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November 14, 2008

Ms. Diane Scott
Chief Accountant and Financial Officer
Retirement Systems of Alabama
P.O. Box 302150
Montgomery, AL 36130-2150

Dear Ms. Scott:

Enclosed are 30 bound copies and one unbound copy of the "Alabama Public Education Employees' Health Insurance Plan Report of Actuary on the Retiree Medical Valuation Prepared as of September 30, 2007".

Sincerely yours,

Alisa Bennett, ASA, EA, MAAA, FCA
Senior Actuary

AB:kc

Enclosure

S:\Alabama PEEHIP\OPEB 9-30-2007\AL Peehip Valuation--Retiree Medical Valuation Report 9-30-07Final.doc

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Alabama Public Education Employees' Health Insurance Plan
Report of Actuary on the Retiree Medical Valuation

Prepared as of September 30, 2007

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Retirement Systems of Alabama
P.O. Box 302150
Montgomery, AL 36130-2150

Members of the Board:

Governmental Accounting Standards Board Statements No. 43 and 45 require actuarial valuations of retiree medical and other post employment benefit plans. We have submitted the results of the annual actuarial valuation of the Alabama Public Education Employees' Health Insurance Plan (PEEHIP) prepared as of September 30, 2007. While not verifying the data at source, the actuary performed tests for consistency and reasonability. The valuation indicates that an annual required contribution of $970,329,620 or 16.45% of active payroll payable for the fiscal year ending September 30, 2010 is required to fund the benefits of the PEEHIP in an actuarially sound manner.

The promised medical and drug benefits of the Plan, as well as the Optional Plans, are included in the actuarially calculated contribution rates which are developed using the unit credit actuarial cost method with projected benefits. GASB requires the discount rate used to value a plan be based on the likely return of the assets held in trust to pay benefits. As of September 30, 2007, the Plan has established the Alabama Retired Education Employees' Health Care Trust with $400,783,000 in assets as of the valuation date. Therefore, the discount rate used in the valuation remains 5%. Gains and losses are reflected in the unfunded accrued liability that is assumed amortized by regular annual contributions as a level percentage of payroll within a 30-year period, on the assumption that payroll will increase by 4.50% annually. The assumptions recommended by the actuary are, in the aggregate, reasonably related to the experience under the Plan and to reasonable expectations of anticipated experience under the Plan and meet the parameters for the disclosures under GASB 43 and 45.

This is to certify that the independent consulting actuary is a member of the American Academy of Actuaries and has experience in performing valuations for public retirement systems, that the valuation was prepared in accordance with principles of practice prescribed by the Actuarial Standards Board, and that the actuarial calculations were performed by qualified actuaries in accordance with accepted actuarial procedures, based on the current provisions of the medical plans and on actuarial assumptions that are internally consistent and reasonably based on the actual experience of the Plan.

Future actuarial results may differ significantly from the current results presented in this report due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as the end of an amortization period or additional cost or contribution requirements based on the plan's funded status); and changes in plan provisions or applicable law. Since the potential impact of such factors is outside the scope of a normal annual actuarial valuation, an analysis of the range of results is not presented herein.

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In our opinion, if the required contributions to the Trust Fund are made by the employer from year to year in the future at the levels required on the basis of the successive actuarial valuations, the Plan will operate in an actuarially sound manner.

Respectfully submitted,

Alisa Bennett, ASA, EA, MAAA, FCA
Senior Actuary

Edward A. Macdonald, ASA, FCA, MAAA
President

AB\EM:kc

TABLE OF CONTENTS

Section	Item	Page No.
I	Summary of Principal Results	1
II	Membership Data	2
III	Assets	2
IV	Comments on Valuation	2
V	Contributions Payable Under the Plan	3
VI	Comments on Level of Funding	3
VII	Accounting Information	4
Schedule		
A	Results of the Valuation	6
B	Plan Assets	7
C	Outline of Actuarial Assumptions and Methods	8
D	Summary of Main Plan Provisions as Interpreted for Valuation Purposes	13

ALABAMA PUBLIC EDUCATION EMPLOYEES'
HEALTH INSURANCE PLAN (PEEHIP)
REPORT OF ACTUARY ON THE RETIREE MEDICAL VALUATION
PREPARED AS OF SEPTEMBER 30, 2007

