciles the estimated payments to the cost-sharing reductions provided and a final settlement is made. In 2018, the Corporation settled the 2017 CSR program benefit year resulting in a reduction to claims incurred of \$12,386. In 2017, the Corporation settled the 2016 CSR program benefit year resulting in a reduction to claims incurred of \$786. The CSR program was terminated in November 2017.

Highmark is subject to a Community Health Reinvestment ("CHR") Agreement with the Department, which establishes an annual CHR commitment for Highmark based on direct written health premiums. Highmark met its minimum social mission commitment of \$77,482 in 2018 and in 2017. The 2019 commitment is expected to approximate the 2018 and 2017 amounts. Highmark has the ability to direct the funds related to the CHR endeavors provided that the funds are used to provide health care coverage for persons who are uninsured or unable to pay for coverage, to fund programs for the prevention and treatment of disease or injury including mental health counseling or the promotion of health or wellness, to fund the prevention of conditions, behavior or activities that are adverse to good health or donations for the benefit of health care providers in furtherance of any of the foregoing purposes.

Because Highmark is not eligible to participate in a Pennsylvania-sponsored guarantee fund, it has established and funded a trust in order to meet a licensing requirement of BCBSA. The fair value of the trust was \$358,324 and \$356,587 at December 31, 2018 and 2017, respectively, and was reported as debt securities in the Combined Balance Sheets.

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Medicare Advantage and Medicare Part D Prescription Drug Plan products offered under contracts with CMS accounted for 25% and 26% of total premiums for the years ended December 31, 2018 and 2017, respectively.

Participation in government sponsored health care programs subjects the Corporation to a variety of federal laws and regulations and risks associated with audits conducted under these programs. These audits may occur in years subsequent to the Corporation providing the relevant services under audit. These risks may include reimbursement claims as well as potential fines and penalties. With respect to the Corporation's Medicare Advantage business, CMS regularly audits the Corporation's performance to determine compliance with CMS's regulations and contracts with CMS and to assess the quality of services provided to Medicare Advantage beneficiaries. CMS uses various payment mechanisms to allocate and adjust premium payments to the Corporation's Medicare Advantage plan by considering the applicable health status of Medicare Advantage members as supported by information prepared, maintained and provided by health care providers. The Corporation collects claim and encounter data from providers and generally rely on providers to appropriately code their submissions and document their medical records, including the diagnosis data submitted to the Corporation with claims. CMS pays increased premiums to Medicare Advantage plans and prescription drug program plans for members who have certain medical conditions identified with specific diagnosis codes. Federal regulators review and audit the providers' medical records to determine whether those records support the related diagnosis codes that determine the members' health status and the resulting risk-adjusted premium payments to the Corporation. In that regard, federal regulators have initiated contract-level risk adjustment data validation audits of certain plans within the Corporation for certain periods to validate coding practices and supporting medical record documentation maintained by health care providers and the resulting risk adjusted premium payments to such plans. CMS may require Corporation to refund premium payments if the Corporation's risk adjusted premiums are not properly supported by medical record data and are outside of acceptable error thresholds. The Corporation is unable to estimate the financial impact, if any, at this time.

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6. Investments

The cost or amortized cost, gross unrealized gains and losses and fair value of investments in debt and equity securities classified as available-for-sale at December 31, 2018 were as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities				
U.S. Treasury and agency obligations	\$ 1,200,112	\$ 3,767	\$ (21,146)	\$ 1,182,733
Agency mortgage-backed securities	652,159	819	(14,333)	638,645
State and political obligations	10,221	613	(72)	10,762
Mortgage-backed securities	70,887	159	(787)	70,259
Asset-backed securities	168,340	1,347	(425)	169,262
Corporate and other debt securities	1,971,404	16,328	(56,453)	1,931,279
Total debt securities	<u>4,073,123</u>	<u>23,033</u>	<u>(93,216)</u>	<u>4,002,940</u>
Equity securities				
Domestic	528,080	151,678	(32,958)	646,800
Foreign	868,087	35,238	(90,212)	813,113
Total equity securities	<u>1,396,167</u>	<u>186,916</u>	<u>(123,170)</u>	<u>1,459,913</u>
Total	<u>\$ 5,469,290</u>	<u>\$ 209,949</u>	<u>\$ (216,386)</u>	<u>\$ 5,462,853</u>

The cost or amortized cost, gross unrealized gains and losses and fair value of investments in debt and equity securities classified as available-for-sale at December 31, 2017 were as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities				
U.S. Treasury and agency obligations	\$ 750,252	\$ 2,180	\$ (13,244)	\$ 739,188
Agency mortgage-backed securities	497,814	5,640	(6,909)	496,545
State and political obligations	10,366	984	(35)	11,315
Mortgage-backed securities	18,142	109	(144)	18,107
Asset-backed securities	54,877	507	(150)	55,234
Corporate and other debt securities	1,579,063	33,290	(9,066)	1,603,287
Total debt securities	<u>2,910,514</u>	<u>42,710</u>	<u>(29,548)</u>	<u>2,923,676</u>
Equity securities				
Domestic	424,234	190,110	(5,171)	609,173
Foreign	487,741	97,485	(1,806)	583,420
Total equity securities	<u>911,975</u>	<u>287,595</u>	<u>(6,977)</u>	<u>1,192,593</u>
Total	<u>\$ 3,822,489</u>	<u>\$ 330,305</u>	<u>\$ (36,525)</u>	<u>\$ 4,116,269</u>

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The gross unrealized losses and fair value of debt and equity investments classified as available-for-sale securities by investment category and length of time an individual security was in a continuous unrealized loss position at December 31, 2018 were as follows:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities						
U.S. Treasury and agency obligations	\$ 412,227	\$ (1,996)	\$ 413,697	\$ (19,150)	\$ 825,924	\$ (21,146)
Agency mortgage-backed securities	204,098	(2,121)	307,915	(12,212)	512,013	(14,333)
State and political obligations	2,420	(42)	1,098	(30)	3,518	(72)
Mortgage-backed securities	42,360	(622)	8,022	(165)	50,382	(787)
Asset-backed securities	17,837	(147)	15,895	(278)	33,732	(425)
Corporate and other debt securities	1,093,710	(40,205)	383,403	(16,248)	1,477,113	(56,453)
Total debt securities	1,772,652	(45,133)	1,130,030	(48,083)	2,902,682	(93,216)
Equity securities						
Domestic	228,713	(31,469)	6,159	(1,489)	234,872	(32,958)
Foreign	694,119	(88,473)	5,493	(1,739)	699,612	(90,212)
Total equity securities	922,832	(119,942)	11,652	(3,228)	934,484	(123,170)
Total	\$ 2,695,484	\$ (165,075)	\$ 1,141,682	\$ (51,311)	\$ 3,837,166	\$ (216,386)

The gross unrealized losses and fair value of debt and equity investments classified as available-for-sale securities by investment category and length of time an individual security was in a continuous unrealized loss position at December 31, 2017 were as follows:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities						
U.S. Treasury and agency obligations	\$ 292,154	\$ (2,189)	\$ 300,204	\$ (11,055)	\$ 592,358	\$ (13,244)
Agency mortgage-backed securities	197,544	(1,914)	199,375	(4,995)	396,919	(6,909)
State and political obligations	2,791	(9)	2,164	(26)	4,955	(35)
Mortgage-backed securities	3,006	(15)	7,620	(129)	10,626	(144)
Asset-backed securities	21,147	(64)	12,450	(86)	33,597	(150)
Corporate and other debt securities	561,564	(6,438)	117,741	(2,628)	679,305	(9,066)
Total debt securities	1,078,206	(10,629)	639,554	(18,919)	1,717,760	(29,548)
Equity securities						
Domestic	29,662	(4,511)	8,113	(660)	37,775	(5,171)
Foreign	112,233	(1,706)	409	(100)	112,642	(1,806)
Total equity securities	141,895	(6,217)	8,522	(760)	150,417	(6,977)
Total	\$ 1,220,101	\$ (16,846)	\$ 648,076	\$ (19,679)	\$ 1,868,177	\$ (36,525)

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At December 31, 2018 and 2017, the Corporation held available-for-sale debt securities with gross unrealized losses of \$93,216 and \$29,548, respectively. Management evaluated the unrealized losses and determined that they were due primarily to volatility in the interest rate environment and market conditions. The Corporation does not intend to sell the related debt securities and it is not likely that the Corporation will be required to sell the debt securities before recovery of their amortized cost basis, which may be maturity. Therefore, management does not consider the available-for-sale debt securities to be other-than-temporarily impaired as of December 31, 2018 and 2017.

At December 31, 2018 and 2017, the Corporation held available-for-sale equity securities with gross unrealized losses of \$123,170 and \$6,977, respectively. Management reviews equity securities in which fair value falls below cost. In determining whether an equity security is other-than-temporarily impaired, management considers both quantitative and qualitative information. The impairment review process is subjective and considers a number of factors, including, but not limited to, the length of time and extent to which the fair value has been less than book value, the financial condition and near-term prospects of the issuer, recommendations of investment advisors, the intent and ability to hold securities for a time sufficient to allow for any anticipated recovery in value and general market conditions and industry or sector-specific factors, including forecasts of economic, market or industry trends. Management does not consider the available-for-sale equity securities to be other-than-temporarily impaired as of December 31, 2018 and 2017.

The amortized cost and fair value of available-for-sale debt securities at December 31, 2018 are shown below by contractual maturity. Expected maturities could differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due within one year or less	\$ 580,514	\$ 579,646
Due after one year through five years	1,192,977	1,179,888
Due after five years through ten years	937,823	910,411
Due after ten years	470,424	454,828
Mortgage and asset-backed securities	891,385	878,167
Total debt securities	<u>\$ 4,073,123</u>	<u>\$ 4,002,940</u>

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Board designated, restricted and other investments by investment type at December 31, 2018 and 2017 consisted of the following:

	2018	2017
Cash and cash equivalents	\$ 210,924	\$ 249,354
Debt securities		
U.S. Treasury and agency obligations	95,217	99,713
Agency mortgage-backed securities	4,422	3,732
Asset and mortgage-backed securities	2,928	2,198
Corporate and other debt securities	88,992	61,187
Total debt securities	<u>191,559</u>	<u>166,830</u>
Equity securities		
Domestic	118,952	100,708
Foreign	88,002	68,710
Beneficial interest in perpetual trusts	228,266	251,177
Common collective trust interests	6,373	262
Total board designated, restricted and other investments	<u>\$ 844,076</u>	<u>\$ 837,041</u>

Board designated, restricted and other investments consist of the following components at December 31, 2018 and 2017:

	2018	2017
Without donor restrictions		
Other investments	\$ 332,584	\$ 271,300
Board designated		
Foundation	33,197	35,335
Capital project funds	167,752	194,556
Self-insurance reserves	2,629	2,919
Grant funds and other	25,857	27,223
Total without donor restrictions	<u>562,019</u>	<u>531,333</u>
With donor restrictions	<u>282,057</u>	<u>305,708</u>
Total board designated, restricted and other investments	<u>\$ 844,076</u>	<u>\$ 837,041</u>

The following is a summary of net investment income (loss) for the year ended December 31, 2018:

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>
Interest and dividends, net	\$ 181,528	\$ 6,185
Net realized gains on investments	58,870	14,698
Net unrealized losses on board designated, restricted and other investments	(26,639)	(35,310)
Loss on extinguishment of debt (Note 12)	(7,495)	-
Total net investment income (loss)	<u>\$ 206,264</u>	<u>\$ (14,427)</u>

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The following is a summary of net investment income for the year ended December 31, 2017:

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>
Interest and dividends, net	\$ 162,405	\$ 5,149
Net realized gains on investments	66,388	11,384
Net unrealized gains on board designated, restricted and other investments	9,771	22,375
Total net investment income	<u>\$ 238,564</u>	<u>\$ 38,908</u>

Net realized gains on investments without donor restrictions include \$7,431 and \$10,839 in 2018 and 2017, respectively, in other-than-temporary impairment charges on available-for-sale securities. Other-than-temporary impairments recognized in 2018 and 2017 resulted from the extent and duration of fair value declines due to market conditions, along with credit related concerns in certain instances. Impaired securities included mainly equity and debt securities within the domestic financial services, commodity and energy business sectors, along with international market holdings.

