



2020

Audited
Financial
Statements

December 31, 2020

Sutter Health and Affiliates
Consolidated Financial Statements
and
Supplementary Information
Years ended December 31, 2020 and 2019

Contents

Audited Consolidated Financial Statements

Report of Independent Auditors	1
Consolidated Balance Sheets	2
Consolidated Statements of Operations and Changes in Net Assets	3
Consolidated Statements of Cash Flows.....	5
Notes to Consolidated Financial Statements	7



Ernst & Young LLP
Sacramento Office
Suite 300
2901 Douglas Boulevard
Roseville, CA 95661

Tel: +1 916 218 1900
Fax: +1 916 218 1999
ey.com

Report of Independent Auditors

The Board of Directors
Sutter Health and Affiliates

We have audited the accompanying consolidated financial statements of Sutter Health and Affiliates, which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sutter Health and Affiliates at December 31, 2020 and 2019, and the consolidated results of their operations and changes in net assets, and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 3, 2021

Sutter Health and Affiliates
Consolidated Balance Sheets

(Dollars in millions)

	December 31,	
	2020	2019
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,169	\$ 505
Short-term investments	6,585	5,272
Patient accounts receivable	1,205	1,244
Other receivables	940	848
Inventories	146	131
Other	211	186
Total current assets	10,256	8,186
Non-current investments	1,227	1,082
Property, plant and equipment, net	8,043	8,345
Other non-current assets	915	914
	\$ 20,441	\$ 18,527
Liabilities and net assets		
Current liabilities:		
Short-term borrowings	\$ 400	\$ —
Accounts payable	698	709
Accrued salaries and related benefits	841	668
Other accrued expenses	2,100	1,360
Current portion of long-term obligations	26	157
Total current liabilities	4,065	2,894
Non-current liabilities:		
Long-term obligations, less current portion	4,601	4,520
Other	2,353	1,773
Net assets:		
Without donor restrictions:		
Controlling	8,741	8,705
Noncontrolling	113	109
With donor restrictions	568	526
Total net assets	9,422	9,340
	\$ 20,441	\$ 18,527

See accompanying notes.

Sutter Health and Affiliates

Consolidated Statements of Operations and Changes in Net Assets

(Dollars in millions)

	Year ended December 31,	
	2020	2019
Net assets without donor restrictions:		
Operating revenues:		
Patient service revenues	\$ 10,532	\$ 11,407
Premium revenues	1,525	1,509
Contributions	821	29
Other	342	359
Total operating revenues	13,220	13,304
Operating expenses:		
Salaries and employee benefits	6,615	6,252
Purchased services	3,378	3,455
Supplies	1,602	1,613
Depreciation and amortization	747	738
Rentals and leases	183	182
Interest	158	157
Insurance	30	21
Other	828	1,434
Total operating expenses	13,541	13,852
Loss from operations	(321)	(548)
Investment income	205	246
Change in net unrealized gains and losses on investments	440	491
Loss on extinguishment of debt	(202)	–
Other components of net periodic postretirement cost	78	–
Income	200	189
Less income attributable to noncontrolling interests	(66)	(75)
Income attributable to Sutter Health	134	114

Sutter Health and Affiliates

Consolidated Statements of Operations and Changes in Net Assets (continued)

(Dollars in millions)

	Year ended December 31,	
	2020	2019
Net assets without donor restrictions (continued):		
Controlling:		
Income attributable to Sutter Health	\$ 134	\$ 114
Change in net unrealized gains and losses on investments classified as other-than-trading	1	5
Net assets released from restriction for equipment acquisition	13	13
Postretirement-related changes other than net periodic postretirement cost	(121)	50
Other	9	(7)
Increase in controlling	36	175
Noncontrolling:		
Income attributable to noncontrolling interests	66	75
Distributions	(58)	(75)
Other	(4)	(3)
Increase (decrease) in noncontrolling	4	(3)
Net assets with donor restrictions:		
Contributions	51	58
Investment income	13	14
Change in net unrealized gains and losses on investments	17	19
Net assets released from restriction	(35)	(34)
Other	(4)	-
Increase in net assets with donor restrictions	42	57
Increase in net assets	82	229
Net assets, beginning of year	9,340	9,111
Net assets, end of year	\$ 9,422	\$ 9,340

See accompanying notes.

Sutter Health and Affiliates
Consolidated Statements of Cash Flows

(Dollars in millions)

	Year ended December 31,	
	2020	2019
Operating activities		
Increase in net assets	\$ 82	\$ 229
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Loss on extinguishment of debt	202	–
Depreciation and amortization	728	725
Amortization of bond issuance costs, (premium) and discount, net	(39)	(41)
Net realized gains and losses and change in net unrealized gains and losses on investments	(618)	(693)
Restricted contributions and investment income	(64)	(72)
Distributions to noncontrolling interests	58	75
Change in net postretirement benefits	37	36
Net changes in operating assets and liabilities:		
Patient accounts receivable and other receivables	(53)	(23)
Inventories and other assets	(19)	(22)
Accounts payable and accrued expenses	902	380
Other non-current liabilities	540	28
Net cash provided by operating activities	1,756	622
Investing activities		
Purchases of property, plant and equipment	(431)	(662)
Proceeds from disposal of property, plant and equipment	3	10
Purchases of investments	(5,571)	(3,038)
Proceeds from sales of investments	4,731	3,360
Other	7	6
Net cash used in investing activities	(1,261)	(324)

Sutter Health and Affiliates

Consolidated Statements of Cash Flows (continued)

(Dollars in millions)

	Year ended December 31,	
	2020	2019
Financing activities		
Proceeds from borrowings on line of credit	\$ 400	\$ —
Payments of long-term obligations	(189)	(159)
Refund of bonds	(2,029)	—
Proceeds from issuance of long-term obligations	1,991	7
Bond issuance costs	(10)	—
Restricted contributions and investment income	64	72
Distributions to noncontrolling interest	(58)	(75)
Net cash provided by (used in) financing activities	169	(155)
Net increase in cash and cash equivalents	664	143
Cash and cash equivalents at beginning of year	505	362
Cash and cash equivalents at end of year	\$ 1,169	\$ 505

See accompanying notes.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements

December 31, 2020 and 2019

(Dollars in millions)

1. ORGANIZATION

Sutter Health is a California not-for-profit multi-provider integrated health care delivery system headquartered in Sacramento, California, which includes a centralized support group and various health care-related businesses operating primarily in Northern California. Sutter Health and its affiliates and subsidiaries provide health care, education, research and administrative services.

Sutter Health's integrated health care delivery system includes acute care, medical foundations, fundraising foundations and a variety of other specialized health care services. These entities are commonly referred to as the affiliates. Most acute care hospitals provide a full range of medical services (e.g., surgical, intensive care, emergency room, and obstetrics). All emergency rooms provide emergency care, regardless of a patient's ability to pay. Sutter Health and its affiliates also serve their communities with various programs, such as health education, health libraries, school-based clinics, home health care, hospice care, adult day care, prenatal clinics, community clinics, immunization services, and health professions education.

2. ACCOUNTING POLICIES

Basis of Consolidation: The Sutter Health and Affiliates consolidated financial statements include the accounts of Sutter Health and its controlled affiliates and subsidiaries (Sutter). All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates: The preparation of financial statements in conformity with United States (U.S.) Generally Accepted Accounting Principles (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 Equivalents: Cash equivalents include all highly liquid investments with original maturities of 90 days or less, including money market accounts with limited market risk, and investment-grade debt instruments, many of which are backed by the U.S. Government or other government agencies. Financial instruments that potentially subject Sutter to concentrations of credit risk include cash equivalents and investments. Cash equivalents are stated at fair market value.

Investments: Investments consist principally of U.S. and foreign equity, corporate and government securities, a hedge fund portfolio and private equity funds, all of which are carried at fair value or net asset value (NAV) as a practical expedient to estimate fair value.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Certain investments are held in trust, including assets held by trustees in accordance with the indentures relating to long-term obligations. In addition, certain investments are designated by the appropriate Sutter governing boards for future capital improvements.

Derivative Instruments: Sutter offsets fair value amounts recognized for certain derivative transactions from contracts executed with the same counterparty under a master netting arrangement. As a result, there is no net exposure to counterparties at December 31, 2020 and 2019.

Patient Accounts Receivable: Sutter's primary concentration of credit risk is patient accounts receivable, which consist of amounts owed from patients and third-party payers. Sutter manages the receivables by regularly reviewing its patient accounts and contracts.

Significant concentrations of gross patient accounts receivable are as follows:

	December 31,	
	2020	2019
Medicare	35%	33%
Medi-Cal	23%	24%

Inventories: Inventories, which consist principally of medical and other supplies, are stated on the basis of cost determined by the first-in, first-out method, which is not in excess of market.

Property, Plant and Equipment: Property, plant and equipment are stated on the basis of cost or, in the case of donated items, on the basis of fair market value at the date of donation, less depreciation and any impairment write-downs. Equipment includes medical equipment, furniture and fixtures, software, and internally-developed software. Routine maintenance and repairs are charged to expense as incurred. Expenditures that increase values, change capacities or extend useful lives are capitalized, as is interest on amounts borrowed to finance constructed assets during the construction phase. Sutter capitalized interest costs of \$5 and \$7 and accrued obligations for property, plant and equipment of \$47 and \$72 as of December 31, 2020 and 2019, respectively.