SECTION I - SUMMARY OF PRINCIPAL RESULTS

1. For convenience of reference, the principal results of the valuation are summarized below:

Valuation Date	9/30/2007	9/30/2006
Number Active and Retired*	205,424	197,188
Annual Salary**	$ 5,897,771,699	$ 5,458,443,133
Assets:		
Market Value	$ 400,783,000	0
Unfunded Actuarial Accrued Liability	$12,564,614,562	$12,532,330,293
Amortization Period (Years)	30	30
Annual Required Contribution (ARC):		
Normal	$521,877,633	$515,461,955
Accrued Liability***	448,451,987	447,299,707
Total	$970,329,620	$962,761,662
Annual Required Contribution as a Percent of Payroll	16.45%	17.64%
Discount Rate	5.00%	5.00%

*Number matches pension report for active and DROP participants and is before the application of the participation assumption and removal of members in units not eligible for PEEHIP. Retiree number comes from actual retiree medical census data provided by PEEHIP.
**Includes DROP salary
***Accrued liability is assumed amortized as a level percent of payroll with inflation assumption of 4.5%, similar to pension plan.

2. The valuation indicates that contributions of $970,329,620 or 16.45% of active payroll are sufficient to support the current benefits of the Plan. Comments on the valuation results as of September 30, 2007 are given in Section IV and further discussion of the contribution levels is set out in Sections V and VI.

3. As of September 30, 2007, the Plan has established the Alabama Retired Education Employees' Health Care Trust with $400,783,000 in assets as of the valuation date. Therefore, the discount rate used in the valuation remains 5%. Schedule C of this report outlines the full set of actuarial assumptions and methods employed in the current valuation. We have shown in Schedule A the

decrease in the liabilities that could be accomplished if the Plan is fully pre-funded in an actuarially sound manner and thereby utilizes a 7% discount rate.

SECTION II - MEMBERSHIP DATA

Data regarding the membership and recent claims and enrollment experience of the Plan for use as a basis of the valuation were furnished by the Retirement System office. Pension data was used for active and DROP participants with a post-employment health plan participation assumption applied. Data for current retired members with their medical, dental, cancer, indemnity and vision elections were supplied separately from the pension data.

SECTION III - ASSETS

Schedule B shows information regarding assets for valuation purposes. As of September 30, 2007, plan assets held in trust solely to provide benefits to retirees and their beneficiaries in accordance with the terms of the plan totaled $400,783,000.

SECTION IV - COMMENTS ON VALUATION

1. Schedule A of this report outlines the results of the actuarial valuation. The results are shown based on a discount rate of 5% and also at 7%. The valuation was prepared in accordance with the actuarial assumptions and the actuarial cost method, which are described in Schedule C.

2. The valuation shows that the Plan has an actuarial accrued liability of $6,409,335,804 for benefits expected to be paid on account of the present active membership, based on service to the valuation date. The liability on account of benefits payable to retirees, covered spouses and DROP participants amounts to $6,556,061,758. The total actuarial accrued liability of the Plan amounts to $12,965,397,562. Against these liabilities, the Plan has present assets for valuation purposes of $400,783,000. Therefore, the unfunded actuarial accrued liability is equal to $12,564,614,562.

3. The normal contribution is equal to the actuarial present value of benefits accruing during the current year. The normal contribution is determined to be $521,877,633.

SECTION V - CONTRIBUTIONS PAYABLE UNDER THE PLAN

ANNUAL REQUIRED CONTRIBUTION

For Fiscal Year Ending September 30, 2010

Annual Required Contribution (ARC):		
Normal	$	521,877,633
Accrued Liability		448,451,987
Total	$	970,329,620

1. The valuation indicates that a normal contribution of $521,877,633 is required to meet the cost of benefits currently accruing.
2. The unfunded actuarial accrued liability amounts to $12,564,614,562 as of the valuation date. An accrued liability contribution of $448,451,987 is sufficient to amortize the unfunded actuarial accrued liability over a 30-year period, based on a 5% investment rate of return and the assumption that the payroll will increase by 4.5% annually.
3. The total Annual Required Contribution is, therefore, $970,329,620 or 16.45% of total active payroll.