The recognition of unrealized gains and losses on investments that are restricted as to use are recorded directly to net assets with donor restrictions as required by donor or regulation. These investments consist primarily of equity securities, agency mortgage-backed securities, corporate debt securities and U.S. Treasury obligations. All unrealized gains and losses on marketable unrestricted board designated and other investments are recognized in net investment income on the Consolidated Statements of Operations.

Certain investment partnership and trust vehicles of the Corporation have redemption restrictions relating to both timing and amounts of withdrawals. Generally, the amounts are available for withdrawal subject to a 30 days' notice requirement. At December 31, 2018 and 2017, these investments totaled \$394,813 and \$384,336, respectively.

Certain other private equity limited partnership interests of the Corporation have redemption restrictions relating to both timing and amounts of withdrawals. Distributions are received as the underlying investments generate income or are liquidated. The Corporation estimates that the underlying assets of certain other private equity limited partnership interests will be liquidated over the next seven to ten years, and the Corporation assumes that the interests will be held until liquidation. At December 31, 2018 and 2017, these investments totaled \$225,311 and \$163,657, respectively.

The following is a summary of the remaining contractual maturity of securities lending transactions accounted for as secured borrowings as of December 31, 2018:

	<u>Overnight and Continuous</u>	<u>Up to 30 days</u>	<u>30-90 days</u>	<u>Greater than 90 days</u>	<u>Total</u>
Securities Lending Transactions					
Corporate fixed income securities	\$ -	\$ 3,178	\$ 6,313	\$ 15,884	\$ 25,375
International fixed income securities	-	14,318	88,483	98,077	200,878
Other	(212)	81,912	11,800	300	93,800
Total borrowings	<u>\$ (212)</u>	<u>\$ 99,408</u>	<u>\$ 106,596</u>	<u>\$ 114,261</u>	<u>\$ 320,053</u>

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The following is a summary of the remaining contractual maturity of securities lending transactions accounted for as secured borrowings as of December 31, 2017:

	Overnight and		30-90 days	Greater than	
	Continuous	Up to 30 days		90 days	Total
Securities Lending Transactions					
Corporate fixed income securities	\$ -	\$ 1,645	\$ 1,514	\$ 4,041	\$ 7,200
International fixed income securities	-	5,208	13,092	35,443	53,743
Other	3,177	47,394	909	-	51,480
Total borrowings	\$ 3,177	\$ 54,247	\$ 15,515	\$ 39,484	\$ 112,423

7. Fair Value of Financial Instruments

Input levels, as defined by FASB, are as follows:

Level 1: Pricing inputs are based on unadjusted quoted market prices for identical financial assets or liabilities in active markets. Active markets are those in which transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2: Pricing inputs include observable inputs other than Level 1 pricing inputs, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Pricing inputs include observable inputs that are supported by little or no market activity and that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

Net asset value as a practical expedient to fair value (NAV): Certain mutual funds classified as common stocks, limited partnerships, and the real estate investment trust are valued at net asset value as a practical expedient to fair value. The underlying assets are measured at fair value as of the reporting date. These investments, if sold, are probable of being sold at amounts equal to NAV per share. A summary of the nature of the investments using NAV as a practical expedient to fair value can be found on the redemption table.

The following methods and assumptions were used to determine the fair value of each class of the following assets and liabilities recorded at fair value in the Consolidated Balance Sheets:

Cash equivalents: Cash is designated as level 1. Cash equivalents include exempt money market mutual funds, commercial paper, discount notes, or securities with a maturity 3 months or less and bank deposits that are purchased or deposited daily with specified yield rates. Cash equivalents are designated as Level 1 or Level 2, depending on structure and the extent of credit-related features.

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Debt securities, available-for-sale: Fair values of available-for-sale debt securities are based on quoted market prices, where available. These fair values are obtained primarily from a third party pricing service, which generally use Level 1 or Level 2 inputs, for the determination of fair value to facilitate fair value measurements and disclosures. U.S. Treasury securities generally are designated Level 1 securities, while Level 2 securities generally include corporate securities, state and political obligations, mortgage-backed securities, and asset-backed securities. Level 2 inputs that are often used in the valuation methodologies include, but are not limited to, broker quotes, benchmark yields, credit spreads, default rates and prepayment speeds. The Corporation has certain fixed maturity, bank loans, corporate, private and other debt securities, which are designated as Level 3 securities. For these securities, the valuation methodologies may incorporate broker quotes or assumptions for benchmark yields, credit spreads, default rates and prepayment speeds that are not observable in the markets.

Equity securities, available-for-sale: Fair values of equity securities are generally designated as Level 1 and are based on quoted market prices for identical assets in active markets. For certain equity securities, quoted market prices for identical securities are not always available and the fair value is estimated by reference to similar or underlying securities for which quoted prices are available. These securities are designated Level 2. The Corporation also has certain equity securities, including private equity securities, for which fair value is estimated based on each security's current condition and future cash flow projections or based on the Corporation's share of the entities' undistributed earnings, which approximates fair value. Such securities are designated Level 3. Certain mutual funds classified as common stock are valued at NAV as a practical expedient to fair value.

Board designated, restricted and other investments: Board designated, investments with donor restrictions include cash equivalents, debt securities and equity securities that follow the same methods and assumptions and fair value designations described above. The fair value for endowments managed by donor selected trustees are designated as Level 3 securities with the interest in these trusts based on the fair value of the underlying trust investments, which approximates the present value of the expected future cash flows for which the Corporation is an income beneficiary. Certain board designated, restricted and other investments are valued at NAV as a practical expedient to fair value.

Other Investments: The fair values of real estate trusts are approximated based on trustee estimates. Limited partnerships and limited liability companies are accounted for using the equity method, and are based on the estimated fair values from the financial statements obtained from the investment vehicle. Limited partnerships, the real estate investment trust, and limited liability companies use NAV as a practical expedient to fair value.

Mortgage Loans: Fair values of mortgage loans are obtained from a third party pricing service, whose valuation is based on the present value of expected future cash flows discounted at the appropriate LIBOR rate, plus an appropriate credit spread. Mortgage loans are designated as Level 3.

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(in thousands of dollars)

Securities lending invested collateral: Fair values of securities lending collateral are based on quoted market prices, where available. These fair values are obtained primarily from third party pricing services, which generally use Level 1 or Level 2 inputs for the determination of fair value to facilitate fair value measurements and disclosures.

The Corporation uses a third party pricing service to obtain quoted prices for each security. The third party service provides pricing based on recent trades of the specific security or like securities, as well as a variety of valuation methodologies for those securities where an observable market price may not exist. The third party service may derive pricing for Level 2 securities from market corroborated pricing, matrix pricing, discounted cash flow analyses and inputs such as yield curves and indices. Pricing for Level 3 securities may be obtained from investment managers for private placements or derived from discounted cash flows, or ratio analysis and price comparisons of similar companies. Securities that use NAV as a practical expedient to fair value carry underlying investments that, if sold, are probable to being sold at amounts equal to NAV per share.

The Corporation performs an analysis of reasonableness of the prices received for fair value by monitoring month-to-month fluctuations and determining reasons for significant differences, selectively testing fair values against prices obtained from other sources, and comparing the consolidated fair value of a class of assets against an appropriate index benchmark. The Corporation did not make adjustments to the quoted market prices obtained from third party pricing services that were material to the Consolidated Financial Statements.

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The following table summarizes fair value measurements by level at December 31, 2018 for financial assets measured at fair value on a recurring basis:

	Fair Value	Level 1	Level 2	Level 3	Net Asset Value
Assets					
Cash and cash equivalents	\$ 886,043	\$ 862,333	\$ 23,710	\$ -	\$ -
Investments					
Debt securities, available-for-sale					
U.S. treasury and agency obligations	1,182,733	655,962	526,771	-	-
Agency mortgage-backed securities	638,645	-	638,645	-	-
State and political obligations	10,762	-	10,762	-	-
Mortgage-backed securities	70,259	-	70,259	-	-
Asset-backed securities	169,262	-	169,262	-	-
Corporate and other debt securities	1,931,279	-	1,824,793	106,486	-
Total debt securities	4,002,940	655,962	3,240,492	106,486	-
Equity securities, available-for-sale					
Domestic	646,800	616,613	-	30,187	-
Foreign	813,113	429,793	-	-	383,320
Total equity securities	1,459,913	1,046,406	-	30,187	383,320
Board designated, restricted and other investments					
Cash and cash equivalents	210,924	210,924	-	-	-
Debt securities					
U.S. Treasury and agency obligations	95,217	49,307	45,910	-	-
Agency mortgage-backed securities	4,422	-	4,422	-	-
Asset and mortgage-backed securities	2,928	-	2,928	-	-
Corporate and other debt securities	88,992	-	88,992	-	-
Equity securities					
Domestic	118,952	111,453	-	7,499	-
Foreign	88,002	88,002	-	-	-
Beneficial interest in perpetual trusts	228,266	-	-	228,266	-
Common collective trust interests	6,373	-	-	-	6,373
Total board designated, restricted and other investments	844,076	459,686	142,252	235,765	6,373
Other investments					
Real estate investment trusts	11,493	-	-	-	11,493
Private limited partnerships and limited liability companies	225,311	-	-	-	225,311
Mortgage loans	3,333	-	-	3,333	-
Total other investments	240,137	-	-	3,333	236,804
457(b) assets	32,353	32,353	-	-	-
Securities lending invested collateral	320,052	-	320,052	-	-
Total assets	\$ 7,785,514	\$ 3,056,740	\$ 3,726,506	\$ 375,771	\$ 626,497