Depreciation is computed by the straight-line method over the estimated useful lives of the assets, which range from 2 to 40 years for buildings and improvements, and leasehold

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

improvements, and from 2 to 20 years for equipment. Amortization of equipment under finance leases is included in depreciation and amortization expense.

Asset Impairment: Sutter routinely evaluates the carrying value of its long-lived assets for impairment. The evaluations address the estimated recoverability of the assets' carrying value, which is principally determined based on a qualitative test using the projected net cash flows generated by the underlying tangible assets. When the carrying value of an asset exceeds estimated recoverability, asset impairment is recognized.

Other Assets: Goodwill represents the excess of purchase price over the fair value of net assets acquired. Goodwill and other intangible assets acquired in business combinations that have indefinite useful lives are subject to impairment tests. Sutter performs impairment tests at the reporting unit level annually or when events occur that require an evaluation to be performed. If the carrying value of goodwill is determined to be impaired, or if the carrying value of a business that is to be sold or otherwise disposed of exceeds its fair value, the carrying value is reduced, including any allocated goodwill, to fair value. Estimates of fair value are based on appraisals, established market prices for comparative assets or internal estimates of future net cash flows based on projected performance, depending on circumstances.

The changes in the carrying amount of goodwill, which are included in Other non-current assets, are as follows:

	Year ended December 31,	
	2020	2019
Goodwill at beginning of year	\$ 140	\$ 148
Impairment and/or disposition	(6)	(8)
Goodwill at end of year	<u>\$ 134</u>	<u>\$ 140</u>

Other Liabilities: Other non-current liabilities consist of (i) insurance liabilities, including estimated liabilities for professional liability and comprehensive general liability losses, and workers' compensation, (ii) the portion of estimated third-party settlements not expected to be settled within a year, (iii) other postretirement benefits liabilities, (iv) a portion of funds received from the Centers for Medicare and Medicaid Services (CMS) as part of the Accelerated and Advance Payment Program (AAPP), and (v) certain other liabilities.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Liquidity Management: As part of its liquidity management, Sutter's strategy is to structure its financial assets to be available to satisfy general operating expenses, current liabilities, and other obligations including AAPP liabilities of \$999 and Short-term borrowings of \$400 as they come due. Sutter invests cash in excess of daily requirements in short-term investments and has a committed syndicated line of credit, as discussed in Note 8, to help manage unanticipated liquidity needs.

Sutter's financial assets available for general operating expenses within one year are as follows:

	December 31,	
	2020	2019
Cash and cash equivalents	\$ 1,169	\$ 505
Short-term investments	6,585	5,272
Patient accounts receivable	1,205	1,244
Other receivables	940	848
	\$ 9,899	\$ 7,869

Risk Management: Sutter Health and most affiliates are insured by a wholly owned self-insured captive insurance company for professional liability claims and comprehensive general liability. Sutter is also self-insured for workers' compensation and employee health for most affiliates. Claim reserves are based on the best data available to Sutter; however, these estimates are subject to a significant degree of inherent variability. Estimates are continually monitored and reviewed, and as reserves are adjusted, the differences are reflected in current operations. Management is of the opinion that the associated liabilities recognized in the accompanying consolidated financial statements are adequate to cover such claims.

The provisions for estimated professional liability and comprehensive general liability claims, workers' compensation, and employee health include estimates of the ultimate costs for both uninsured reported claims and claims incurred-but-not-reported, in accordance with actuarial projections or paid claims lag models based on historical experience. Professional liabilities and comprehensive general liabilities were \$139 and \$128, discounted at a rate of 0.4% and 1.9%, as of December 31, 2020 and 2019, respectively. Workers' compensation liabilities were \$314 and \$276, discounted at a rate of 1.0% and 2.2%, as of December 31, 2020 and 2019, respectively. Employee health

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

liabilities were \$74 and \$56 as of December 31, 2020 and 2019, respectively, and were recorded on an undiscounted basis.

Sutter has entered into reinsurance, excess, and stop loss policy agreements with independent insurance companies to limit its losses on professional liability, comprehensive general liability, workers' compensation, and employee health claims.

In lieu of a workers' compensation security deposit requirement, Sutter paid assessment charges to participate in the California Self Insurers' Alternative Security Program, which provided coverage of \$278 and \$289 as of December 31, 2020 and 2019, respectively.

Contingencies: Estimated losses from contingencies are recorded when they are probable and reasonably estimable.

Net Assets: Net resources that are not restricted by donors are included in Net assets without donor restrictions. Gifts of long-lived operating assets, such as property, plant or equipment, are reported as Net assets without donor restrictions and excluded from income. Resources restricted by donors for a specified time or purpose are reported as Net assets with donor restrictions.

When the specific purposes are met, either through passage of a stipulated time period or when the purpose for restriction is accomplished, they are released to Other operating revenues in the Statements of Operations and Changes in Net Assets. Resources restricted by donors for additions to property, plant and equipment are initially reported as Net assets with donor restrictions and are transferred to Net assets without donor restrictions when expended. Donor-imposed restrictions, which stipulate that the resources be maintained permanently, are reported as Net assets with donor restrictions.

Investment income related to net assets with donor restrictions is classified as either Net assets without donor restrictions or Net assets with donor restrictions based on the intent of the donor.

Purchased Services: Purchased services expense is made up of a wide variety of contracted and other purchased services, including medical group compensation, other professional fees, repairs and maintenance, and capitated purchased services. Medical group compensation is accrued by Sutter according to professional services agreements between affiliated medical foundations and contracted medical groups. Capitated purchased

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

services includes paid claims, sub-capitation payments, stop-loss payments, and accruals for incurred-but-not-reported estimates based on historical experience and available data.

Research and Development: Sutter expenses research and development costs as incurred. Research and development expense, included in Operating expenses, was \$66 and \$60 for the years ended December 31, 2020 and 2019, respectively.

Income Taxes: Sutter Health, the legal entity, and many affiliates have been determined to be exempt organizations by the Internal Revenue Service and the California Franchise Tax Board and generally are not subject to taxes on income. Certain activities of Sutter are subject to income taxes; however, such activities are not significant to the consolidated financial statements. With respect to its taxable activities, Sutter records income taxes using the liability method, under which deferred tax assets and liabilities are determined based on the differences between the financial accounting and tax basis of assets and liabilities. Deferred tax assets or liabilities at the end of each period are determined using the currently enacted tax rate expected to apply to taxable income in the periods that the deferred tax asset or liability is expected to be realized or settled.

Sutter recognizes the tax benefit from uncertain tax positions, only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The statute of limitations for tax years 2017 through 2019 remains open in U.S. tax jurisdictions in which Sutter and its affiliates are subject to taxation. Sutter recognizes interest and penalties related to income tax matters in Operating expenses. There were no such uncertain tax positions recognized at December 31, 2020 and 2019.

Performance Indicator: “Income” and “Income attributable to Sutter Health”, as reflected in the Consolidated Statements of Operations and Changes in Net Assets, are performance indicators. The performance indicators include all changes in Net assets without donor restrictions, excluding Net assets released from restriction for equipment acquisition, Changes in net unrealized gains and losses on investments classified as other-than-trading, Postretirement-related changes other than net periodic postretirement cost, and Other changes.

Adoption of New Accounting Pronouncements: In August 2018, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer’s Accounting for*

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

2. ACCOUNTING POLICIES (continued)

Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. This ASU aligns the requirements for capitalizing implementation costs incurred in a cloud hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. Sutter is evaluating the impact of this guidance, which will be effective in 2021.

3. SIGNIFICANT EVENTS – COVID-19

COVID-19, a respiratory disease caused by a novel strain of coronavirus, has spread around the world, including in Northern California in which Sutter does business. Since the Centers for Disease Control and Prevention confirmed the spread of the disease to the United States in January 2020 and the World Health Organization declared COVID-19 a pandemic in March 2020, the federal government and the State of California have declared, and remain in, a state of emergency. The State of California was one of the first states in the United States with a confirmed case of COVID-19 on January 26, 2020, and California Governor Gavin Newsom was the first governor to issue a community shelter-in-place order on March 19, 2020.

The need for Sutter to adjust its entire integrated network to respond to COVID-19 has been, and continues to be, a costly and difficult endeavor. The impact of COVID-19 on future operations and financial results will depend upon many factors many of which could be beyond Sutter's ability to control. Such factors include, but are not limited to, the scope and duration of community shelter-in-place orders, which began in March 2020 and continued intermittently throughout 2020 and into 2021, business closures and other restrictions, the effects of restrictions on providing non-emergency healthcare services, declines in patient volumes for an indeterminable length of time, increases in the number of uninsured patients as a result of higher sustained rates of unemployment, incremental expenses required for supplies and personal protective equipment, and changes in liability exposures as a result of COVID-19. These financial statements include the impact of these factors on the information provided herein as of and for the year ended December 31, 2020. Because of these uncertainties, Sutter cannot estimate the length or severity of the impact of COVID-19 on Sutter's operations, which could continue to impact cash flows, revenues, reserves, and potential impairments of goodwill and long-lived assets.