SECTION VI - COMMENTS ON LEVEL OF FUNDING

1. The monthly contribution for retirees to opt into the medical plan is based on plan election, Medicare eligibility, and tobacco use. For members retiring October 1, 2005 or after, a Retiree Sliding Scale premium based on years of service is applicable.
2. The valuation indicates that a decrease in the recommended employer contribution rate over last valuation's recommended rate from 17.64% of payroll to 16.45% is required to fund the plan in an actuarially sound manner. This corresponds to a state contribution of $970,329,620 required to meet the cost of benefits currently accruing and provide for the amortization of the unfunded

actuarial accrued liability over a period of 30 years. The major cause of the decrease in the contribution rate is favorable claims experience with cost increases less than the first year trend rate assumption used in the previous valuation.

SECTION VII - ACCOUNTING INFORMATION

1. Governmental Accounting Standards Board Statements 43 and 45 set forth certain items of required supplementary information to be disclosed in the financial statements of the Plan and the employer.

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Projected Unit Credit (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)*	UAAL as a Percentage of Covered Payroll ((b - a) / c)
6/30/2003*	$0	$ 7,836,000,000	$ 7,836,000,000	0%	$ 4,486,058,170	174.7%
9/30/2005	0	14,611,991,403	14,611,991,403	0	4,733,415,807	308.7%
9/30/2006	0	12,532,330,293	12,532,330,293	0	5,458,443,133	229.6%
9/30/2007	400,783,000	12,965,397,562	12,564,614,562	3.1%	5,897,771,699	213.0%

*Reported by prior actuarial firm.

2. The information presented in the required supplementary schedules was determined as part of the actuarial valuation at September 30, 2007. Additional information as of the latest actuarial valuation follows.

Valuation date	9/30/2007
Actuarial cost method	Projected unit credit
Amortization method	Level percent of pay, open
Remaining amortization period	30 years
Asset valuation method	Market Value of Assets
Actuarial assumptions:	
Investment Rate of Return*	5.00%
Medical cost trend rate*	11.00%
Ultimate trend rate	5.00%
Year of Ultimate trend rate	2016
Dental trend rate	5.00%
*Includes inflation at	4.50%

RESULTS OF THE VALUATION AND THE BENEFITS OF ADVANCE FUNDING PREPARED AS OF SEPTEMBER 30, 2007

			5% Discount Rate (Current Funding Level)	7% Discount Rate (Contribute Full ARC Annually)
1.	**PAYROLL**		$ 5,897,771,699	$ 5,897,771,699
2.	**ACTUARIAL ACCRUED LIABILITY**			
	Present value of prospective benefits payable in respect of:			
	(a)	Present active members:	$ 6,409,335,804	$ 4,308,379,795
	(b)	Present retired members and surviving spouses and DROP participants:	6,556,061,758	5,116,840,506
	(c)	Total actuarial accrued liability	$12,965,397,562	$ 9,425,220,301
3.	**PRESENT ASSETS FOR VALUATION PURPOSES**		$ 400,783,000	$ 400,783,000
4.	**UNFUNDED ACTUARIAL ACCRUED LIABILITY [(2)(C) minus (3)]**		$12,564,614,562	$ 9,024,437,301
5.	**AMORTIZATION PERIOD**		30	30
6.	**NORMAL CONTRIBUTION**		$ 521,877,633	$ 329,108,913
7.	**ACCRUED LIABILITY CONTRIBUTION**		448,451,987	433,504,875
8.	**TOTAL CONTRIBUTION (6) + (7)**		$ 970,329,620	$ 762,613,788
9.	**TOTAL CONTRIBUTION AS A PERCENT OF PAYROLL (8) ÷ (1)**		16.45%	12.93%

PLAN ASSETS

GASB 43 and 45 define plan assets as resources, usually in the form of stocks, bonds, and other classes of investments, that have been segregated and restricted in a trust, or equivalent arrangement, in which (a) employer contributions to the plan are irrevocable, (b) assets are dedicated to providing benefits to retirees and their beneficiaries, and (c) assets are legally protected from creditors of the employers or plan administrator, for the payment of benefits in accordance with the terms of the plan. Since the previous valuation, the Alabama Retired Education Employees' Health Care Trust has been established and, as of the valuation date, the market value of assets amounted to $400,783,000. The development of the market value of assets is shown in the following table.