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The following table summarizes fair value measurements by level at December 31, 2017 for financial assets measured at fair value on a recurring basis:

	Fair Value	Level 1	Level 2	Level 3	Net Asset Value
Assets					
Cash and cash equivalents	\$ 2,354,426	\$ 2,112,989	\$ 241,437	\$ -	\$ -
Investments					
Debt securities, available-for-sale					
U.S. treasury and agency obligations	739,188	455,843	283,345	-	-
Agency mortgage-backed securities	496,545	-	496,545	-	-
State and political obligations	11,315	-	11,315	-	-
Mortgage-backed securities	18,107	-	18,107	-	-
Asset-backed securities	55,234	-	55,234	-	-
Corporate and other debt securities	1,603,287	-	1,557,735	45,552	-
Total debt securities	2,923,676	455,843	2,422,281	45,552	-
Equity securities, available-for-sale					
Domestic	609,173	597,231	-	11,942	-
Foreign	583,420	209,349	-	-	374,071
Total equity securities	1,192,593	806,580	-	11,942	374,071
Board designated, restricted and other investments					
Cash and cash equivalents	249,354	249,354	-	-	-
Debt securities					
U.S. Treasury and agency obligations	99,713	49,263	50,450	-	-
Agency mortgage-backed securities	3,732	-	3,732	-	-
Asset and mortgage-backed securities	2,198	-	2,198	-	-
Corporate and other debt securities	61,187	-	61,187	-	-
Equity securities					
Domestic	100,708	93,209	-	7,499	-
Foreign	68,710	68,710	-	-	-
Beneficial interest in perpetual trusts	251,177	-	-	251,177	-
Common collective trust interests	262	-	-	-	262
Total board designated, restricted and other investments	837,041	460,536	117,567	258,676	262
Other investments					
Real estate investment trusts	10,265	-	-	-	10,265
Private limited partnerships and limited liability companies	163,504	-	-	-	163,504
Private equity	21,496	-	-	21,496	-
Total other investments	195,265	-	-	21,496	173,769
457(b) assets	31,581	31,581	-	-	-
Securities lending invested collateral	112,429	-	112,429	-	-
Total assets	\$ 7,647,011	\$ 3,867,529	\$ 2,893,714	\$ 337,666	\$ 548,102

Transfers between levels, if any, are recorded annually as of the end of the reporting period unless, with respect to a particular issue, a significant event occurred that necessitated the transfer be reported at the date of the event.

There were no material transfers between Levels 1 and 2 during the years ended December 31, 2018 and 2017.

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The changes in fair value for assets measured using significant unobservable inputs (Level 3) for the year ended December 31, 2018 was as follows:

	Corporate and other debt securities	Equity securities	Beneficial Interest in perpetual trusts	Mortgage loans	Total
Balance at January 1	\$ 45,552	\$ 40,937	\$ 251,177	\$ -	\$ 337,666
Net unrealized losses	(5,843)	-	(33,030)	(4)	(38,877)
Net realized gains	391	9,646	19,332	7	29,376
Purchases	99,350	115	-	3,330	102,795
Sales	(32,964)	(13,012)	(9,213)	-	(55,189)
Balance at December 31	\$ 106,486	\$ 37,686	\$ 228,266	\$ 3,333	\$ 375,771

The changes in fair value for assets measured using significant unobservable inputs (Level 3) for the year ended December 31, 2017 was as follows:

	Corporate and other debt securities	Equity securities	Beneficial Interest in perpetual trusts	Private limited partnerships and limited liability companies	Total
Balance at January 1	\$ 48,802	\$ 21,119	\$ 224,405	\$ 3,000	\$ 297,326
Net unrealized (losses) gains	(564)	-	20,255	-	19,691
Net realized gains (losses)	345	(1,678)	15,084	-	13,751
Impairments	(110)	-	-	-	(110)
Purchases	23,717	22,428	11	-	46,156
Sales	(26,638)	(932)	(8,578)	(3,000)	(39,148)
Balance at December 31	\$ 45,552	\$ 40,937	\$ 251,177	\$ -	\$ 337,666

The following table summarizes the nature of the funds valued based on net asset value as a practical expedient for fair value as of December 31, 2018:

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Common collective trust interests	\$ 389,693	\$ -	Daily, Quarterly, Monthly	1-120 Days
Real estate investment trust	11,493	-		
Private limited partnerships	225,311	229,571		
Total	\$ 626,497	\$ 229,571		

The following table summarizes the nature of the funds valued based on net asset value as a practical expedient for fair value as of December 31, 2017:

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Common collective trust interests	\$ 374,333	\$ -	Daily, Quarterly, Monthly	1-120 Days
Real estate investment trust	10,265	-		
Private limited partnerships	163,504	132,852		
Total	\$ 548,102	\$ 132,852		

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Fair Value Option

The Corporation elected the fair value option for its AHN held unrestricted investments, with the exception of the available-for-sale debt and equity securities held by Palladium Risk Retention Group Inc., AHN's captive insurance company. At December 31, 2018 and 2017, AHN reported unrestricted investments of \$572,534 and \$531,333 respectively under the fair value option within the Board designated, restricted and other investments at fair value on the consolidated balance sheets. AHN has recorded unrealized losses of \$26,639 and unrealized gains of \$9,771 (included in net investment income on the Consolidated Statements of Operations) for the years ended December 31, 2018 and 2017, respectively.

8. Property and Equipment, Net

Property and equipment at December 31, 2018 and 2017 was comprised of the following:

	2018	2017
Land, buildings and leasehold improvements	\$ 1,658,045	\$ 1,583,779
Office furniture and equipment	1,271,381	1,197,031
Capitalized software	877,692	841,335
Construction in progress	<u>303,429</u>	<u>76,938</u>
	4,110,547	3,699,083
Less accumulated depreciation and amortization	<u>(2,125,664)</u>	<u>(1,879,050)</u>
Property and equipment, net	<u>\$ 1,984,883</u>	<u>\$ 1,820,033</u>

Depreciation and amortization expense related to property and equipment amounted to \$319,239 and \$297,572 for 2018 and 2017, respectively.

9. Goodwill and Other Intangible Assets, Net

The changes in the carrying amount of goodwill for the years ended December 31, 2018 and 2017 are as follows:

	Total
Goodwill, at January 1, 2017	\$ 790,587
Impairment	(277,738)
Sale of subsidiary	(96,837)
Consolidation of affiliate	14,880
Goodwill, at December 31, 2017	<u>\$ 430,892</u>
Other adjustments	9,734
Goodwill, at December 31, 2018	<u>\$ 440,626</u>

No impairment charges were recorded in 2018. As part of the annual impairment analysis, a goodwill impairment charge of \$277,738 was recorded in 2017 within the Consolidated Statements of Operations related to a subsidiary. The impairment charge represents the excess of the book value of the subsidiary over the fair value, as determined by a valuation model.

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The gross carrying amount of intangible assets and accumulated amortization in 2018 and 2017 was as follows:

	2018			2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	\$ 60,412	\$ 21,276	\$ 39,136	\$ 60,412	\$ 18,400	\$ 42,012
Trademarks	20,575	12,214	8,361	20,575	11,144	9,431
Patient records	10,268	5,758	4,510	9,021	5,489	3,532
Other	46,137	22,925	23,212	36,243	21,796	14,447
Total	<u>\$ 137,392</u>	<u>\$ 62,173</u>	<u>\$ 75,219</u>	<u>\$ 126,251</u>	<u>\$ 56,829</u>	<u>\$ 69,422</u>

Amortization expense related to intangible assets was \$5,344 and \$4,025 in 2018 and 2017, respectively.

At December 31, 2018, estimated future amortization expense for the intangible assets, excluding insurance licenses with indefinite lives of \$3,916, was as follows:

Years ending December 31,	
2019	\$ 7,023
2020	6,020
2021	5,978
2022	5,943
2023	5,943
Thereafter	<u>40,396</u>
Total	<u>\$ 71,303</u>

10. Claims and Claim Adjustment Expenses Outstanding

The Corporation's insurance business has three business segments, which are referred to as Commercial business, Government business and Diversified business. The Commercial business segment is a combination of fully-insured business and self-funded business. The Government business includes fully-insured health business such as Medicare products, Medicaid products, pre-65 individual including ACA products and Small Group products. The Diversified business includes Vision, Dental and Stop-loss insurance product offerings.

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A reconciliation of the beginning and ending balance for claims and claim adjustment expenses outstanding, by segment, for the year ended December 31, 2018 is as follows:

	Commercial	Government	Diversified	Total
Claims and claim adjustment expenses outstanding, beginning of year	\$ 1,426,336	\$ 658,972	\$ 486,168	\$ 2,571,476
Provider advances, beginning of year	39,909	-	-	39,909
Reinsurance recoverables, beginning of year	(34,749)	(16,953)	(65,321)	(117,023)
Non-risk claim liabilities, beginning of year	(1,029,738)	-	(31,557)	(1,061,295)
Net balance, beginning of year	401,758	642,019	389,290	1,433,067
Net incurred claims				
Current year	3,715,527	5,903,056	1,761,983	11,380,566
Prior year	(26,113)	(79,253)	(54,683)	(160,049)
Total net incurred claims	3,689,414	5,823,803	1,707,300	11,220,517
Net payments attributable to:				
Current year	(3,390,288)	(5,203,824)	(1,455,315)	(10,049,427)
Prior year	(362,467)	(541,878)	(303,441)	(1,207,786)
Total net payments	(3,752,755)	(5,745,702)	(1,758,756)	(11,257,213)
Net claims payable, end of year	338,417	720,120	337,834	1,396,371
Provider advances, end of year	(37,929)	(5,641)	-	(43,570)
Reinsurance recoverables, end of year	36,533	4,595	70,976	112,104
Non-risk claim liabilities, end of year	1,079,442	-	35,937	1,115,379
Claims and claim adjustment expenses outstanding, end of year	\$ 1,416,463	\$ 719,074	\$ 444,747	\$ 2,580,284

A reconciliation of the beginning and ending balance for claims and claim adjustment expenses outstanding, by segment, for the year ended December 31, 2017 is as follows:

	Commercial	Government	Diversified	Total
Claims and claim adjustment expenses outstanding, beginning of year	\$ 1,391,745	\$ 810,481	\$ 406,307	\$ 2,608,533
Provider advances, beginning of year	47,747	6	-	47,753
Reinsurance recoverables, beginning of year	(30,055)	(81,901)	(64,509)	(176,465)
Non-risk claim liabilities, beginning of year	(910,151)	-	(35,862)	(946,013)
Net balance, beginning of year	499,286	728,586	305,936	1,533,808
Claim liabilities assumed through consolidation of affiliate	-	44,203	-	44,203
Net incurred claims				
Current year	3,532,325	5,600,385	1,922,561	11,055,271
Prior year	(12,185)	(188,713)	(3,327)	(204,225)
Total net incurred claims	3,520,140	5,411,672	1,919,234	10,851,046
Net payments attributable to:				
Current year	(3,149,273)	(5,036,986)	(1,549,668)	(9,735,927)
Prior year	(468,395)	(505,456)	(286,212)	(1,260,063)
Total net payments	(3,617,668)	(5,542,442)	(1,835,880)	(10,995,990)
Net claims payable, end of year	401,758	642,019	389,290	1,433,067
Provider advances, end of year	(39,909)	-	-	(39,909)
Reinsurance recoverables, end of year	34,749	16,953	65,321	117,023
Non-risk claim liabilities, end of year	1,029,738	-	31,557	1,061,295
Claims and claim adjustment expenses outstanding, end of year	\$ 1,426,336	\$ 658,972	\$ 486,168	\$ 2,571,476

Amounts incurred related to prior years vary from previously estimated liabilities as the claims ultimately are settled. Negative amounts reported for incurred related to prior years result from claims being ultimately settled for amounts less than originally estimated (favorable development). The cumulative number of reported claims for each claim year for each segment has been developed using historical data captured by our enterprise data warehouse.