From April 2020 through December 2020, Sutter received approximately \$812 in COVID-19 Relief Funds (Relief Funds) from the Department of Health & Human Services. These Relief Funds are not subject to repayment, provided Sutter is able to comply with the terms and conditions of the funding, including demonstrating that the Relief Funds

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

3. SIGNIFICANT EVENTS – COVID-19 (continued)

received have been used for healthcare-related expenses attributable to COVID-19 and the remainder applied to lost revenues, represented as a negative change from budgeted 2020 patient care revenue. Based on an analysis of the compliance and reporting requirements of the Relief Funds and the impact of the pandemic on Sutter's operating results, Sutter believes the applicable terms and conditions have been met to recognize most of the Relief Funds as of December 31, 2020. Therefore, Sutter reported Relief Funds of \$786 as Contributions and \$5 as Patient service revenues in the Consolidated Statements of Operations and Changes in Net Assets and reported \$21 as Other accrued expenses in the Consolidated Balance Sheets. Sutter will continue to monitor the terms and conditions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act and the impact of COVID-19 on revenues and expenses. If Sutter is unable to comply with future terms and conditions, the ability to retain some or all of the Relief Funds received may have an impact on the revenue recognized historically or in the future.

Additionally, Sutter received approximately \$999 from CMS as part of the AAPP, pursuant to which providers receive advance Medicare disbursements. These AAPP disbursements are reported in Other accrued expenses and Other non-current liabilities and are a loan that providers have to pay back as offsets from future services. Sutter expects the full amount of the \$999 received under the AAPP to be reconciled and repaid by the Summer of 2022.

The CARES Act also provides for a deferral of payments of the employer portion of payroll tax incurred during the pandemic, allowing half of such payroll taxes to be deferred until December 2021 and the remaining half deferred until December 2022. As of December 31, 2020, Sutter deferred \$209 of payroll taxes that are reported in Accrued salaries and related benefits and Other non-current liabilities in the Consolidated Balance Sheets. Additionally, the CARES Act created a payroll tax credit designed to encourage companies to retain employees during the pandemic. Sutter evaluated its eligibility for this credit and recorded \$13 of employee retention payroll tax credits pursuant to the CARES Act. These tax credits are reported as Other operating revenues in the Consolidated Statements of Operations and Changes in Net Assets.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

4. INVESTMENTS

Investments are held for the following uses:

	December 31,	
	2020	2019
Principal, interest and other reserves held in trust under bond indentures	\$ –	\$ 14
Board-designated Investments	281	306
	7,531	6,034
	7,812	6,354
Less short-term investments	(6,585)	(5,272)
Non-current investments	\$ 1,227	\$ 1,082

5. FAIR VALUE MEASUREMENTS

Sutter accounts for certain assets at fair value. A fair value hierarchy for valuation inputs has been established to prioritize the valuation inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels, which is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1: Quoted prices are available in active markets for identical assets as of the measurement date.

Level 2: Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets.

Level 3: Pricing inputs are generally unobservable for the assets and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets. The fair values are therefore determined using factors that involve judgment and interpretations, including, but not limited to, private and public comparables, third-party appraisals, discounted cash flow models, fund manager estimates and net asset valuations provided by the underlying private investment companies and/or their administrators. Sutter held no Level 3 financial instruments as of December 31, 2020 and 2019.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

5. FAIR VALUE MEASUREMENTS (continued)

The fair value of Sutter's assets measured on a recurring basis consists of the following:

	December 31, 2020		
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total
Liquid investments			
Cash equivalents	\$ 236	\$ —	\$ 236
Equity securities			
U.S. equity	1,438	—	1,438
Foreign equity	538	—	538
Fixed income securities			
U.S. government	687	—	687
U.S. government agencies	—	7	7
U.S. state and local government	—	49	49
U.S. federal agency mortgage-backed	—	321	321
Foreign government	—	233	233
U.S. corporate	69	1,104	1,173
Foreign corporate	8	227	235
	\$ 2,976	\$ 1,941	\$ 4,917
Investments measured at net asset value			2,895
			\$ 7,812

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

5. FAIR VALUE MEASUREMENTS (continued)

	December 31, 2019		
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total
Liquid investments			
Cash equivalents	\$ 199	\$ –	\$ 199
Equity securities			
U.S. equity	1,162	–	1,162
Foreign equity	513	–	513
Fixed income securities			
U.S. government	427	–	427
U.S. government agencies	–	1	1
U.S. state and local government	–	74	74
U.S. federal agency mortgage-backed	–	273	273
Foreign government	–	200	200
U.S. corporate	58	481	539
Foreign corporate	8	153	161
	\$ 2,367	\$ 1,182	\$ 3,549
Investments measured at net asset value			2,805
			\$ 6,354

As of December 31, 2020 and 2019, the Level 2 instruments listed in the fair value hierarchy tables above use the following valuation techniques and inputs:

U.S. government agencies securities: The fair value of investments in U.S. government agencies securities classified as Level 2 is primarily determined using consensus pricing methods of observable market-based data. Significant observable inputs include quotes, spreads, and data points for yield curves.

U.S. state and local government securities: The fair value of U.S. state and local government securities classified as Level 2 is determined using a market approach. The inputs include yield benchmark curves, prepayment speeds, and observable market data, such as institutional bids, dealer quotes, and two-sided markets.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

5. FAIR VALUE MEASUREMENTS (continued)

U.S. federal agency mortgage-backed securities: The fair value of U.S. federal agency mortgage-backed securities classified as Level 2 is primarily determined using matrices. These matrices utilize observable market data of bonds with similar features, prepayment speeds, credit ratings, and discounted cash flows. Additionally, observed market movements, tranche cash flows and benchmark yields are incorporated in the pricing models.

Foreign government and corporate securities: The fair value of investments in foreign government and corporate securities classified as Level 2 is primarily determined using consensus pricing methods of observable market-based data. Significant observable inputs include quotes, bid and ask yields, and issue-specific factors.

U.S. corporate securities: The fair value of investments in U.S. corporate securities classified as Level 2 is primarily determined using techniques that are consistent with the market approach. Significant observable inputs include reported trades, dealer quotes, security-specific characteristics, and multiple sources of spread data points in developing yield curves.

Investments measured at net asset value: Certain investments that are measured using the NAV per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The NAV amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the Consolidated Balance Sheets.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

5. FAIR VALUE MEASUREMENTS (continued)

Certain of the investments are reported using a calculated NAV per share (or its equivalent). These investments are not expected to be sold at amounts that are different from NAV. The following tables and explanations identify attributes relating to the nature and risk of such investments:

	December 31, 2020			
	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Commingled funds – U.S. equity securities	\$ 289	\$ –	Daily	1 day
Commingled funds – foreign equity securities	528	–	Monthly	5–30 days
Commingled funds – debt securities	134	–	Daily	3 days
Commodity-linked funds	131	–	Daily	None
Hedge funds	1,132	–	Monthly, Quarterly, Annually	10–120 days
Private equity funds	414	427	None	None
Private equity real estate funds	267	300	None	None
Total	\$ 2,895	\$ 727		

	December 31, 2019			
	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Commingled funds – U.S. equity securities	\$ 91	\$ –	Daily	1 day
Commingled funds – foreign equity securities	476	–	Monthly	5–30 days
Commingled funds – debt securities	315	–	Daily, Monthly	1–15 days
Commodity-linked funds	138	–	Daily	None
Hedge funds	1,251	–	Monthly, Quarterly, Annually	10–120 days
Private equity funds	313	290	None	None
Private equity real estate funds	221	242	None	None
Total	\$ 2,805	\$ 532		

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

5. FAIR VALUE MEASUREMENTS (continued)

Commingled funds – U.S. and foreign equity securities: This class includes investments in commingled funds that invest primarily in U.S. or foreign equity securities and attempt to match the returns of specific equity indices. As of December 31, 2020, approximately 35% of this class is redeemable daily with a 1-day notice period. The remaining 65% of this class is redeemable monthly with a notice period of 5 to 30 days.

Commingled funds – debt securities: This class includes investments in commingled funds that invest primarily in foreign debt, of which the majority are traded in over-the-counter markets. As of December 31, 2020, these funds are redeemable daily with a notice period of 3 days.

Commodity-linked funds: This class includes commodity-linked funds that pursue long-only fully collateralized commodity futures strategies to provide diversification and inflation protection. As of December 31, 2020, these funds are redeemable daily with no notice period.