Market Value of Assets as of September 30, 2007

(all $ amounts in thousands)

Market Value October 1, 2006	$ 0
Contributions	718,214
Benefits	(328,470)
Cash flow	$ 389,744
Investment Income	11,039
Market Value September 30, 2007	$ 400,783

OUTLINE OF ACTUARIAL ASSUMPTIONS AND METHODS

The decremental assumptions used in the valuation were selected based on the actuarial experience study prepared as of September 30 2005, submitted to and adopted by the board on May 21, 2007.

VALUATION DATE: September 30, 2007

DISCOUNT RATE: 5.0% per annum, compounded annually.

HEALTH CARE COST TREND RATES: Following is a chart detailing Medical/Rx trend assumptions. The trend assumption for the Optional Plans is 5% per year and the trend on retiree contributions is 2% per year.

Year	Trend
2007	11.0%
2008	11.0%
2009	10.0%
2010	9.0%
2011	8.0%
2012	7.0%
2013	6.5%
2014	6.0%
2015	5.5%
2016 and beyond	5.0%

AGE RELATED MORBIDITY: Per capita costs are adjusted to reflect expected cost changes related to age. The increase to the net incurred claims was assumed to be:

Participant Age	Annual Increase
< 40	0.0%
40 – 44	2.6%
45 – 49	2.6%
50 – 54	3.2%
55 – 59	3.4%
60 - 64	3.7%
65 – 69	3.2%
70 – 74	2.4%
75 – 79	1.8%
80 – 84	1.3%
85 and over	0.0%

Optional plan costs are not age adjusted.

ANTICIPATED PLAN PARTICIPATION: The assumed annual rates of plan participation and spouse coverage is as follows:

Medical	Under 65	Over 65
Participation	80%	80%
Spouse Coverage	60%	35%

Optional Plans	
Plan	**Participation**
Hospital Indemnity	10%
Dental	40%
Cancer	10%
Vision	10%

ANNUAL EXPECTED MEDICAL/RX CLAIMS (AGE 65): Following is a chart detailing expected medical/RXclaims for pre and post Medicare for the year following the valuation date. Claims are age-adjusted to age 65.

	Medical/Rx
Pre-65	$8,762
Post-65	$3,031

ANNUAL EXPECTED OPTIONAL PLAN CLAIMS: Following is a chart detailing expected optional plan claims for the year following the valuation date. Claims are not age-adjusted.

Dental	Vision	Cancer	Hospital
$419	$95	$289	$275

ACTUARIAL METHOD: Costs were determined using the Projected Unit Credit Actuarial Cost Method. The annual service cost is the present value of the portion of the projected benefit attributable to participation service during the upcoming year, and the accumulated postretirement benefit obligation (APBO) is equal to the present value of the portion of the projected benefit attributable to service before the valuation date. Service from hire date through full eligibility was used in allocating costs.

SEPARATIONS BEFORE SERVICE RETIREMENT: Representative values of the assumed annual rates of death, disability, and withdrawal are as follows:

Age	Annual Rate of Death	Disability	Withdrawal — Years of Service 0-4	5-9	10-20	20+
		Male				
20	0.05%	0.05%	30.00%			
25	0.07	0.06	16.50	12.00%		
30	0.08	0.07	15.00	5.50	5.50%	
35	0.09	0.13	15.00	5.50	3.00	
40	0.11	0.20	14.50	5.50	3.00	1.25%
45	0.16	0.21	14.50	5.25	3.00	1.00
50	0.26	0.64	12.00	4.50	3.00	1.00
55	0.44	1.20	11.50	4.00	2.25	1.00
60	0.80		10.00	4.00		
65	1.45		10.00	6.00		
69	2.17		10.00	6.00		
		Female				
20	0.03%	0.10%	30.00%			
25	0.03	0.10	14.50	8.00%		
30	0.04	0.10	14.50	6.00	4.00%	
35	0.05	0.15	13.50	6.00	3.50	
40	0.08	0.16	12.00	4.50	2.50	1.50%
45	0.10	0.37	11.50	3.75	2.50	0.75
50	0.16	0.70	11.00	3.75	2.50	0.75
55	0.26	1.10	10.50	3.75	2.50	0.75
60	0.51		11.00	4.50		
65	0.97		14.00	6.00		
69	1.37		14.00	6.00		

SERVICE RETIREMENT: Representative values of the assumed annual rates of service retirement are as follows:

For members first eligible for unreduced benefits upon attaining 25 years of service but before age 65, rates are as follows:

	Annual Rate*	
Age	Male	Female
45	30.0%	30.0%
50	15.0	16.0
55	48.0	53.0
60	40.0	49.0
62	50.0	55.0

*Retirement rates are increased by 7% in year when member first becomes eligible for unreduced service retirement on or after age 50 but before age 60.