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Incurred and paid claims development, net of reinsurance, for the Commercial Business for the years ended December 31, 2016 through 2018 is as follows:

<i>Commercial</i>	Cumulative Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance			As of December 31, 2018	
	2016	2017	2018	Total of Incurred-but-Not-Reported Liabilities Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
	(Unaudited)	(Unaudited)			
Claim Year					
2016	\$ 3,560,891	\$ 3,547,728	\$ 3,544,576	\$ 597	12,091
2017		3,532,325	3,509,364	\$ 4,964	12,007
2018			3,715,527	\$ 315,313	12,250
Total			\$ 10,769,467		

<i>Commercial</i>	Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance		
Claim Year	2016	2017	2018
	(Unaudited)	(Unaudited)	
2016	\$ 3,077,865	\$ 3,529,023	\$ 3,534,982
2017		3,149,273	3,505,780
2018			3,390,288
Total			\$ 10,431,050

Incurred and paid claims development, net of reinsurance, for the Government Business as of and for the years ended December 31, 2016 through 2018 is as follows:

<i>Government</i>	Cumulative Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance			As of December 31, 2018	
	2016	2017	2018	Total of Incurred-but-Not-Reported Liabilities Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
	(Unaudited)	(Unaudited)			
Claim Year					
2016	\$ 6,465,398	\$ 6,286,969	\$ 6,281,594	\$ 1,446	27,916
2017		5,600,385	5,526,507	\$ 11,220	25,013
2018			5,903,056	\$ 806,621	23,051
Total			\$ 17,711,157		

<i>Government</i>	Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance		
Claim Year	2016	2017	2018
	(Unaudited)	(Unaudited)	
2016	\$ 5,793,450	\$ 6,252,552	\$ 6,261,478
2017		5,036,986	5,525,735
2018			5,203,824
Total			\$ 16,991,037

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Incurred and paid claims development, net of reinsurance, for the Diversified Business as of and for the years ended December 31, 2016 through 2018 is as follows:

<i>Diversified</i>	Cumulative Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance			As of December 31, 2018	
	2016	2017	2018	Total of Incurred-but-Not-Reported Liabilities Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims
	(Unaudited)	(Unaudited)			
Claim Year					
2016	\$ 1,557,136	\$ 1,569,064	\$ 1,569,154	\$ 43	6,034
2017		1,922,561	1,867,788	\$ 19,820	7,173
2018			1,761,983	\$ 302,033	7,333
Total			\$ 5,198,925		

<i>Diversified</i>	Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance		
	2016	2017	2018
	(Unaudited)	(Unaudited)	
Claim Year			
2016	\$ 1,226,082	\$ 1,552,667	\$ 1,563,173
2017		1,549,669	1,842,603
2018			1,455,315
Total			\$ 4,861,091

The reconciliation of the Commercial, Government, and Diversified Businesses incurred and paid claims development information, reflected in the tables above, to the consolidated ending balance for claims outstanding, as of December 31, 2018, is as follows:

	Commercial	Government	Diversified	Total
Cumulative incurred claims and allocated claim adjustment expenses, net of reinsurance	\$ 10,769,467	\$ 17,711,157	\$ 5,198,925	\$ 33,679,549
Less: cumulative paid claims and allocated claim adjustment expenses, net of reinsurance	10,431,050	16,991,037	4,861,091	32,283,178
Net claims payable, end of year	\$ 338,417	\$ 720,120	\$ 337,834	\$ 1,396,371

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11. Employee Benefit Plans

The Corporation covers certain employees meeting age and service requirements through multiple non-contributory defined benefit pension plans (the "pension plans"); the Highmark Retirement Plan ("Highmark pension plan"), the Retirement Plan for Eligible Employees of the West Penn Allegheny Health System (the "WPAHS pension plan"), the Jefferson Retirement Plan (the "JRMC pension plan"), and the Saint Vincent Health System Pension Plan (the "SVHS pension plan"). The Highmark and WPAHS pension plans provide participants with a frozen legacy benefit as well as a cash-balance account consisting of pay credits, based on age and years of service, interest credits and limited transition credits. Effective December 31, 2018, the West Penn Retirement Plan for Eligible Represented Employees was merged with the West Penn Retirement Plan for Eligible Non-Represented Employees, creating the WPAHS pension plan. The plan merger had no impact on participant benefit accruals. In 2017, West Penn Allegheny Health System ("WPAHS") froze the Retirement Plan for Eligible Non-Represented Employees of WPAHS effective December 31, 2017. The JRMC and SVHS pension plans are frozen. The Highmark pension plan was closed to new participants effective June 30, 2017, and benefit accruals will freeze effective December 31, 2020.

The Corporation funds its pension plans according to minimum funding requirements of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended. During 2019, the Corporation expects to contribute \$59,900 to the pension plans.

Highmark Inc. sponsors a defined benefit other postretirement plan; the Highmark Postretirement Welfare Benefits Plan (the "welfare plan"). The welfare plan provides various postretirement health and life insurance benefits to retirees of participating subsidiaries and affiliates. The welfare plan is closed to new employees and benefit accruals were frozen as of December 31, 2016. The life insurance benefit has been discontinued to participants retiring after December 31, 2016.

Highmark Inc. uses voluntary employees' beneficiary association ("VEBA") trusts and a 401(h) account to fund the welfare plan and expects to contribute \$2,000 to the VEBA trusts and 401(h) account in 2019.

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The amounts recognized in the Consolidated Balance Sheets were as follows:

	Pension Benefits		Other Postretirement Benefits	
	2018	2017	2018	2017
Change in benefit obligations				
Benefit obligations at beginning of year	\$ 3,685,620	\$ 3,444,378	\$ 540,457	\$ 515,487
Service cost	58,962	77,160	519	537
Interest cost	113,524	112,494	15,224	16,117
Plan amendments	-	-	(1,457)	916
Participant contributions	16	22	5,081	4,987
Benefit payments	(183,039)	(196,326)	(29,720)	(33,261)
Curtailment gain	(247)	(13,336)	-	-
Actuarial (gain) loss	(250,662)	261,228	(39,233)	35,674
Benefit obligations at end of year	<u>\$ 3,424,174</u>	<u>\$ 3,685,620</u>	<u>\$ 490,871</u>	<u>\$ 540,457</u>
Change in plan assets				
Net plan assets at beginning of year	\$ 3,135,162	\$ 2,797,569	\$ 350,804	\$ 254,993
Actual (loss) return on plan assets	(163,082)	418,971	(24,471)	44,513
Participant contributions	16	22	5,081	4,987
Employer contributions	214,972	114,926	4,357	78,809
Benefit payments	(183,040)	(196,326)	(29,857)	(32,498)
Net plan assets at end of year	<u>\$ 3,004,028</u>	<u>\$ 3,135,162</u>	<u>\$ 305,914</u>	<u>\$ 350,804</u>
Amounts recognized in the consolidated balance sheets				
Benefit plan assets	\$ -	\$ 1,129	\$ -	\$ -
Benefit plan liabilities	\$ (420,146)	\$ (551,587)	\$ (184,957)	\$ (189,653)
Amounts included in net assets without donor restrictions				
Prior service credit	\$ 54,570	\$ 81,933	\$ 9,067	\$ 8,864
Actuarial loss	(891,621)	(805,637)	(120,332)	(122,165)
Net amounts recognized	<u>\$ (837,051)</u>	<u>\$ (723,704)</u>	<u>\$ (111,265)</u>	<u>\$ (113,301)</u>

The estimated prior service credit and actuarial loss for the pension plans that will be amortized from net assets in 2019 are \$27,400 and \$28,499, respectively. The estimated prior service credit and actuarial loss for the welfare plan that will be amortized from net assets in 2019 are \$1,200 and \$2,900, respectively.

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The following table provides the components of net periodic benefit (income) cost for the years ended December 31, 2018 and 2017:

	Pension Benefits		Other Postretirement Benefits	
	2018	2017	2018	2017
Service cost	\$ 58,962	\$ 77,160	\$ 519	\$ 537
Interest cost	113,524	112,494	15,224	16,117
Expected return on plan assets	(216,318)	(200,447)	(16,109)	(12,958)
Amortization of:				
Prior service credit	(27,363)	(27,362)	(1,254)	(1,193)
Actuarial loss	41,686	30,037	2,980	2,856
Settlement loss	822	-	-	-
Net periodic benefit (income) costs	<u>\$ (28,687)</u>	<u>\$ (8,118)</u>	<u>\$ 1,360</u>	<u>\$ 5,359</u>

The Corporation's weighted-average assumptions related to the calculation of the pension benefit obligations and net periodic benefit cost for the pension and other postretirement plans are presented in the table below:

Weighted-average assumptions	Pension Benefits		Postretirement Benefits	
	2018	2017	2018	2017
Discount rate - benefit obligations	4.16%	3.51%	3.94%	3.24%
Discount rate - net periodic costs	3.56%	4.01%	3.26%	3.61%
Expected return on plan assets	7.10%	7.10%	5.00%	5.00%; 7.00%
Rate of compensation increase	2.45 - 7.50%	2.45 - 7.50%	3.40 - 7.50%	3.40 - 7.50%

The expected return on pension plan assets is developed using inflation expectations, risk factors and input from actuaries to arrive at a long-term nominal expected return for each asset class. The nominal expected return for each asset class is then weighted based on the target asset allocation to develop the expected long-term rate of return on plan assets.

The expected return on other postretirement plan assets is developed based on historical returns and the future expectations for returns for each asset class as well as the asset allocation of the other postretirement plan assets.