Hedge funds: This class includes investments in hedge funds that expand the universe of potential investment approaches available by employing a variety of strategies and techniques within and across various asset classes. The primary objective for these funds is to balance returns, while limiting volatility by allocating capital to external portfolio managers selected for expertise in one or more investment strategies that may include, but are not limited to, equity long/short, event driven, relative value, and directional. The following summarizes the redemption criteria for the hedge fund portfolio as of December 31, 2020:

% of Hedge Funds	Redemption Criteria	Notice Period
53%	Redeemable monthly	10–90 days
14%	Redeemable quarterly	45–120 days
3%	Redeemable within one year, with quarterly gates from 25% to 100%	65 days
11%	Limited to a 25% gate, redeemable quarterly	60–90 days
1%	One-year lock-ups expiring through July 2021	75–90 days
12%	Two-year rolling lock-up expiring in December 2021 and quarterly gate limited to 10% annually	60–120 days
6%	Redeemable over five years after a rolling annual election with quarterly payments or limited to a 5% quarterly gate	120 days

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

5. FAIR VALUE MEASUREMENTS (continued)

Private equity funds: This class includes domestic and foreign private equity funds that specialize in providing capital to a variety of investment groups including, but not limited to venture capital, leveraged buyout, mezzanine debt, distressed debt, and other strategies, which may include land, water processing, and alternative energy. There is no provision for redemptions during the life of these funds.

Private equity real estate funds: This class includes domestic and foreign investments in real estate that are held in limited partnership funds, joint ventures, and other investments comprised of retail, office, industrial, and multi-family properties. There is no provision for redemptions during the life of these funds.

6. PROPERTY PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	December 31,	
	2020	2019
Land improvements	\$ 210	\$ 208
Leasehold improvements	667	556
Buildings and improvements	9,633	9,446
Equipment	4,410	4,129
	14,920	14,339
Less amortization and accumulated depreciation	(7,793)	(7,099)
	7,127	7,240
Land	571	583
Construction-in-progress	345	522
	\$ 8,043	\$ 8,345

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

7. OTHER NON-CURRENT ASSETS

Other non-current assets consist of the following:

	December 31,	
	2020	2019
Right-of-use assets for operating leases	\$ 470	\$ 501
Goodwill, net	134	140
Trust receivable	117	108
Reinsurance recoveries receivable	73	73
Cost report settlements	30	9
Non-current portion of pledges receivable	25	23
Other	66	60
	\$ 915	\$ 914

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

8. LONG-TERM OBLIGATIONS

Long-term obligations consist of the following:

	December 31,	
	2020	2019
Non-taxable revenue bonds under the Sutter Health Master Indenture of Trust, fixed interest at 4.0% to 5.0%, through 2048 (includes net unamortized premiums and discounts of \$164 and \$291 and debt issuance costs of (\$8) and (\$17) at December 31, 2020 and 2019, respectively)	\$ 1,752	\$ 3,673
Taxable revenue bonds under the Sutter Health Master Indenture of Trust, fixed interest at 1.32% to 4.09%, through 2050 (includes unamortized discount of (\$3) and (\$4) and debt issuance costs of (\$14) and (\$4) at December 31, 2020 and 2019, respectively)	2,660	779
Various collateralized and unsecured obligations	21	27
Obligations under finance leases	194	198
	4,627	4,677
Less current portion	(26)	(157)
	\$ 4,601	\$ 4,520

The central financing vehicle for Sutter is the Obligated Group. Those entities that comprise the Obligated Group are each nonprofit public benefit corporations organized and existing under the laws of the State of California. In October 2020, financial obligations under the Master Trust Indenture were amended and updated. Only the Obligated Group members are subject to the requirements and financial obligations under the Master Trust Indenture, dated as of October 1, 2020. Each Obligated Group member has granted to the Master Trustee a security interest in its gross receivables to secure the timely payment and performance of its obligations, agreements, and covenants under the Master Trust Indenture.

In October 2020, \$1,989 of Series 2020A Sutter Health taxable revenue bonds were issued by Sutter to advance refund \$1,723 of tax-exempt revenue bonds (collectively, the Refunded Prior Bonds). The proceeds of Series 2020A Sutter Health taxable revenue bonds, together with the release of certain funds related to the Refunded Prior Bonds, were

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

8. LONG-TERM OBLIGATIONS (continued)

placed in escrow funds pursuant to the related escrow agreements with the related bond trustee. The funds held in each escrow fund will be sufficient to pay the regularly scheduled interest payments when due, and 100% of the principal amount of the applicable Refunded Prior Bonds at the applicable redemption date. The Refunded Prior Bonds were legally defeased and derecognized at the date of refunding, with redemptions scheduled to occur through November 2026. These refunds resulted in a loss on extinguishment of debt of \$202.

Sutter redeemed \$30 of tax-exempt revenue bonds and \$100 of taxable revenue bonds in 2020 and \$100 of tax-exempt revenue bonds in 2019, which did not result in a gain or loss.

Sutter Health had a short-term credit facility with commercial banks to meet temporary capital requirements and to provide flexibility in meeting Sutter's capital needs of \$400. In March 2020, Sutter Health drew down \$400 and, in February 2021, paid down the outstanding amount and terminated the credit facility. In April 2020, Sutter Health entered into another \$100 credit facility, which it never drew upon, and in February 2021, Sutter Health terminated this credit facility. In February 2021, Sutter Health entered into a new short-term credit facility with commercial banks, which matures in February 2024. The aggregate amount available to Sutter Health under this credit facility is \$500. There are currently no draws outstanding under this credit facility.

Aggregate principal payments of long-term obligations, excluding finance leases, various collateralized and unsecured obligations, net unamortized premiums and discounts, and issuance costs, as of December 31, 2020, are as follows:

2021	\$	18
2022		17
2023		29
2024		31
2025		332
Thereafter		3,846
	\$	<u>4,273</u>

Sutter paid interest of \$213 and \$200 for the years ended December 31, 2020 and 2019, respectively.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

9. LEASES

Sutter leases property and equipment under operating and finance leases. The related assets and obligations are recorded at the present value of lease payments over the term of the agreements. Many of Sutter's leases include rental escalation clauses, renewal options and/or termination options that are factored into the determination of lease payments. Variable lease payments are non-lease services related to the lease and are excluded from the ROU assets and lease liabilities and are recognized in the period in which the obligation of those payments is incurred. Generally, Sutter does not include renewal options in the lease terms for calculating the lease liability, as Sutter maintains operational flexibility and is not reasonably certain the renewal options will be exercised. Most of Sutter's leases do not provide a readily determinable implicit rate in the contract, therefore, the incremental borrowing rate is estimated to discount the lease payments based on information available at lease commencement. Upon adoption of the new lease standard, discount rates for existing leases were established at January 1, 2019.

Sutter elected the package of practical expedients permitted under the transition guidance within the new standard which, among other things, allowed the historical lease classification not to be reassessed. Sutter made an accounting policy election not to apply the recognition requirements of the guidance to short-term leases with a term of 12 months or less for equipment and vehicle classes of assets. Sutter also made an accounting policy election not to separate non-lease components from lease components for all classes of assets. Sutter did not elect the hindsight practical expedient, which permits entities to use hindsight in determining the lease term and assessing impairment.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

9. LEASES (continued)

Lease-related assets and liabilities are recorded on the balance sheet as follows:

	<u>Consolidated Balance Sheets</u>	<u>December 31,</u>	
		<u>2020</u>	<u>2019</u>
Right-of-use Assets			
Operating	Other non-current assets	\$ 470	\$ 501
Finance	Property, plant and equipment, net	170	181
		<u>\$ 640</u>	<u>\$ 682</u>
Current Liabilities			
Operating	Other accrued expenses	\$ 107	\$ 99
Finance	Current portion of long-term obligations	3	2
Non-current Liabilities			
Operating	Other	416	458
Finance	Long-term obligations, less current portion	191	196
		<u>\$ 717</u>	<u>\$ 755</u>

Weighted-average operating leases remaining lease term	8.73 years
Weighted-average finance leases remaining lease term	26.86 years
Weighted-average operating lease discount rate	3.66%
Weighted-average finance lease discount rate	4.47%

The components of lease costs are as follows:

	<u>Year ended December 31,</u>	
	<u>2020</u>	<u>2019</u>
Lease Costs		
Operating lease cost	\$ 125	\$ 126
Variable lease cost	\$ 25	\$ 25
Finance lease cost		
Amortization of leased assets	\$ 7	\$ 4
Interest on lease liabilities	\$ 9	\$ 9

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

9. LEASES (continued)

Supplemental cash flow information related to leases is as follows:

	Year ended December 31,	
	2020	2019
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash outflows for operating leases	\$ 128	\$ 131
Operating cash outflows for finance leases	\$ 9	\$ 9
Financing cash outflows for finance leases	\$ 1	\$ 1
Right-of-use assets obtained in exchange for lease obligations:		
Operating leases	\$ 67	\$ 84
Finance leases	\$ 2	\$ 4

Future lease payments as of December 31, 2020, for operating and finance leases are as follows:

	Operating Leases	Finance Leases
2021	\$ 123	\$ 11
2022	112	11
2023	88	11
2024	69	10
2025	45	10
Thereafter	186	304
	623	357
Less imputed interest	(100)	(163)
	<u>\$ 523</u>	<u>\$ 194</u>

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

10. NET ASSETS AND CONTRIBUTIONS

Sutter receives donations from generous individuals and organizations that support certain programs and services. Donations included in Net assets with donor restrictions were maintained for the following purposes:

	December 31,	
	2020	2019
Subject to expenditure for specified purpose:		
Capital projects and medical equipment	\$ 36	\$ 47
Research and education	109	104
Operations and/or capital projects	253	210
	398	361
Subject to passage of time	25	24
Subject to donor restrictions in conjunction with Sutter's spending policy:		
Investment in perpetuity – endowment	145	141
	\$ 568	\$ 526

From time to time, a Sutter board will designate certain unrestricted funds to be used in the future for specific projects. Board-designated funds included in Net assets without donor restrictions were maintained for the following purposes:

	December 31,	
	2020	2019
Capital projects and medical equipment	\$ 113	\$ 97
Research and education	24	14
Operations and/or capital projects	144	195
	\$ 281	\$ 306

Sutter reports individuals' and organizations' unconditional promises to give cash or other assets at fair value at the date Sutter receives the promises. Sutter reports conditional promises to give and conditional indications of intentions to give at fair value when the conditions are met. Therefore, Sutter does not recognize any revenue or receivable at the time a conditional promise or indication of intent is received. Sutter's conditional promises or indications of intent received were \$201 and \$187 for the years ended

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

10. NET ASSETS AND CONTRIBUTIONS (continued)

December 31, 2020 and 2019, respectively. These gifts will support clinical programs and technology.