For members first eligible for unreduced benefits before attaining 25 years of service and all members age 65 and over, the rates are as follows:

	Annual Rate	
Age	Male	Female
60	13.0%	22.0%
62	30.0	30.0
65	34.0	35.0
67	26.0	27.0
69	25.0	26.0
70	25.0	26.0
72	26.0	25.0
75	100.0	100.0

DEATHS AFTER RETIREMENT: Rates of mortality for the period after service retirement are according to the 1994 Group Annuity Mortality Table set forward one year for females. Special tables are used for the period after disability retirement. Representative values of the assumed annual rates of death after service and disability retirement are as follows:

	Annual Rate of Death after			
	Service Retirement		Disability Retirement	
Age	Male	Female	Male	Female
40	0.11%	0.08%	3.32%	2.60%
45	0.16	0.10	3.49	2.43
50	0.26	0.16	3.76	2.50
55	0.44	0.26	4.20	2.67
60	1.80	0.51	4.88	2.95
65	1.45	0.97	5.95	3.39
70	2.37	1.50	7.63	4.08
75	3.72	2.53	10.22	5.16
80	6.20	4.40	14.17	6.85
85	9.72	7.53	20.09	9.47
90	15.29	12.88	28.67	13.46

SUMMARY OF MAIN PLAN PROVISIONS AS INTERPRETED FOR VALUATION PURPOSES

ELIGIBILITY: Retiree medical eligibility is attained when an employee retires, and is immediately eligible to draw a retirement annuity from the Alabama Teachers Retirement System.

RETIREE CONTRIBUTIONS: Vary based on plan election, dependent coverage, Medicare eligibility and election, and tobacco use. Plan costs are determined for valuation purposes considering claims costs net of member premiums paid.

In November 2004, the Alabama Legislature enacted legislation (Act 2004-649) that required the Public Education Employees' Insurance Board to implement a sliding scale premium on all employees retiring after September 30, 2005, based on their years of service.

The premium for retiree coverage is broken down into the employer share (what PEEHIP pays) and the retiree share. Under the sliding scale, the retiree will still be responsible for the retiree share, however, the employer share will increase or decrease based upon a retiree's years of service. For those employees retiring with 25 years of service, the employer would pay 100% of the employer share of the premium. For each year less than 25, the employer share would be reduced by 2% and the retiree share will be increased accordingly. For each year over 25, the employer share would be increased by 2% and the retiree share reduced accordingly.

Retired Members

The premiums listed below show the retiree's out-of-pocket cost after subtracting the retiree allocation. These rates apply only to members who retire prior to October 1, 2005. All members who retire on or after October 1, 2005 will be subject to the Retiree Sliding Scale premium based on years of service.

Adopted for fiscal Year 2008 - 2009

Rate	Type of Contract	Retiree Monthly Out-of-Pocket Expense	Cost to State
A	Individual Coverage/ Non-Medicare Eligible Retired Member	$ 97.54	$ 487.46
B	Family Coverage/Non-Medicare Eligible Retired Member and Non-Medicare Eligible Dependent(s)	$ 284.94	$ 813.06
C	Family Coverage/Non-Medicare Eligible Retired Member and Dependent Medicare Eligible	$ 188.54	$ 698.46
D	Individual Coverage/ Medicare Eligible Retired Member	$ 1.14	$ 288.86
E	Family Coverage/Medicare Eligible Retired Member and Non-Medicare Eligible Dependent(s)	$ 188.54	$ 614.46
F	Family Coverage/Medicare Eligible Retired Member and Dependent Medicare Eligible	$ 92.14	$ 499.86

The out-of-pocket costs for an eligible husband and wife who choose to combine their insurance allocations must be calculated on an individual basis because of the new Retiree Sliding Scale legislation.