For measurement purposes, at December 31, 2018, the assumed annual rate of increase in the per capita costs of covered health care benefits of the other postretirement plans was 6.51% in 2019, gradually decreasing to 4.50% by the year 2039 and remaining at that level thereafter.

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Assumed health care cost trend rates have a significant effect on the amounts reported for the other postretirement plans. At December 31, 2018, a one-percentage-point change in assumed health care cost trend rates would have had the following effects:

	One-Percentage-Point	
	Increase	Decrease
Effect on total of service and interest cost components	\$ 200	\$ (300)
Effect on other postretirement benefit plan obligations	\$ 10,000	\$ (10,000)

Estimated benefit payments are expected as follows:

	Pension Benefits	Other Postretirement Benefits
2019	\$ 212,000	\$ 32,000
2020	\$ 204,000	\$ 35,000
2021	\$ 210,000	\$ 37,000
2022	\$ 218,000	\$ 39,000
2023	\$ 224,000	\$ 42,000
2024-2028	\$ 1,127,000	\$ 215,000

Highmark pension plans represent approximately 69% and 68% of total plan assets as of December 31, 2018 and 2017, respectively. Allegheny Health pension plans represent approximately 31% and 32% of total plan assets as of December 31, 2018 and 2017, respectively. Highmark pension plans primarily set an investment strategy to achieve a mix of 62% of long-duration fixed income securities meant to hedge the benefit obligations, 34% of investments for long-term growth and 4% for near-term benefit payments with a diversification of asset types, fund strategies and fund managers. The target allocations for Highmark pension plan assets are approximately 69% fixed income securities, 12% equity securities, 15% alternative investments and 4% cash equivalents. The Allegheny Health pension plans primarily set an investment strategy to achieve a mix of 25% of long-duration fixed income securities meant to hedge the benefit obligations, 73% of investments for long-term growth and 2% for near-term benefit payments with a diversification of asset types, fund strategies and fund managers. The target allocations for Allegheny Health plan assets are approximately 25% fixed income securities, 60% equity securities, 13% alternative investments and 2% cash equivalents. Equity securities primarily include stock investments in U.S. developed and emerging market corporations. Fixed income securities primarily include bonds of domestic and foreign companies from diversified industries, domestic mortgage-backed securities and bonds of U.S. and foreign governments and agencies. Alternative investments include investments in real estate and private equity funds that follow several different strategies.

For the welfare plan, the Corporation's overall investment strategy is to achieve a mix of 95% of investments for long-term growth and 5% for near-term benefit payments with a diversification of asset types, fund strategies and fund managers. The target allocations for plan assets are 60% equity securities, 35% fixed income securities and 5% cash equivalents. Equity securities primarily include stock investments in U.S., developed and emerging market corporations. Fixed income securities primarily include bonds of domestic and foreign companies from diversified industries and bonds of U.S. and foreign governments and agencies.

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The pension plans' and welfare plan's overall investment strategies are determined by the plans' investment committees, investment advisors and plan administrators. Overall, the goals of the Corporation are to achieve sufficient diversification of asset types, fund strategies and fund managers in order to minimize volatility and maximize returns over the long term, while still having sufficient funds to pay those benefits due in the near term.

The following table summarizes the fair value measurements by level at December 31, 2018:

	Fair Value	Level 1	Level 2	Level 3	Net Asset Value
Pension plan assets					
Cash and cash equivalents	\$ 815	\$ 815	\$ -	\$ -	\$ -
Debt securities:					
U.S. Treasury and agency obligations	659,423	654,834	4,589	-	-
Agency mortgage-backed securities	12,372	-	12,372	-	-
State and political obligations	10,513	-	10,513	-	-
Corporate and other debt securities	795,010	-	794,760	250	-
Total debt securities	1,477,318	654,834	822,234	250	-
Equity securities:					
Domestic	225,825	225,354	339	132	-
Foreign	144,255	144,255	-	-	-
Total equity securities	370,080	369,609	339	132	-
Registered investment company shares	565,014	565,014	-	-	-
Private equity limited partnerships	241,119	-	-	-	241,119
Common collective trust interests	335,185	-	699	-	334,486
Total	\$ 2,989,531	\$ 1,590,272	\$ 823,272	\$ 382	\$ 575,605
Other postretirement plan assets					
U.S. Treasury and agency obligations	23,148	23,148	-	-	-
Agency mortgage backed securities	23,596	-	23,596	-	-
Corporate and other debt securities	46,706	-	46,706	-	-
Domestic equity securities	47,297	47,297	-	-	-
Foreign equity securities	2,904	2,904	-	-	-
Registered investment company shares	154,343	154,343	-	-	-
Common collective trust funds	7,175	-	-	-	7,175
Total	\$ 305,169	\$ 227,692	\$ 70,302	\$ -	\$ 7,175

At December 31, 2018, the fair value of pension plan assets excluded guaranteed insurance contract assets of \$2,066, carried at contract value, as well as accrued interest and other receivables of \$12,431.

At December 31, 2018, the fair value of other postretirement plan assets excluded accrued interest and other receivables of \$745.

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The following table summarizes the nature of the funds valued based on net asset value as a practical expedient for fair value as of December 31, 2018:

Pension plan assets

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Private equity limited partnerships	\$ 241,119	\$ 241,119	Quarterly, N/A	30 Days, N/A
Common collective trust funds	334,486	-	Daily, Monthly	1-15 Days
Total	\$ 575,605	\$ 241,119		

Other postretirement plan assets

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Common collective trust funds	\$ 7,175	\$ -	Daily	1 Day
Total	\$ 7,175	\$ -		

The following table summarizes the fair value measurements by level at December 31, 2017:

	Fair Value	Level 1	Level 2	Level 3	Net Asset Value
Pension plan assets					
Cash and cash equivalents	\$ 4,589	\$ 4,589	\$ -	\$ -	\$ -
Debt securities:					
U.S. Treasury and agency obligations	578,443	573,853	4,590	-	-
Agency mortgage-backed securities	14,390	-	14,390	-	-
State and political obligations	8,564	-	8,564	-	-
Corporate and other debt securities	726,943	-	726,443	500	-
Total debt securities	1,328,340	573,853	753,987	500	-
Equity securities:					
Domestic	375,857	375,603	254	-	-
Foreign	202,345	202,345	-	-	-
Total equity securities	578,202	577,948	254	-	-
Registered investment company shares	603,224	603,224	-	-	-
Private equity limited partnerships	166,251	-	-	-	166,251
Common collective trust interests	443,528	-	73,792	-	369,736
Total	\$ 3,124,134	\$ 1,759,614	\$ 828,033	\$ 500	\$ 535,987
Other postretirement plan assets					
Cash and cash equivalents	\$ 191	\$ 191	\$ -	\$ -	\$ -
U.S. Treasury and agency obligations	15,321	15,321	-	-	-
Agency mortgage backed securities	15,460	-	15,460	-	-
Corporate and other debt securities	38,530	-	38,530	-	-
Domestic equity securities	53,774	53,774	-	-	-
Foreign equity securities	1,871	1,871	-	-	-
Registered investment company shares	216,003	216,003	-	-	-
Common collective trust funds	7,903	-	-	-	7,903
Total	\$ 349,053	\$ 287,160	\$ 53,990	\$ -	\$ 7,903

At December 31, 2017, the fair value of pension plan assets excluded guaranteed insurance contract assets of \$2,469, carried at contract value as well as accrued interest and other receivables of \$8,559.

At December 31, 2017, the fair value of other postretirement plan assets excluded accrued interest and other receivables of \$1,751.

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The following table summarizes the nature of the funds valued based on net asset value as a practical expedient for fair value as of December 31, 2017:

Pension plan assets

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Private equity limited partnerships	\$ 166,251	\$ 212,000	Quarterly, N/A	30 Days, NA
Common collective trust funds	369,736	-	Daily, Monthly	1-15 Days
Total	\$ 535,987	\$ 212,000		

Other postretirement plan assets

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Common collective trust funds	\$ 7,903	\$ -	Daily	1 Day
Total	\$ 7,903	\$ -		

The changes in fair value for pension plan and other postretirement assets measured using significant unobservable inputs (Level 3) for the years ended December 31, 2018 and 2017 were as follows:

	2018	2017
Balance at January 1,	\$ 500	\$ 771
Realized net losses on investments	9	(4)
Unrealized net holding losses arising during the period	-	(765)
Purchases	250	500
Sales	(259)	(2)
Transfers in (when applicable)	132	-
Transfers out (when applicable)	(250)	-
Balance at December 31,	\$ 382	\$ 500

The Corporation sponsors several defined contribution savings plans (the "savings plans"), covering substantially all of the Corporation's employees and employees of certain participating affiliates. The savings plans allow participating employees to contribute a percentage of their annual salaries, subject to current Internal Revenue Service ("IRS") limitations. Employee contributions are matched by the Corporation at various percentages. Effective January 1, 2018, a new 401(k) plan was established for the benefit of eligible employees at AHN and existing 401(k) and 403(b) plans sponsored by the AHN hospitals and their subsidiaries were frozen effective December 31, 2017. The Corporation recognized expense associated with its contributions to the savings plans of \$76,054 and \$47,852 for the years ended December 31, 2018 and 2017, respectively.

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The Corporation also sponsors deferred compensation plans for certain eligible employees. Participating employees may contribute a certain amount of their annual compensation to these plans. Certain deferred compensation plans provide for matching contributions based on employee deferrals. The deferred compensation plans pay interest on the deferrals at various rates. The Corporation made matching contributions to the deferred compensation plans of \$381 and \$607 in 2018 and 2017, respectively. The Corporation also sponsors IRC 457 plans for certain eligible employees of Highmark Health and Allegheny Health. The 457 plans are nonqualified benefit plans that provide supplemental benefits to participants in the form of employer contributions. The Corporation made contributions to the 457 plans of \$3,027 and \$2,275 in 2018 and 2017, respectively. Deferred compensation and 457 plan liabilities of \$50,377 and \$52,037 were recorded in other payables and accrued expenses in the Consolidated Balance Sheets at December 31, 2018 and 2017, respectively. Changes in the liabilities are reported in other operating expenses in the Consolidated Statements of Operations.

The Corporation also sponsors an unfunded nonqualified supplemental retirement plan (the "nonqualified retirement plan") covering certain eligible employees. The weighted-average assumptions used in the measurement of the nonqualified plan liabilities were consistent with the assumptions used in the measurement of the pension plans and adjusted, when needed, for nonqualified plan specific characteristics. In 2017, lump-sum benefit payments of \$6,686 resulted in recognition of settlement losses of \$1,525 for the nonqualified retirement plan. The nonqualified retirement plan liabilities recorded in other payables and accrued expenses in the Consolidated Balance Sheets at December 31, 2018 and 2017 were \$53,901 and \$56,101, respectively.