Endowments: Sutter follows the Uniform Prudent Management of Institutional Funds Act (UPMIFA). UPMIFA eliminates the concept of “historic dollar value” and allows an institution to spend or accumulate as the board determines is prudent for the uses, benefits, purposes, and duration of the endowment fund, unless the gift instrument states a particular spending rate or formula. California’s version of UPMIFA also includes a rebuttable provision that spending greater than 7% of the average fair market value, calculated at least quarterly over a minimal period of three years, is presumed to be imprudent.

In accordance with UPMIFA, Sutter considers the following factors when appropriating or accumulating an endowment fund: (i) general economic conditions, (ii) effects of inflation and deflation, (iii) the purposes of the institution and the endowment fund, (iv) expected total return from income and appreciation of investments, (v) Sutter’s other resources, (vi) the duration and preservation of the endowment fund, and (vii) Sutter’s investment policies.

If the fair market value of assets associated with individual endowment funds falls below the corpus, Sutter management assesses facts and circumstances to determine whether to suspend appropriation activities until the corpus has recovered or to continue to withdraw funds in compliance with UPMIFA in order to fund critical initiatives. There were no deficiencies of this nature reported in Net assets with donor restriction as a result of unfavorable investment market fluctuations as of December 31, 2020 and 2019.

Following UPMIFA, Sutter’s investment and spending policies for endowment assets attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under these policies, endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results, while assuming a moderate level of investment risk.

To satisfy its long-term rate-of-return objectives, Sutter relies on a balanced investment strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Sutter targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

10. NET ASSETS AND CONTRIBUTIONS (continued)

The endowment net assets composition by type of fund consists of the following:

	December 31, 2020		
	Net Assets without Donor Restrictions	Net Assets with Donor Restrictions	Total
Donor-restricted endowment funds	\$ –	\$ 222	\$ 222
Board-designated funds	138	–	138
Total funds	<u>\$ 138</u>	<u>\$ 222</u>	<u>\$ 360</u>

	December 31, 2019		
	Net Assets without Donor Restrictions	Net Assets with Donor Restrictions	Total
Donor-restricted endowment funds	\$ –	\$ 206	\$ 206
Board-designated funds	114	–	114
Total funds	<u>\$ 114</u>	<u>\$ 206</u>	<u>\$ 320</u>

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

10. NET ASSETS AND CONTRIBUTIONS (continued)

The changes in endowment net assets are as follows:

	Net Assets without Donor Restrictions	Net Assets with Donor Restrictions	Total
Balance at December 31, 2018	\$ 102	\$ 193	\$ 295
Investment return, net	14	25	39
Contributions	–	1	1
Appropriation of endowment assets for expenditure	(3)	(4)	(7)
Other	1	(9)	(8)
Balance at December 31, 2019	114	206	320
Investment return, net	29	27	56
Contributions	–	4	4
Appropriation of endowment assets for expenditure	(4)	(6)	(10)
Other	(1)	(9)	(10)
Balance at December 31, 2020	\$ 138	\$ 222	\$ 360

11. OPERATING REVENUES

Sutter records revenue in four financial statement categories: Patient service revenues, Premium revenues, Contributions, and Other. Performance obligations are identified based on the nature of the services provided.

Sutter elected the practical expedient and does not adjust the promised amount of consideration for the effects of a significant financing component, due to Sutter's expectation that the period between the time the service is provided and the receipt of payment will be one year or less. However, Sutter does, in certain instances, enter into payment agreements that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract. Additionally, Sutter elected to apply the optional exemption, because all of its performance obligations relate to contracts with a duration of less than one year. Therefore, Sutter is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially satisfied at the end of the reporting period.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

11. OPERATING REVENUES (continued)

Patient service revenues: Sutter's Patient service revenues are reported at the amount that reflects the consideration to which Sutter expects to be paid for providing patient care. These amounts are due from patients and third-party payers, including health insurers and government programs. Patients who meet Sutter's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue. Generally, Sutter bills patients and third-party payers after services are performed.

Patient service revenues are recognized as performance obligations are satisfied. Inpatient services are performance obligations satisfied over time and revenue is recognized based on actual charges incurred in relation to total expected or actual charges. Unsatisfied or partially unsatisfied performance obligations relate to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period. Outpatient services are performance obligations satisfied at a point in time and revenue is recognized when goods or services are provided, and Sutter does not believe it is required to provide additional goods or services.

Sutter uses a portfolio approach to account for categories of patient contracts as a collective group, rather than recognizing revenue on an individual contract basis. The portfolios consist of major payer classes for inpatient and outpatient revenue. Based on historical collection trends, Sutter believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach was used.

The health care industry is subject to voluminous and complex laws and regulations of federal, state and local governments. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement laws and regulations, anti-kickback and anti-referral laws and false claims prohibitions and, in the case of tax-exempt hospitals, the requirements of tax exemption. Sutter operates an Ethics and Compliance Program, which reviews compliance with government health care program requirements and investigates allegations of non-compliance received from internal and external sources. From time to time, findings may result in repayment of monies previously received from government and other third-party payers and/or disclosure of such overpayments including, but not limited to, disclosure to CMS and its contracted agents, or the Office of Inspector

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

11. OPERATING REVENUES (continued)

General, Department of Health and Human Services. As a result, there is at least a reasonable possibility that the recorded estimates may change by a material amount in the near term.

The majority of Sutter's services are provided to patients with third-party coverage and Sutter has agreements with third-party payers that provide for payments to Sutter at contractually adjusted amounts. Patient service revenues are estimated based on the terms of the contractual agreement with the payer, Sutter's historical settlement activity and other information. Settlements with third-party payers for retroactive adjustments due to audits, reviews or investigations are considered variable consideration, and are included in the determination of Patient service revenues when information becomes available. Additional revenues arising from a change in the estimate of transaction price concessions for performance obligations satisfied in prior years were \$58 and \$75 for the years ended December 31, 2020 and 2019, respectively.

Payment arrangements are as follows:

Medicare: Inpatient acute care services and outpatient services provided to Medicare program beneficiaries are paid at prospectively determined rates per diagnosis. Sutter is paid for cost-reimbursable items at a tentative rate. Physician services are paid based upon established fee schedules. Outpatient services are paid using prospectively determined rates. Amounts received from the Medicare programs are subject to audit and final settlement by a Medicare Administrative Contractor after submission of annual cost reports. Sutter's Medicare cost reports have been audited generally through December 31, 2016. The estimated net settlement balances and adjustments from the finalization of prior-year cost reports were immaterial in 2020 and 2019.

Medi-Cal: Inpatient and outpatient services provided to Medi-Cal program beneficiaries are paid either under contracted rates or cost-reimbursable items at a tentative rate. Services are generally paid at prospectively determined rates per discharge, per occasion of service, or per covered member. Amounts received from Medi-Cal programs are subject to audit and final settlement by the California Department of Health Care Services after submission of annual cost reports. Sutter's Medi-Cal cost reports have been audited generally through December 31, 2016. The estimated net settlement balances and adjustments from the finalization of prior-year cost reports were immaterial in 2020 and 2019.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

11. OPERATING REVENUES (continued)

Commercial: Inpatient and outpatient services provided to patients covered under commercial insurance policies are paid using a variety of payment methodologies based on contractual agreements. The transaction price for commercial payers is reduced by explicit contractual adjustments and implicit price concessions based on collection history with this portfolio of patients.

Other: Inpatient and outpatient services provided to patients, not covered by third-party payers, are paid based on Sutter's policies and the patient's ability to pay. Sutter reduces the transaction price by implicit price concessions to uninsured patients and patients with uninsured balances, such as copays and deductibles. The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts Sutter expects to collect based on its collection history with this portfolio of patients. Subsequent changes to the estimates are considered variable consideration and are included in Patient service revenues when information becomes available.

As part of its Patient service revenues analysis, Sutter examines the fluctuations in payer, geographical area, and entity type as each factor represents a varying degree of uncertainty regarding the nature, timing, and extent of payments.