The State allocation can be used to purchase the new PEEHIP Supplemental Plan or two optional plans at no cost to the retiree if the retiree is not using the allocation for one of the hospital medical plans. Additional optional plans can be purchased for $38.00 per month per plan.

Optional Coverage:	Active and Retired Members
Cancer	$38.00/month Individual or Family Coverage
Indemnity	$38.00/month Individual or Family Coverage
Dental	$38.00/month Individual or Family Coverage
Vision	$38.00/month Individual or Family Coverage

Retiree premiums for the four optional plans, Hospital Indemnity, Dental, Cancer and Vision, are $38 per retiree per month. Since these plans can be purchased with State allocations, it is assumed that 75% of participants in the Dental plan and 50% of participants in the other optional plans are making the $38 per month contributions.

The University System makes a contribution to PEEHIP for every University retiree regardless of age or plan tier election. For 2009, this amount is $382 per month.

PLAN SUMMARIES AND BENEFITS: The following summaries describe benefits for Non-Medicare-eligible and Medicare-eligible retirees.

PEEHIP Hospital Medical Coverage

(Coverage for Active Members and Non-Medicare-eligible Retirees)

Hospital Benefits *(Administered by Blue Cross and Blue Shield of Alabama)*

- **Inpatient Hospitalization:** Services are covered in full for 365 days without a dollar limit.
- **Deductible:** $100 for each admission.
- **Outpatient Hospital Charges:** $75 facility copay for outpatient surgery and $25 facility copay for medical emergencies and hemodialysis.

Major Medical Benefits *(Administered by Blue Cross and Blue Shield of Alabama)*

- **Deductible:** $100 deductible per person per calendar year; maximum of 3 deductibles per family per year.
- **Maximum:** $1,000,000 lifetime maximum for each covered member.
- **Coinsurance:** After you pay the $100 deductible, the plan pays 80%of the Usual Customary Rates (UCR) of covered expenses for the first $2000 and 100% UCR thereafter.

Preferred Medical Doctor (PMD)

- **$3 Copay Per Test**
- **$20 Copay Per visit**

Pharmacy Program *(Administered by Express Scripts)*

- Participating Pharmacy
  - $5 for any covered generic prescription drug
  - $30 for any covered preferred brand drug
  - $50 for any covered non-preferred brand drug
- The PEEHIP prescription drug plan includes Step Therapy and prior authorization for certain medications.

Non-Participating Pharmacy

- There are no benefits for a non-participating pharmacy in Alabama.

Excluded Services

- Coverage is not proved for nursing home costs, vision and dental care (except accidental injuries), cosmetic surgery, hearing aids and experimental procedures.

PEEHIP Medicare Plus

(Coverage for Medicare-Eligible Retirees)

This plan is a supplement to hospital and medical benefits provided under Medicare Part A and Part B, and is available to Medicare-eligible retirees.

If a Medicare-eligible member or dependent chooses to enroll in a Medicare Part D plan, he or she will lose the PEEHIP prescription drug coverage.

PEEHIP Hospital Benefits

(Administered by Blue Cross and Blue Shield of Alabama)

Benefit		
Inpatient Hospital Charges		
Medicare Pays	PEEHIP Pays	Retiree Pays
All but the Part A deductible per admission. All but applicable coinsurance after 60 days.	All but $100 per admission. Applicable coinsurance after 60 days.	A $100 deductible and any personal charges (such as private room, telephone, TV etc.)

PEEHIP Non-Hospital Benefits

Benefit		
Outpatient Hospital Charges		
Medicare Pays	PEEHIP Pays	Retiree Pays
80% of Medicare's approved amount after the Medicare Part B deductible.	20% of Medicare's approved amount after the member meets Medicare Part B deductible and the $20 copay for physician visit.	The Part B deductible, a copay up to $20 for physician visits, any charges not covered by Medicare or PEEHIP, and charges above the Medicare allowable amount when using unassigned providers.

Pharmacy Program *(Administered by Express Scripts)*

- Participating Pharmacy:
  - $5 for any covered generic prescription drug
  - $30 for any covered preferred brand drug
  - $50 for any covered non-preferred brand drug
- The PEEHIP prescription drug plan includes Step Therapy and prior authorization for certain medications.
- There are no benefits for using a non-participating pharmacy in Alabama.