12. Debt

The Corporation's total debt at December 31, 2018 and 2017 consisted of the following:

	2018	2017
Unsecured Senior Notes due May 15, 2021	\$ 349,023	\$ 348,612
Unsecured Senior Notes due May 15, 2041	237,967	237,834
AHN Series 2018 revenue bonds	991,069	-
AHN Series 2017 revenue bonds	-	992,268
Revolving credit facility with maximum available for for draw of \$85,000 expires December 2022	10,000	20,000
Mortgage loan, due March 15, 2032, interest at 6.00%	22,059	22,668
Capital leases due through 2023 at varying interest rates	12,338	50,435
Mortgage and other loans due through 2021 at varying interest rates	6,521	8,262
Total debt	\$ 1,628,977	\$ 1,680,079

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A summary of scheduled principal repayments on debt for the next five years and thereafter is as follows:

Years ending December 31,	
2019	\$ 11,345
2020	10,699
2021	358,744
2022	37,356
2023	26,706
Thereafter	<u>1,184,127</u>
Total	<u>\$ 1,628,977</u>

Unsecured Notes

At December 31, 2018 and 2017, Highmark Inc. had outstanding unsecured Senior Notes of \$349,023 and \$348,612, respectively, due May 15, 2021 with interest payable semi-annually at 4.75%. The unamortized discount was \$335 and \$476 at December 31, 2018 and 2017, respectively. The debt issuance costs were \$641 and \$912 at December 31, 2018 and 2017, respectively.

At December 31, 2018 and 2017, Highmark Inc. also had outstanding unsecured Senior Notes of \$237,967 and \$237,834, respectively, due May 15, 2041 with interest payable semi-annually at 6.125%. The unamortized discount was \$1,118 and \$1,170 at December 31, 2018 and 2017, respectively. The debt issuance costs were \$1,792 and \$1,872 at December 31, 2018 and 2017, respectively.

AHN Allegheny County Hospital Development Authority Bond ("AHN Authority Bonds")

Series 2018 Revenue Bonds

In August 2018, AHN issued tax exempt revenue bonds with a par value of \$943,365 (Series 2018A) through the Allegheny County Hospital Development Authority ("ACHDA") at a premium of \$56,639 for total proceeds of \$1,000,004. The proceeds were used to refund the Series 2017 Revenue Bonds (further described below). The Series 2018 Revenue Bonds consist of both serial and term bonds scheduled to mature at various dates through April 2047. Interest rates are fixed and range from 4.00% to 5.00%. AHN is required to pay interest only through 2021, with level debt service thereafter consisting of principal and interest. The unamortized premium was \$54,823 at December 31, 2018. Deferred bond issuance costs of \$7,199 were recognized in association with the issuance and reported on the consolidated balance sheet with debt. The bonds are collateralized by the gross receivables and other property of AHN.

Highmark Health

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Series 2017 Revenue Bonds

In December 2017, AHN issued aggregate tax exempt revenue bonds of \$1,000,000 (\$300,000 (Series 2017A); \$250,000 (Series 2017B); \$250,000 (Series 2018C); and \$200,000 (Series 2017D)) through the ACHDA for direct purchase by a financial institution. While the bonds were scheduled to mature in April 2047, the structure of the multimodal master trust agreement required that the initial mode with the financial institution end by December 1, 2022, to be replaced with an alternate mode of the bond instrument as remarketed. Under the multimodal structure of the bonds, the bonds can be remarketed in a fixed rate mode. The variable rate interest on the bonds under the initial mode was payable monthly and AHN has an option during the initial mode to select the interest rate based on either one-month LIBOR, 60 day LIBOR or 90 day LIBOR plus a credit spread. The interest rate was subject to change upon a revision in the federal corporate tax rate. AHN selected one-month LIBOR at December 31, 2017, with a rate of 2.59% at December 31, 2017.

Proceeds from the bonds were used to refinance existing bond debt at Jefferson Regional Medical Center ("JRMC") and Saint Vincent Health System ("SVHS") as well as the 2014 term loan at WPAHS and provide funding of \$194,556 for various capital projects, which are reported in a project fund included in board designated, restricted and other investments in the consolidated balance sheets. The bonds were collateralized by a guarantee from Highmark Inc. (related only to the initial mode) as well as the gross receivables (excluding restricted amounts) and mortgages on property and equipment of the WPAHS hospitals.

Deferred bond issuance costs of \$7,732 were recognized in association with the issuance and reported on the consolidated balance sheet in 2017. With the refunding of the Series 2017 Revenue Bonds, the unamortized balance of the deferred bond issuance costs were recognized resulting in a loss on debt extinguishment of \$7,495 reported on the Consolidated Statements of Operations.

AHN was party to a several interest rate swap agreements with highly-rated major U.S. financial institutions, related to the bond debt at JRMC and SVHS as well as the 2014 term loan at WPAHS. The interest rate swap agreements were terminated and settled in December 2017 as part of AHN's retirement of the related debt. In 2017, AHN paid \$5,989 to the counterparties for settlements under the interest rate swap agreements. This amount was included in interest expense in the Consolidated Statements of Operations. Additionally, the termination of the WPAHS swap agreement resulted in a gain of \$2,298 and is reported in net investment income on the Consolidated Statements of Operations.

During 2018, AHN entered into an interest rate swap agreement with a highly-rated major U.S. financial institution, related to the Series 2017 Revenue Bonds. The intent of the interest rate swap agreement was to hedge interest rate risk on the bonds by converting the variable rate to a fixed rate. In August 2018, the swap agreement was terminated in conjunction with the refunding of the Series 2017 Revenue Bonds and resulted in a gain of \$1,366 which is reported in net investment income on the Consolidated Statements of Operations.

Revolving Credit Facilities

Highmark holds a \$275,000 revolving credit facility with four financial institutions that would have expires on June 7, 2021. Amounts borrowed under this facility bear interest at variable interest rates. In September 2017, Highmark repaid its outstanding borrowings totaling \$275,000.

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On November 30, 2017, HVHC terminated its revolving credit facility, which had a total commitment of \$275,000 and an expiration date of December 29, 2020. There was no outstanding balance on this revolving credit facility as of the date of termination. On December 1, 2017, the revolving credit facility was replaced with a revolving credit and security agreement with a total commitment of \$85,000 and an expiration date of December 1, 2022. This revolving credit facility also provides for a swing loan subfacility of up to \$8.5 million and a letter of credit subfacility of up to \$5.0 million. Amounts borrowed under this agreement bear interest at variable interest rates. As of December 31, 2018 and 2017, \$10,000 and \$20,000, respectively, were outstanding on the revolving credit and security agreement. HVHC had not utilized the swing loan subfacility for the years ended December 31, 2018 and 2017.

In addition to the arrangements set forth in the table above, Highmark also has a revolving credit facility that provides for total borrowings of \$15,000. As of December 31, 2018 and 2017, there were no amounts outstanding.

Other Debt

SVHS has an outstanding mortgage loan of \$22,059 and \$22,668 at December 31, 2018 and 2017, respectively, related to a medical office building. The mortgage note matures on March 15, 2032 and requires monthly principal and interest payments. The note is secured by the related medical office building.

Several of the debt agreements referred to above contain covenants, including covenants relating to debt service coverage and financial reporting. At December 31, 2018 and 2017, the Corporation was in compliance with all debt covenants that could affect the financial position or results from operations of the Corporation.

The carrying amount of debt reported in the Consolidated Balance Sheets at December 31, 2018 and 2017 was \$1,628,977 and \$1,680,079, respectively. Using a discounted cash flow technique that considered credit ratings, with adjustments for duration and risk profile, the Corporation determined that the fair value of its debt at December 31, 2018 and 2017 was \$1,645,028 and \$1,729,327, respectively.

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13. Income Taxes

The components of the income tax provision for the years ended December 31, 2018 and 2017 were as follows:

	2018	2017
Federal		
Current	\$ (69,796)	\$ 170,904
Deferred	157,368	(129,224)
Total federal	<u>87,572</u>	<u>41,680</u>
Foreign		
Current	1,263	1,147
State		
Current	8,501	2,184
Deferred	(1,466)	6,574
Total state	<u>7,035</u>	<u>8,758</u>
Total income tax provision	<u>\$ 95,870</u>	<u>\$ 51,585</u>

The components of deferred income taxes at December 31, 2018 and 2017 were as follows:

	2018	2017
Deferred tax assets		
Net operating loss carryforwards	\$ 102,625	\$ 128,416
Tax credit carryforwards	78,732	233,506
Other payables and accrued expenses	74,156	68,085
Benefit plan liabilities	65,691	86,722
Charitable contribution carryforwards	34,949	37,275
Allowance for doubtful accounts	9,802	8,989
Other	13,022	12,335
Total deferred tax assets	<u>378,977</u>	<u>575,328</u>
Less valuation allowance	(181,274)	(211,439)
Total deferred tax assets, net of valuation allowance	<u>197,703</u>	<u>363,889</u>
Deferred tax liabilities		
Investment in partnerships/affiliates	16,076	10,122
Property and equipment	11,980	24,032
Net unrealized gains on available-for-sale securities	6,367	67,070
Other	3,204	1,766
Total deferred tax liabilities	<u>37,627</u>	<u>102,990</u>
Deferred income taxes, net	<u>\$ 160,076</u>	<u>\$ 260,899</u>

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Notes to Consolidated Financial Statements

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In addition to the income tax provision, the deferred tax asset increased by \$58,782 and decreased by \$47,126 in 2018 and 2017, respectively, primarily related to net holding losses on investments and changes in benefit plan assets and liabilities. As these changes were recorded within net assets, they did not impact the income tax provision.

The realization of net deferred tax assets is dependent on the Corporation's ability to generate sufficient taxable income in future periods. The amount of deferred tax assets considered realizable, however, could change if estimates of future taxable income change.

The Tax Cuts and Jobs Act of 2017 (the "TCJA"), signed into law on December 22, 2017, reduced the federal income tax rate of the Corporation from 35% to 21% for periods beginning after December 31, 2017. This change resulted in a decrease in the value of the Corporation's net deferred tax assets due to the reduced deferred benefit of deductible temporary differences reversing in future periods. As of December 31, 2017, the Corporation recorded \$101,803 of deferred tax expense through the Combined Statements of Operations as a provisional amount to revalue net deferred tax assets. During the period ended December 31, 2018, the Company finalized their evaluation of, and related accounting for, the income tax effects of the TCJA, resulting in a decrease to the provisional amount of \$15,348.

The realization of net deferred tax assets is dependent on the Corporation's ability to generate sufficient taxable income in future periods. The amount of deferred tax assets considered realizable, however, could change if estimates of future taxable income change.