The composition of Patient service revenues by payer is as follows:

	Year ended December 31,	
	2020	2019
Medicare	\$ 2,891	\$ 2,964
Medi-Cal	1,519	1,621
Commercial	5,937	6,603
Other	185	219
	<u>\$ 10,532</u>	<u>\$ 11,407</u>

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

11. OPERATING REVENUES (continued)

The composition of Patient service revenues, based on Sutter's areas of operations and entity types, is as follows:

	Year ended December 31, 2020			
	Sutter Health Bay Area	Sutter Health Valley Area	Other	Total
Acute Care	\$ 3,742	\$ 3,119	\$ 109	\$ 6,970
Medical Foundation	2,071	1,061	–	3,132
Other	103	22	630	755
Eliminations	(103)	(104)	(118)	(325)
	\$ 5,813	\$ 4,098	\$ 621	\$ 10,532

	Year ended December 31, 2019			
	Sutter Health Bay Area	Sutter Health Valley Area	Other	Total
Acute Care	\$ 4,093	\$ 3,182	\$ 118	\$ 7,393
Medical Foundation	2,447	1,145	–	3,592
Other	121	29	590	740
Eliminations	(108)	(95)	(115)	(318)
	\$ 6,553	\$ 4,261	\$ 593	\$ 11,407

The State of California enacted legislation for a hospital fee program to fund certain Medi-Cal coverage expansions. The program charges certain hospitals a quality assurance fee that is used to obtain federal matching funds for Medi-Cal, with the proceeds redistributed as supplemental payments to California hospitals that treat Medi-Cal patients. There are two hospital fee programs that had activity in 2020 and 2019: a 30-month hospital fee program covering the period from January 1, 2017 through June 30, 2019, and a 30-month hospital fee program covering the period from July 1, 2019 through December 31, 2021. Supplemental payments met all criteria related to revenue recognition, and the quality assurance fees are both probable and estimable. Accordingly, all related supplemental payments have been recognized as revenue and related quality assurance fees recognized as expense in 2020 and 2019.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

11. OPERATING REVENUES (continued)

Patient service revenues and Other expenses include amounts for the hospital fee program as follows:

	Year ended December 31,	
	2020	2019
Hospital fee program revenue	\$ 483	\$ 579
Hospital fee program expense	(321)	(322)
Income from operations from hospital fee program	\$ 162	\$ 257
	December 31,	
	2020	2019
Other receivables	\$ 649	\$ 616
Accounts payable	\$ 256	\$ 258

Premium revenues: Sutter has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, preferred provider organizations, and members of individual and family plans and subscribing employers for small and large cap coverage. The basis for payment to Sutter, under these agreements, includes capitated arrangements, prospectively determined rates per diagnosis, prospectively determined daily rates, rates by demographics and rates by a number of factors, including experience. The transaction price may be reduced by discounts, reinsurance premiums, and implicit price concessions based on collection history. Other adjustments may include prior year settlements, stop loss recoveries, ceded premiums and risk adjustment factors. Performance obligations are satisfied over the passage of time by standing ready to provide services.

Settlements with third-party payers for retroactive adjustments are considered variable consideration and are included in the determination of Premium revenues when information becomes available. Adjustments from the finalization of prior-year settlements and adjustments arising from a change in the transaction price were immaterial as of December 31, 2020 and 2019.

As part of its Premium revenues analysis, Sutter examines the fluctuations in geographical area and entity type, as each factor represents a varying degree of uncertainty regarding the nature, timing and extent of payments. Sutter's premium revenue is reported at an amount that reflects the consideration to which Sutter expects to be paid.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

11. OPERATING REVENUES (continued)

The composition of Premium revenues, based on Sutter's areas of operations and lines of business, is as follows:

	Year ended December 31, 2020			
	Sutter Health Bay Area	Sutter Health Valley Area	Other	Total
Acute Care	\$ 196	\$ 420	\$ –	\$ 616
Medical Foundation	326	383	–	709
Insurance	–	–	573	573
Other	1	45	107	153
Eliminations	(1)	(5)	(520)	(526)
	\$ 522	\$ 843	\$ 160	\$ 1,525

	Year ended December 31, 2019			
	Sutter Health Bay Area	Sutter Health Valley Area	Other	Total
Acute Care	\$ 210	\$ 390	\$ 1	\$ 601
Medical Foundation	322	366	–	688
Insurance	–	–	517	517
Other	–	37	81	118
Eliminations	–	(6)	(409)	(415)
	\$ 532	\$ 787	\$ 190	\$ 1,509

Contributions: Sutter receives contributions and grants from donors and government agencies. In 2020, Sutter reported \$786 as contributions from Relief Funds from the Department of Health & Human Services (see Note 3).

Other revenues: Sutter has additional revenue streams from tuition, health professionals, rental properties and parking. Revenue is recognized when obligations under the terms of the contract are satisfied. Revenues from these services are measured as the amount of consideration Sutter expects to receive for those services.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

12. COMMUNITY BENEFIT EXPENSE

Services for the poor and underserved include traditional charity care, unpaid costs of public programs treating Medi-Cal, county, and indigent beneficiaries, other services for the poor and underserved, and cash donations towards programs and services for the underserved. Charity care covers health care services provided to persons who meet certain criteria and cannot afford to pay. Sutter provided charity care services to patients at an estimated cost of \$109 and \$125 for 2020 and 2019, respectively. Sutter received funding of \$5 from Health Resources and Services Administration for services provided to uninsured patients at an estimated cost of \$10 for 2020 and these costs are not reflected in the charity care estimated costs. Estimated costs are based on a ratio of costs to charges.

Benefits for the broader community include costs of providing the following services: health screenings and other health-related services, training health professionals, educating the community with various seminars and classes, the cost of performing medical research, and the costs associated with providing free clinics and community services. Benefits for the broader community also include contributions Sutter makes to community agencies to fund charitable activities.

The following is a summary of Sutter's estimated costs of providing services to the poor and broader community for the year ended December 31, 2020 (unaudited):

Services for the poor and underserved	
Traditional charity care	\$ 109
Unpaid costs of public programs:	
Medi-Cal	698
Other public programs	62
Other benefits for the poor and underserved	57
Total services for the poor and underserved	<u>926</u>
 Benefits for the broader community	
Nonbilled services	33
Education and research	57
Cash and in-kind donations	11
Other community benefits	2
Total benefits for the broader community	<u>103</u>
	<u>\$ 1,029</u>

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

13. POSTRETIREMENT BENEFITS

Sutter sponsors and participates in various employee benefit plans, including a noncontributory defined benefit plan (the “Retirement Plan”), a noncontributory defined contribution plan, and several contributory defined contribution plans. In addition, certain affiliates participate in multiemployer defined benefit retirement plans. Sutter’s total net postretirement benefits were \$361 and \$380 in 2020 and 2019, respectively.

Sutter’s measurement date for plan assets, pension obligations and net periodic pension cost associated with the Retirement Plan is December 31. The changes in benefit obligations and plan assets for the Retirement Plan are as follows:

	Year ended December 31,	
	2020	2019
Projected benefit obligation at beginning of year	\$ 5,376	\$ 4,582
Service cost	309	267
Interest cost	194	205
Actuarial loss	713	499
Benefits paid	(224)	(177)
Other change in benefit obligation	(22)	—
Projected benefit obligation at measurement date	\$ 6,346	\$ 5,376
Fair value of plan assets at beginning of year	\$ 4,737	\$ 3,983
Actual gain on plan assets	842	741
Employer contributions	325	190
Benefits paid	(224)	(177)
Fair value of plan assets at measurement date	\$ 5,680	\$ 4,737
Net accrued benefit cost at end of year	\$ (666)	\$ (639)

The accumulated benefit obligation for the Retirement Plan was \$5,317 and \$4,569 as of December 31, 2020 and 2019, respectively.

The actuarial loss of \$713 for the year ended December 31, 2020, was primarily due to the decrease in discount rate of 2.8% in 2020 from 3.5% in 2019, updated mortality projection scale and changes in census data that differed from expectations. This was offset by actual termination and retirements, terminated vested lump sum window and the decrease in inflation rate of 1.9% in 2020 from 2.0% in 2019. The actuarial loss of \$499 for the year

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

13. POSTRETIREMENT BENEFITS (continued)

ended December 31, 2019, was primarily due to the decrease in discount rate of 3.5% in 2019 from 4.3% in 2018, change in the rate of compensation increases of 4.3% in 2019 from 4.0% in 2018 and changes in census data that differed from expectations. This was offset by the cash balance interest crediting rate decrease of 2.5% in 2019 from 3.4% in 2018 and updated mortality tables and projection scale.

Included in Controlling net assets without donor restrictions as of December 31, 2020, and 2019, are the following amounts that have not yet been recognized in net periodic benefit cost: unrecognized prior service credits of \$22 and \$0, respectively, and unrecognized actuarial losses of \$1,365 and \$1,223, respectively.

The benefits expected to be paid from the Retirement Plan in each of the next five years, and in the aggregate for the next five years, are as follows:

2021	\$	203
2022		220
2023		236
2024		252
2025		268
2026–2030		1,567
	\$	<u>2,746</u>

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

13. POSTRETIREMENT BENEFITS (continued)

The actuarial assumptions used by the Retirement Plan are as follows:

	December 31,	
	2020	2019
Weighted-average discount rates for calculating pension expense	3.5%	4.3%
Weighted-average discount rates for calculating projected benefit obligation	2.8%	3.5%
Weighted-average rates of compensation increase for calculating pension expense	4.3%	4.0%
Weighted-average rates of compensation increase for calculating projected benefit obligation	4.3%	4.3%
Weighted-average interest crediting rates for calculating projected benefit expense	2.5%	3.4%
Weighted-average interest crediting rates for calculating pension obligation	2.5%	2.5%
Expected long-term rates of return on plan assets for calculating pension expense	7.1%	7.0%

As of December 31, 2020 and 2019, the healthy mortality assumption reflected the Pri-2012 table. As of December 31, 2020, the mortality projection scale was updated to the MP-2020 without adjustment. In contrast, as of December 31, 2019, the mortality projection scale was updated to the MP-2019, with adjustments to the long-term rate of improvement at 0.75%, gradually declining to 0.00% from age 85 to 115 and a 10-year convergence period for age and 20-year for cohort from 2015.

The components of the Retirement Plan's net periodic benefit cost are as follows:

	Year ended December 31,	
	2020	2019
Service cost	\$ 309	\$ 267
Interest cost	194	205
Expected return on plan assets	(330)	(273)
Amortization of actuarial loss	60	70
	\$ 233	\$ 269

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

13. POSTRETIREMENT BENEFITS (continued)

In addition to the Retirement Plan, Sutter also has noncontributory postretirement health benefit plans (the “Health Plans”). Sutter’s measurement date for plan assets, retiree medical obligations and net periodic retiree medical cost associated with the Health Plans is December 31. The changes in benefit obligations for the Health Plans are as follows:

	Year ended December 31,	
	2020	2019
Projected benefit obligation at beginning of year	\$ 291	\$ 265
Service cost	14	12
Interest cost	10	11
Actuarial loss	25	16
Benefits paid	(14)	(13)
Other change in benefit obligation	7	–
Projected benefit obligation at measurement date	\$ 333	\$ 291
Fair value of plan assets at beginning of year	\$ 242	\$ 212
Actual gain on plan assets	43	40
Employer contributions	3	3
Benefits paid	(14)	(13)
Fair value of plan assets at measurement date	\$ 274	\$ 242
Net accrued benefit cost at end of year	\$ (59)	\$ (49)

The actuarial loss of \$25 for the year ended December 31, 2020, was primarily due to discount rate decreases in ranges of 2.5% to 2.7% in 2020 from ranges of 3.3% to 3.4% in 2019, and changes in census data that differed from expectations. This was offset primarily by actual termination and retirements. The actuarial loss of \$16 for the year ended December 31, 2019, was primarily due to discount rate decreases in ranges of 3.3% to 3.4% in 2019 from ranges of 4.2% to 4.3% in 2018, offset by removal of the Affordable Care Act excise tax from the valuation.

Included in Controlling net assets without donor restrictions as of December 31, 2020, and 2019, are the following amounts that have not yet been recognized in net periodic benefit cost: unrecognized prior service costs of \$7 and \$5, respectively, and unrecognized actuarial gain of \$1 and \$0, respectively.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

13. POSTRETIREMENT BENEFITS (continued)

The benefits expected to be paid from the Health Plans in each of the next five years, and in the aggregate for the next five years, are as follows:

2021	\$	18
2022		21
2023		22
2024		23
2025		24
2026–2030		127
	<u>\$</u>	<u>235</u>

The actuarial assumptions used by the Health Plans are as follows:

	December 31,	
	2020	2019
Weighted-average discount rates for calculating retiree medical expense	3.3%–3.4%	4.2%–4.3%
Weighted-average discount rates for calculating projected benefit obligation	2.5%–2.7%	3.3%–3.4%
Expected long-term rates of return on plan assets for calculating retiree medical expense	7.1%	7.0%

The components of the Health Plans' net periodic benefit cost are as follows:

	Year ended December 31,	
	2020	2019
Service cost	\$ 14	\$ 12
Interest cost	10	11
Expected return on plan assets	(17)	(14)
Amortization of prior service cost	1	1
Other adjustments to net benefit cost	4	–
	<u>\$ 12</u>	<u>\$ 10</u>

Sutter's projected medical cost trend rate related to the Health Plans for 2021 is 6.0%. The assumed medical cost trend rate is expected to gradually decrease in subsequent years to 4.8% in 2027 and thereafter.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

13. POSTRETIREMENT BENEFITS (continued)

The Retirement Benefits Investment Committee oversees the investments and investment policy of the plans. Management of the assets is governed by the application of modern portfolio theory, resulting in asset class diversification and mean-variance optimization. Sutter's investment strategy is to balance the liquidity needs of the plans with the long-term return goals necessary to satisfy future obligations.

The target asset allocation seeks to reduce volatility while capturing the equity premium from the capital markets over the long term and maintaining security of principal to meet near-term expenses and obligations. The target asset allocation at December 31, 2020, by major asset category, is as follows:

Major Asset Category	Target Allocation
Equity securities	47%
Fixed income securities	12%
Other investments – alternative	31%
Real estate investments	10%
Total	100%

Equity securities are comprised of U.S. and foreign equity securities, common and collective trusts, and commingled funds. The equity securities' target asset allocation of 47% is further comprised of 19% domestic large capitalization, 5% domestic small capitalization and 23% international/global.

The portfolio long-term return assumption of 7.1% and 7.0% for 2020 and 2019, respectively, was based on the weighted-average return of comparative market indices for the major asset classes represented in the portfolio, net of administrative expenses.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

13. POSTRETIREMENT BENEFITS (continued)

A fair value hierarchy has been established, with three levels that prioritize the valuation inputs into each level (see Note 5). The fair value and NAV of the Retirement Plan's and the Health Plans' assets measured on a recurring basis consist of the following:

	December 31, 2020			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Net Asset Value (NAV)	Total
Liquid investments:				
Cash equivalents	\$ 48	\$ —	\$ 224	\$ 272
Equity securities:				
U.S. equity	1,160	—	—	1,160
Foreign equity	593	—	—	593
Common collective trusts	—	—	652	652
Commingled funds	—	—	725	725
Fixed income securities:				
U.S. government and agencies	193	5	—	198
U.S. federal agency mortgage-backed	—	179	—	179
Foreign government	—	162	—	162
U.S. corporate	—	244	—	244
Foreign corporate	—	83	—	83
Common collective trusts and commingled funds	—	—	40	40
Other investments:				
Private equity funds	—	—	492	492
Private equity real estate funds	—	—	420	420
Commodity-linked funds	—	—	99	99
Commingled funds	—	—	11	11
Hedge funds	—	—	614	614
Accrued income	10	—	—	10
Total Retirement Plan and Health Plan assets	\$ 2,004	\$ 673	\$ 3,277	\$ 5,954

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

13. POSTRETIREMENT BENEFITS (continued)

	December 31, 2019			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Net Asset Value (NAV)	Total
Liquid investments:				
Cash equivalents	\$ 30	\$ –	\$ 94	\$ 124
Equity securities:				
U.S. equity	1,036	–	–	1,036
Foreign equity	549	–	–	549
Common collective trusts	–	–	448	448
Commingled funds	–	–	528	528
Fixed income securities:				
U.S. government and agencies	154	5	–	159
U.S. federal agency mortgage-backed	–	142	–	142
Foreign government	–	119	–	119
U.S. corporate	–	128	–	128
Foreign corporate	–	56	–	56
Common collective trusts and commingled funds	–	–	120	120
Other investments:				
Private equity funds	–	–	365	365
Private equity real estate funds	–	–	355	355
Commodity-linked funds	–	–	104	104
Commingled funds	–	–	12	12
Hedge funds	–	–	709	709
Accrued income	7	–	–	7
	\$ 1,776	\$ 450	\$ 2,735	\$ 4,961
Other receivables				18
Total Retirement Plan and Health Plan assets				\$ 4,979

Other receivables are comprised of the second installment of private equity real estate funds sold effective December 31, 2019, received in 2020.

Certain affiliates participate in multiemployer defined benefit retirement plans. The risks of participating in multiemployer plans are different from single-employer plans in the following aspects: (i) assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers; (ii) if a participating employer stops contributing to the plan, the unfunded obligations of the plan

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

13. POSTRETIREMENT BENEFITS (continued)

may be borne by the remaining participating employers; and (iii) if the affiliates choose to stop participating in the multiemployer plan, the affiliates may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability. Sutter's contributions to such plans were \$26 and \$18 in 2020 and 2019, respectively.

Sutter also maintains various defined contribution plans for eligible employees. Sutter's contributions to such plans were \$90 and \$83 in 2020 and 2019, respectively.

14. FUNCTIONAL CLASSIFICATION OF EXPENSES

Sutter groups like expenses into financial statement lines and classifies programmatic expenses by business line. Expenses that are attributable to one or more programs or supporting functions are allocated based on operating expenses, square footage, and other criteria.