At December 31, 2018, the Corporation had non-expiring alternative minimum tax credit carryforwards related to Highmark, Highmark WV and Highmark DE of \$39,944, \$17,182, and \$21,138, respectively, recognized in deferred income taxes. The TCJA repealed the alternative minimum tax for corporations and provided a mechanism for taxpayers to monetize historical credits not utilized to offset future tax liabilities. As such, the Corporation released a valuation allowance in 2017 previously recognized due to the uncertainty of realizing a tax benefit for alternative minimum tax credits by Highmark WV and Highmark DE prior to enactment of the TCJA.

At December 31, 2018, various subsidiaries and affiliates of the Corporation had state net operating loss carryforwards totaling \$425,581 that are available to offset future state taxable income of the subsidiary that generated the loss carryforward which will generally expire between 2019 and 2038. The utilization of the state net operating loss carryforwards is subject to certain limitations; therefore, the Corporation recognized a valuation allowance for that portion of the state net operating loss carryforward not expected to be utilized.

At December 31, 2018, various subsidiaries and affiliates of the Corporation had federal net operating loss carryforwards of \$329,571. Of the total, \$42,131 has no expiration and \$287,440 expire in various amounts through 2037. The utilization of the federal net operating loss carryforwards is subject to certain limitations; therefore, the Corporation recognized a valuation allowance for that portion of the federal net operating loss carryforward not expected to be utilized.

At December 31, 2018, various subsidiaries and affiliates of the Corporation had charitable contributions carryforwards of \$166,541, which expire in various amounts through 2023. The utilization of the charitable contributions carryforwards is subject to certain limitations; therefore, the Corporation recognized a valuation allowance for that portion of the charitable contributions carryforward not expected to be utilized.

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(in thousands of dollars)

A reconciliation of income tax expense recorded in the Consolidated Statements of Operations and amounts computed at the statutory federal rate for the years ended December 31, 2018 and 2017 was as follows:

	2018	2017
Income taxes at statutory rate	\$ 139,698	\$ 390,914
IRC section 833(b) deduction	(70,266)	(351,543)
Health insurance providers fee	32,244	-
Other impacts of tax reform	(15,348)	101,803
Change in valuation allowance	(12,662)	(149,765)
Gain on sale of subsidiary	11,385	(29,343)
Nondeductible compensation	8,437	10,365
Income from tax exempt entities	(7,148)	(21,466)
State taxes, net of federal tax benefit	5,558	5,693
Imputed Interest	772	7,350
Impairment of goodwill	-	84,745
Other	3,200	2,832
	<u>\$ 95,870</u>	<u>\$ 51,585</u>
Total income tax provision		

Prior to January 1, 1987, the Corporation was exempt from federal income taxes. With the enactment of the Tax Reform Act of 1986 (the "Act"), the Corporation, and all other Blue Cross and Blue Shield plans, became subject to federal income tax. Among other provisions of the Internal Revenue Code, these plans were granted a deduction under Code Section 833(b) (the "special deduction") for regular tax calculation purposes. The special deduction is calculated as the excess of 25% of incurred claims and claim adjustment expenses for the tax year over adjusted surplus, as defined, limited to taxable income. The amount of taxable income before the special deduction has the effect of increasing the adjusted surplus balance used in calculating the special deduction. Once the cumulative adjusted surplus balance exceeds 25% of incurred claims and claim adjustment expenses for the current taxable year, the deduction is eliminated. Little technical guidance has been issued by the taxing authorities regarding the special deduction and therefore some uncertainty exists in its calculation. In 2011, the Corporation requested refunds of approximately \$185,000 (plus interest) for the 2004 through 2007 tax years related to the Special Deduction that have not yet been received. On June 30, 2017 the Corporation filed suit in the United States Court of Federal Claims requesting the refund. In the opinion of management, an adequate reserve against the requested refunds receivable has been made in the financial statements related to this matter, and the amount that is ultimately received is not expected to materially affect the financial position of the Corporation. In addition, a portion of the alternative minimum tax credit carryforwards monetized as part of the TCJA are unrecognized due to the impact of the uncertainty associated with the special deduction calculation described here. See further discussion below. Future adjustments may be made to the Corporation's estimated tax benefit as additional information becomes available.

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The changes in the carrying amount of gross unrecognized tax benefits from uncertain tax positions in 2018 and 2017 were as follows:

	2018	2017
Balance at January 1	\$ 163,219	\$ 169,796
Additions for tax positions related to		
Current year	47,880	586
Prior years	8,410	771
Reductions to balance relating to		
Changes in tax positions of prior years	-	(2,799)
Statute of limitation expiration	(34)	(4,649)
Settlements	(301)	(486)
Balance at December 31	<u>\$ 219,174</u>	<u>\$ 163,219</u>

Most of the current year additions for the period ended December 31, 2018 relate to unrecognized tax benefits associated with the alternative minimum tax credit carryforwards monetized as part of the TCJA. As discussed earlier, the uncertainty is associated with the special deduction calculation.

At December 31, 2018 and 2017, gross unrecognized tax benefits (excluding the federal benefit received from state positions) were \$216,365 and \$157,830, respectively, and, if recognized, would have impacted the effective tax rate.

At December 31, 2018 and 2017, the Corporation recorded no significant potential interest and penalties receivable or payable in net income tax recoverable in the Consolidated Balance Sheets.

Highmark's consolidated federal income tax return has been examined by the IRS through 2015.

Except for the impact on the alternative minimum tax credit carryforwards described earlier, the Corporation does not anticipate that any significant increase or decrease to unrecognized tax benefits will be recorded in 2019.

Highmark Health
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(in thousands of dollars)

14. Net Assets With Donor Restrictions

Nets assets with donor restrictions are restricted for the following purposes or periods for the years ended December 31, 2018 and 2017 include:

	2018	2017
Subject to expenditure for specific purpose:		
Capital improvements	\$ 743	\$ 579
Education and Scholarships	1,140	1,169
Research	4,493	3,747
Healthcare services	18,966	17,315
	<u>25,342</u>	<u>22,810</u>
Subject to the Corporations' policy and appropriation		
Investment in perpetuity, the income of which is expendable to support:		
Healthcare services	262,225	285,584
Total net assets with donor restrictions	<u>\$ 287,567</u>	<u>\$ 308,394</u>

15. Liquidity and Availability of Financial Assets

The Corporation's working capital and cash flows are subject to variability during the year attributable to variations in volume and cash receipts. To manage liquidity, the Corporation maintains unrestricted investments portfolios to manage fluctuations in cash flow.

The following table reflects the Corporation's financial assets reduced by amounts not available for general use within one year because of contractual or donor-imposed restrictions or internal designations. Amounts available include donor-restricted amounts that are available for general expenditures. Amounts not available include amounts set aside for operating and other reserves that could be drawn upon if the Board of Directors approves the action.

The financial assets available to meet cash needs for general expenditures within one year at December 31, 2018 were as follows:

Cash and cash equivalents	\$ 886,043
Investments	7,023,028
Receivables	2,669,407
Total financial assets	<u>10,578,478</u>
Contractual or donor-imposed restrictions:	
Beneficial interests in perpetual trusts	(228,266)
Endowment funds	(53,791)
Equity method investments	(43,334)
Grant funds	(25,857)
Bond project funds	(167,752)
Board designations:	
Capital improvements	(33,197)
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 10,026,281</u>

Highmark Health
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(in thousands of dollars)

16. Leases

Several noncancellable operating leases, primarily for EDP equipment and office space, were in effect at December 31, 2018. Rental expense is recognized on a straight-line basis over the lease term. Aggregate future rental commitments for all operating leases having initial or remaining noncancellable lease terms in excess of one year with commitments in one or more of the next five years and thereafter are shown in the following table:

Years ending December 31,	Operating Lease Commitments
2019	\$ 168,375
2020	157,405
2021	131,289
2022	98,906
2023	74,616
Thereafter	<u>231,445</u>
Total	<u>\$ 862,036</u>

Rent expense of \$203,636 and \$214,941 in 2018 and 2017, respectively, was recorded in other operating expenses in the accompanying Consolidated Statements of Operations.

17. Contingencies

The National Organization of Life & Health Insurance Guaranty Associations ("NOLHGA") is a voluntary organization consisting of the state life and health insurance guaranty associations located throughout the U.S. Such associations, working together with NOLHGA, provide a safety net for their state policyholders, ensuring that they continue to receive coverage, subject to state maximum limits, even if the policyholders' insurer is declared insolvent. Penn Treaty Network America Insurance Company and its subsidiary American Network Insurance Company (collectively "Penn Treaty") were placed into rehabilitation by order of the Commonwealth Court of Pennsylvania on January 6, 2009. On July 27, 2016, the Commissioner, as Rehabilitator for Penn Treaty, filed in Commonwealth Court a petition to convert the rehabilitation to liquidation. The court granted that petition on March 1, 2017, declaring that Penn Treaty was insolvent and placing Penn Treaty into liquidation. The liquidation order triggered state guaranty association assessments of member insurers. As of December 31, 2018 and 2017, certain of the Corporation's subsidiaries, which are subject to these assessments, recorded a combined liability of \$59,000, respectively. Through December 31, 2018, the Corporation has been assessed a combined amount of \$46,500, which was paid in 2017 and have an estimated liability remaining of \$13,000 related to anticipated future assessments. In January 2019, the Corporation was assessed an additional \$4,365.

Highmark Health

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On October 1, 2014, Cole's Wexford Hotel, Inc., on behalf of small group purchasers which obtained health insurance coverage from July 2010 through March 2012, filed a third amended class action complaint in the United States District Court for the Western District of Pennsylvania alleging that the Corporation and UPMC Health System violated antitrust laws by entering into an illegal agreement to restrain trade and by conspiring to create monopolies in the Western Pennsylvania health insurance market. The plaintiff filed a motion for class certification which the Corporation has opposed. Such motion remains pending. The Corporation believes, based on consultation with legal counsel, that it has meritorious defenses to the claims in this matter, but it is unable to predict the outcome of the matter or to reasonably estimate a range of possible loss.

A number of class action lawsuits filed throughout the United States against various Blue Cross and/or Blue Shield plans (the "BCBS Plans"), including the Corporation, have been consolidated in a multi-district litigation in the U.S. District Court for the Northern District of Alabama under the caption In re: Blue Cross Blue Shield Antitrust Litigation. The lawsuits state that they were filed on behalf of (i) healthcare providers in the United States who have provided services to any patient insured by or who was a member or beneficiary of any BCBS Plan and/or (ii) members and subscribers of any BCBS Plan. The lawsuits primarily deal with alleged conspiracy and price fixing by and among the BCBS Plans and the BCBSA, the competitive impact of exclusive service areas granted by BCBSA, and alleged contract provisions of the BCBS Plans. Plaintiffs generally seek a judgment that the defendants have violated Section 1 of the Sherman Act, an injunction prohibiting defendants from entering into agreements that restrict the territories in which any BCBS Plan may compete, and an award of treble damages. The District Court has found that the exclusive service areas licensed to the BCBS Plans in conjunction with the national "best efforts" requirements and other applicable BCBSA rules constitute per se violations of federal antitrust laws and that the "Blue Card" system providing for the BCBS Plans' payment of out-of-area claims would be subject to a rule of reason analysis. The Corporation believes, based on consultation with legal counsel, that it has meritorious defenses to the claims in this matter, but it is unable to predict the outcome of the matter or to reasonably estimate a range of possible loss.