The following is a functional classification of Sutter's expenses:

	Year ended December 31, 2020						
	Program				General and Administrative	Total	
	Acute Care	Medical Foundation	Other	Eliminations			
Salaries and employee benefits	\$ 3,898	\$ 1,245	\$ 941	\$ (285)	\$ 816	\$ 6,615	
Purchased services	1,995	2,450	588	(1,845)	190	3,378	
Supplies	1,096	342	177	(20)	7	1,602	
Depreciation and amortization	554	146	130	(94)	11	747	
Rentals and leases	51	99	52	(37)	18	183	
Interest	126	28	1	-	3	158	
Insurance	58	9	19	(62)	6	30	
Other	452	52	726	(473)	71	828	
Total operating expenses	<u>\$ 8,230</u>	<u>\$ 4,371</u>	<u>\$ 2,634</u>	<u>\$ (2,816)</u>	<u>\$ 1,122</u>	<u>\$ 13,541</u>	

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

14. FUNCTIONAL CLASSIFICATION OF EXPENSES (continued)

	Year ended December 31, 2019						
	Program				General and Administrative		Total
	Medical						
	Acute Care	Foundation	Other	Eliminations			
Salaries and employee benefits	\$ 3,696	\$ 1,157	\$ 884	\$ (281)	\$ 796	\$ 6,252	
Purchased services	1,946	2,478	571	(1,821)	281	3,455	
Supplies	1,092	369	168	(23)	7	1,613	
Depreciation and amortization	546	146	135	(100)	11	738	
Rentals and leases	52	101	50	(37)	16	182	
Interest	139	32	–	(14)	–	157	
Insurance	40	6	11	(42)	6	21	
Other	460	57	1,249	(455)	123	1,434	
Total operating expenses	\$ 7,971	\$ 4,346	\$ 3,068	\$ (2,773)	\$ 1,240	\$ 13,852	

15. CONTINGENCIES AND COMMITMENTS

Contingencies: From time to time, Sutter receives, and responds to, investigations and requests concerning possible violations of reimbursement, false claims, anti-kickback and anti-referral statutes and regulations by healthcare providers from federal and state regulatory agencies, including, but not limited to, CMS, the U.S. Department of Justice (DOJ), the California Attorney General, and the California Department of Public Health. Sutter is also involved in litigation such as medical malpractice and contractual disputes, as both plaintiff and defendant, and other routine labor matters, proposed class-action complaints, tax examinations, security events resulting in potential privacy incidents, internal compliance activities (including those discussed in Note 11) and regulatory investigations and examinations arising in the ordinary course of business. Based on Sutter's assessment of the matters, the uncertainty of litigation, and the preliminary stages of many of the matters, Sutter cannot estimate the reasonable possible loss or range of loss that may result from these matters, except as stated in this note. However, there can be no assurance that the resolution of any of these matters will not have a material adverse effect on Sutter's consolidated financial position or results of operations. The COVID-19 pandemic has generally delayed the outcome of many of these matters. Following is a discussion of matters of note.

A plaintiff filed a civil class action lawsuit against Sutter Health and certain affiliates, alleging violations of Federal antitrust law arising out of, among other things, Sutter Health and those certain affiliates' arrangements with health plans. The courts certified the class as to injunctive relief and a monetary damages class, but excluded plaintiffs' damages

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

15. CONTINGENCIES AND COMMITMENTS (continued)

claims for the 2008-2010 time period. The trial for this matter is currently scheduled for October 2021.

UFCW & Employers Benefit Trust, a self-funded labor union trust fund which accesses the Sutter Health network through Sutter Health's contract with Blue Shield, filed a civil class action lawsuit against Sutter Health and certain affiliates. The lawsuit alleges that Sutter Health and those certain affiliates' contracting practices led to high prices and reduced competition for health care services in violation of state antitrust and unfair competition laws. The California Attorney General filed a separate complaint and the cases were consolidated for all purposes. Sutter Health and the related affiliates maintain their contracting practices were, and remain, in compliance with industry standards and with all applicable laws and regulations. However, to avoid a protracted trial, combined with years of appeals, Sutter Health and the related affiliates agreed, in principle, to a settlement consisting of an expected cash payment of \$575, which was accrued in Other expenses in the third quarter of 2019 and included in Other accrued expenses as of December 31, 2020 and 2019, and injunctive relief, which consists of modifications to contracting practices with insurance companies and certain agreements related to caps on hospital charge increases for the next five years and adjustments to rates for certain out of network services. On September 22, 2020, the court denied the plaintiffs' motion for preliminary approval of the settlement on the ground that the process utilized for selecting a monitor to oversee compliance with the proposed injunction was inadequate. On October 20, 2020, the court approved a new monitor selection process (in which the parties are currently engaged) and scheduled a hearing on preliminary approval of the settlement for March 9, 2021.

Two anonymous plaintiffs filed a civil class action lawsuit against Sutter Health, alleging Sutter Health shared the medical information of plaintiffs and a proposed class of similarly-situated individuals with third parties without authorization. The court twice dismissed the matter with leave to amend. Plaintiffs filed a second amended complaint.

Sutter Health and one of its affiliates finalized contractual dispute issues with third-party commercial payers related to a lab outreach program, and those settlement amounts have been reflected in prior financial statements. Management is also in the process of responding to inquiries from the DOJ related to the lab outreach program.

Sutter Health received notice from the DOJ that it was investigating Sutter Health and certain affiliates for potential False Claims Act violations in connection with the provision of diagnostic and other data submitted to Medicare Advantage (MA) organizations or MA plans related to MA enrollees who have received medical services from those affiliates.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

15. CONTINGENCIES AND COMMITMENTS (continued)

Sutter Health and the related affiliates agreed to settle the matter solely on an overpayment basis as to all related affiliates except one and the settlement amount has been reflected in prior financial statements. As to the single remaining related affiliate involved in the investigation, the government intervened in the lawsuit that prompted the investigation. Sutter accrued an amount for potential liabilities and Sutter Health and the related affiliates are in the process of negotiating a resolution of the matter.

Two separate proposed class-action complaints were filed against Sutter Health and subsequently consolidated by the courts, alleging that Sutter Health, as fiduciaries of Sutter Health's 403(b) savings plan (Plan) and Sutter Health's Retirement Benefits Investment Committee (RBIC), breached the fiduciary duties of loyalty and prudence that they owed to the Plan, to plaintiffs, and others under the Employee Retirement Income Security Act (ERISA). The complaint asserts claims for: (1) breach of fiduciary duty related to the selection of investment options and failure to monitor other fiduciaries of the Plan; (2) failure to monitor against Sutter Health for failing to adequately monitor the RBIC and against the RBIC for failing to monitor delegated appointees; and (3) an alternative claim of liability for knowing breach of trust against all defendants seeking equitable relief in the event any of the defendants are not deemed a fiduciary or co-fiduciary under ERISA. Sutter filed a motion to dismiss the consolidated complaint.

A plaintiff filed a proposed class action lawsuit against Sutter Health and certain affiliates, premised on the theory that Sutter Health and the related affiliates submitted and received payment from plaintiff for anesthesia services that were either not provided, separately billed by a third party anesthesiologist, or reimbursed through other charges on the hospitals' bills. The hearing on class certification is currently set for May 20, 2021.

As of December 31, 2020, Sutter has approximately 55,000 employees, of whom approximately 25% are represented by collective bargaining units. Of these employees, approximately 91% are represented by collective bargaining agreements that will expire in 2021. While working to mitigate any potential work stoppages through successful negotiations, Sutter remains prepared to address the possibility of work stoppages. Should such disruptions occur, they may have a material adverse effect on the operations or on the financial position or results of operations of Sutter. Despite these uncertainties, Sutter remains committed to bargaining in good faith, evaluating positions that remain grounded in the realities of market pay and practices, reflecting business priorities, and acknowledging the needs of the workforce. Additionally, Sutter faces the difficulties of operating in a competitive and complex Northern California labor market further exacerbated by the protracted challenges of the COVID-19 pandemic.

Sutter Health and Affiliates

Notes to Consolidated Financial Statements (continued)

(Dollars in millions)

15. CONTINGENCIES AND COMMITMENTS (continued)

Commitments: Sutter is required to remediate certain of its health care facilities to comply with earthquake retrofit requirements under a State of California law, which is estimated at a cost of \$3,600 (unaudited). Sutter's care facilities subject to these requirements are compliant or have received extensions to bring the facilities into compliance no later than 2030. Sutter is undertaking a comprehensive review of the System's strategic initiatives and priorities across various timelines including its capital allocation plan. Factors under consideration include the impact of the COVID-19 pandemic, federal and state regulations, and the rapidly evolving health care delivery environment. Any update of the System's strategic framework will build on Sutter's key objectives to deliver health care that is safe, personal, affordable and accessible. Given the impact of the pandemic, Sutter is also actively evaluating the timing and scope of Sutter's capital requirements, facility utilization, and resource allocations in 2021 and over the next several years and is considering all options. The current commitments are estimated at \$900 (unaudited). Sutter remains committed to prioritizing capital investments that strengthen affordability and quality of care, while ensuring all capital decisions remain carefully considered, strategic, and effective.

16. SUBSEQUENT EVENTS

Sutter has evaluated subsequent events and disclosed all material events through March 3, 2021, which is the date these consolidated financial statements were issued.