Cyndie Nordi, a direct pay subscriber, brought a class action lawsuit in Allegheny County Orphan's Court on September 26, 2014 which has been subsequently transferred to the Civil Division of the Allegheny County Court of Common Pleas. The complaint seeks relief from the Corporation's alleged unlawful conduct on behalf of policyholders. The case challenges the Corporation's operations and accumulation of surplus funds following a February 2005 Determination ("Determination") by the Department that set parameters for an appropriate, sufficient operating surplus. The plaintiff alleges that, despite acceptance of the Determination, the Corporation unlawfully continues to generate significant underwriting gains. Ms. Nordi seeks relief in the form of monetary damages up to disgorging the Corporation of all profits unjustly received and retained. A Petition to Intervene by three other prospective plaintiffs was granted on August 7, 2017 and the plaintiffs filed a First Amended Class Action Complaint on September 6, 2017. The Corporation believes, based on consultation with legal counsel, that it has meritorious defenses to the claims in this matter, but it is unable to predict the outcome of the matter or to reasonably estimate a range of possible loss.

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(in thousands of dollars)

On May 11, 2017, Presque Isle Colon and Rectal Surgery, on behalf of all independent physicians and physician practices in Pennsylvania, filed a class action complaint in the United States District Court for the Western District of Pennsylvania against the Corporation containing antitrust, breach of contract and unjust enrichment claims based on allegations that such physicians were subjected to anticompetitive and other unlawful practices in relation to services rendered to patients covered by an ACA health insurance exchange product. On September 6, 2018, the Court dismissed with prejudice in part and dismissed without prejudice in part the plaintiff's complaint. The plaintiff filed a motion for reconsideration of the court's dismissal with prejudice of portions of its complaint on October 1, 2018, which was granted by the Court on November 5, 2018. The plaintiffs filed an amended complaint on December 3, 2018. The Corporation believes, based on consultation with legal counsel, that it has meritorious defenses to the claims in this matter, but it is unable to predict the outcome of the matter or to reasonably estimate a range of possible loss.

On June 29, 2018, the Corporation filed an amended complaint against U.S. Health Group LLC, Atlantic Health Group LLC, Aron Leibowich, Biomatrix Sprx, Matrix Health Group, Elwyn Pharmacy Group, Medex Biocare, FFP Acquisition II, LLC, Bruce Greenberg and John Does 1-15 relating to the defendants pattern of fraudulent conduct aimed at procuring health insurance and reimbursement payments for health insurance claims. The defendants that are pharmacies filed a complaint against the Corporation on July 6, 2018 as a result of the Corporation's refusal to pay for health insurance claims submitted by or on behalf of members and dependents of U.S. Health Group LLC and Atlantic Health Group LLC. All parties entered into a confidential settlement agreement resolving all of their claims against each other and a voluntary dismissal of such lawsuits with prejudice was filed by all parties on February 12, 2019.

The Corporation is subject to various other contingencies, including legal and compliance actions and proceedings that arise in the ordinary course of its business. Due to the complex nature of these actions and proceedings, the timing of the ultimate resolution of these matters is uncertain. In the opinion of management, based on consultation with legal counsel, adequate provision has been made in the financial statements for any potential liability related to these matters, and the amount of ultimate liability is not expected to materially affect the financial position or results of operations of the Corporation.



Report of Independent Auditors

To the Board of Directors of Highmark Health

We have audited the consolidated financial statements of Highmark Health and its subsidiaries as of and for the year ended December 31, 2018 and our report thereon appears on pages one and two of this document. That audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating 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 consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and cash flows of the individual companies and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations and cash flows of the individual companies.

PRICEWATERHOUSE COOPERS LLP

March 26, 2019

Highmark Health Consolidating Balance Sheet December 31, 2018

(in thousands of dollars)

Assets	Highmark Health	Highmark Inc.	HM Health Solutions	HM Health Holding Co.	Allegheny Health	Eliminations	Total
Cash and cash equivalents	\$ 21,148	\$ 673,797	\$ 26,655	\$ 1,939	\$ 162,504	\$ -	\$ 886,043
Accounts receivable	-	2,256,778	-	-	-	-	2,256,778
Insurance, less allowance for doubtful accounts of \$23,651	-	-	-	-	373,930	(186,148)	187,782
Patient service, less allowance for doubtful accounts of \$54,884	-	-	-	-	70,121	(224,072)	224,847
Other	55,992	202,241	119,597	968	-	-	4,002,940
Investments	-	3,931,259	-	-	71,681	-	1,459,913
Debt securities, available-for-sale at fair value	-	1,449,398	-	-	10,515	-	-
Equity securities, available-for-sale at fair value	-	-	-	-	-	-	-
Board designated, restricted and other investments at fair value	6,401,058	-	-	-	844,076	-	844,076
Other	-	194,847	4,265	65	43,334	(6,167,607)	475,962
Reinsurance recoverables	-	240,137	-	-	-	-	240,137
Securities lending invested collateral	-	112,104	-	-	-	-	112,104
Inventory, net	-	320,052	-	-	-	-	320,052
Income tax recoverable, net	-	93,511	-	-	-	-	159,724
Deferred income taxes, net	-	91,867	7,790	(1,411)	66,213	-	97,997
Property and equipment, net	-	148,382	11,364	52	(1,519)	-	160,076
Goodwill and other intangible assets, net	147,728	455,308	15,915	-	1,365,932	-	1,984,883
Other assets	-	390,645	331	-	124,869	-	515,845
	9,113	450,804	8,037	-	93,796	(17,240)	544,510
Total assets	\$ 6,635,039	\$ 11,011,130	\$ 193,954	\$ 2,883	\$ 3,225,730	\$ (6,595,067)	\$ 14,473,669
Liabilities and Net Assets							
Claims and claim adjustment expenses outstanding	\$ -	\$ 2,760,759	\$ -	\$ -	\$ -	\$ (180,475)	\$ 2,580,284
Unearned revenue	-	191,510	26,591	-	-	-	218,101
Amounts held for others	-	595,410	-	-	-	-	595,410
Accrued salaries and benefits	55,420	179,270	61,159	1,245	132,879	-	429,973
Other payables and accrued expenses	49,079	924,235	97,866	303	362,586	(199,662)	1,234,407
Securities lending payable	-	320,053	-	-	-	-	320,053
Benefit plan liabilities	-	274,085	-	-	331,018	-	605,103
Debt	-	600,345	21,949	-	1,023,334	(16,651)	1,628,977
Other liabilities	-	43,817	-	-	196,681	(30,672)	209,826
Total liabilities	104,499	5,889,484	207,565	1,548	2,045,498	(427,460)	7,822,134
Net Assets							
Without donor restrictions - Highmark Health	6,242,973	5,018,721	(13,676)	1,335	873,595	(5,879,975)	6,242,973
Without donor restrictions - noncontrolling interest	-	102,925	65	-	18,070	(65)	120,995
Total net assets without donor restrictions	6,242,973	5,121,646	(13,611)	1,335	891,665	(5,880,040)	6,363,968
With donor restrictions	287,567	-	-	-	287,567	(287,567)	287,567
Total net assets	6,530,540	5,121,646	(13,611)	1,335	1,179,232	(6,167,607)	6,651,535
Total liabilities and net assets	\$ 6,635,039	\$ 11,011,130	\$ 193,954	\$ 2,883	\$ 3,225,730	\$ (6,595,067)	\$ 14,473,669

The schedules of supplemental consolidating financial information are prepared in accordance with accounting policies described in the accompanying notes to the consolidated financial statements. These schedules are not intended to be a presentation in accordance with accounting principles generally accepted in the United States of America as a result of the exclusion of all required disclosures, as well as the information included within the "Eliminations" column.

Highmark Health
Consolidating Statement of Operations
Year Ended December 31, 2018

(in thousands of dollars)

	Highmark Health	Highmark Inc.	HM Health Solutions	HM Health Holding Co.	Allegheny Health	Eliminations	Total
Revenue and other support							
Premium revenue, net	\$ -	\$ 13,773,039	\$ -	\$ -	\$ -	\$ -	\$ 13,773,039
Net patient service revenue	-	-	-	-	3,112,937	(729,634)	2,383,303
Vision revenue	-	956,564	-	-	-	-	956,564
Service revenue	26,198	1,116,204	946,573	825	166,314	(663,434)	1,592,680
Affiliates revenue	49,100	15,255	1,105	-	-	-	65,460
Net assets released from restrictions	-	-	-	-	5,367	-	5,367
Total revenue and other support	<u>75,298</u>	<u>15,861,062</u>	<u>947,678</u>	<u>825</u>	<u>3,284,618</u>	<u>(1,393,068)</u>	<u>18,776,413</u>
Expenses							
Claims and claim adjustment expenses	-	11,889,155	-	-	-	(668,638)	11,220,517
Salaries, wages and fringe benefits	191,063	1,492,689	462,052	6,701	1,779,716	(15,311)	3,916,910
Patient care supplies	-	-	-	-	663,366	-	663,366
Depreciation and amortization	22,062	155,730	2,642	-	144,045	-	324,479
Other operating expenses, net	(146,170)	1,846,378	482,722	(7,002)	658,464	(709,119)	2,125,273
Total operating expenses	<u>66,955</u>	<u>15,383,952</u>	<u>947,416</u>	<u>(301)</u>	<u>3,245,591</u>	<u>(1,393,068)</u>	<u>18,250,545</u>
Operating gain	8,343	477,110	262	1,126	39,027	-	525,868
Net investment income (expense), including net realized gains on investments	48	206,154	481	(7)	146	(558)	206,264
Interest expense	-	(32,605)	(709)	-	(34,150)	558	(66,906)
Equity gains of subsidiaries	562,386	-	-	31	-	(562,417)	-
Excess of revenues over expenses before income taxes	570,777	650,659	34	1,150	5,023	(562,417)	665,226
Income tax provision	-	93,379	829	317	1,345	-	95,870
Excess (deficit) of revenues over expenses before noncontrolling interest	570,777	557,280	(795)	833	3,678	(562,417)	569,356
(Deficit) excess of revenue over expenses attributable to noncontrolling interest	-	(2,260)	31	-	839	(31)	(1,421)
Excess (deficit) of revenue over expenses attributable to Highmark Health	<u>\$ 570,777</u>	<u>\$ 559,540</u>	<u>\$ (826)</u>	<u>\$ 833</u>	<u>\$ 2,839</u>	<u>\$ (562,386)</u>	<u>\$ 570,777</u>

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