

Public Education Employees' Health Insurance Fund

(A Component Unit of the State of Alabama)

FINANCIAL STATEMENTS

For the Fiscal Year Ended September 30, 2011

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INDEPENDENT AUDITORS' REPORT

To the Public Education Employees'
Health Insurance Board

We have audited the accompanying balance sheet of the Public Education Employees' Health Insurance Fund (a component unit of the State of Alabama) as of September 30, 2011, and the related statement of revenues, expenses and changes in fund equity and cash flows for the year then ended. These financial statements are the responsibility of the Public Education Employees' Health Insurance Fund. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the Public Education Employees' Health Insurance Fund's 2010 financial statements and, in our report dated January 28, 2011, we expressed an unqualified opinion on such financial statements.

We conducted our audit 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2011 financial statements referred to above present fairly, in all material respects, the financial position of the Public Education Employees' Health Insurance Fund (a component unit of the State of Alabama) as of September 30, 2011, and its changes in fund equity and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 2 through 4 and the claims development information on page 18 are not required parts of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Carr, Riggs & Ingram, L.L.C.

January 31, 2012
Montgomery, Alabama

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Management's Discussion and Analysis

The Public Education Employees' Health Insurance Fund (the PEEHIF) is a health insurance plan for active and retired employees of state and local educational institutions. The contributions and benefit payments related to retirees that are processed through the PEEHIF are segregated from the PEEHIF and reported as part of the Alabama Retired Education Employees' Health Care Trust (the Trust). The following discussion provides an overview of the financial position and results of operations for the PEEHIF as of and for the year ended September 30, 2011, respectively. For more detailed information, please refer to the financial statements, including the Notes to the Financial Statements and the Required Supplementary Information.

Financial Statements and Required Supplementary Information

The financial statements include the Balance Sheet, Statement of Revenues, Expenses and Changes in Fund Equity and the Statement of Cash Flows. The Notes to the Financial Statements are considered an integral part of the financial statements. The financial statements are prepared using the economic resources measurement focus and accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred, regardless of when cash is received or expended. Investments are reported at fair value.

The Balance Sheet includes all of the assets and liabilities of the PEEHIF and provides a snapshot of the financial position of the PEEHIF as of the end of the fiscal year. Assets primarily consist of receivables and short-term investments. Liabilities primarily consist of claims related payables.

The Statement of Revenues, Expenses and Changes in Fund Equity includes all of the revenues and expenses of the PEEHIF for the fiscal year. Revenues primarily consist of premiums, reimbursements from the Early Retiree Reinsurance Program, and interest income. Expenses primarily consist of claims.

The Statement of Cash Flows provides information about the cash receipts and payments of the PEEHIF during the year. The cash flow statement is divided into three sections – operating, investing, and noncapital financing activities. A reconciliation of operating income to net cash provided by operating activities is also presented. The PEEHIF had no activities related to capital and related financing during the fiscal year. The PEEHIF cash flow statement was prepared using the direct method, as required by GASB Statement Number 34. Under the direct method, major classes of receipts and payments are displayed. The net change in cash during the year plus the cash at the beginning of the year equals the cash at the end of the year.

The Notes to the Financial Statements include a description of the organization, a summary of significant accounting policies, a description of contract administrators and their respective fees, and other disclosures related to credit risks, concentrations of investments, unpaid claims liabilities, employee pension plans and other postemployment benefits.

The Required Supplementary Information following the Notes to the Financial Statements provide a claims development table illustrating ten-year historical trend information on how PEEHIF's earned revenues and interest income compare to related costs of claims and other expenses assumed by the PEEHIF as of the year-end.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Management's Discussion and Analysis

Summary Comparative Balance Sheet
As of September 30, 2011 and 2010
(Amounts in Thousands)

	2011	2010	Variance	% Increase (Decrease)
Assets				
Cash	\$ 5,843	\$ 4,889	\$ 954	19.51%
Receivables	23,371	7,960	15,411	193.61
Deposits with Claims-Paying Agent	1,403	3,411	(2,008)	(58.87)
Investments	192,781	80,723	112,058	138.82
Total Assets	\$ 223,398	\$ 96,983	\$ 126,415	130.35
Liabilities				
Payables	\$ 37,997	\$ 35,903	\$ 2,094	5.83
Claims Incurred but Not Reported	35,452	42,009	(6,557)	(15.61)
Total Liabilities	73,449	77,912	(4,463)	(5.73)
Fund Equity - unrestricted	149,949	19,071	130,878	686.27
Total Liabilities and Fund Equity	\$ 223,398	\$ 96,983	\$ 126,415	130.35

Summary Comparative Statement of Revenues, Expenses and Changes in Fund Equity
For the Fiscal Years Ended September 30, 2011 and 2010
(Amounts in Thousands)

	2011	2010	Variance	% Increase (Decrease)
Operating Revenue				
Premiums	\$ 862,764	\$ 764,313	\$ 98,451	12.88%
Early Retiree Reinsurance Program	21,196	-	21,196	100.00
Total Operating Revenues	883,960	764,313	119,647	15.65
Operating Expenses				
Claims	750,951	787,216	(36,265)	(4.61)
Administrative	2,587	3,160	(573)	(18.13)
Total Operating Expenses	753,538	790,376	(36,838)	(4.66)
Operating Income (Loss)	130,422	(26,063)	156,485	(600.41)
Investment Revenues				
Interest Income	456	295	161	54.58
Total Investment Revenues	456	295	161	54.58
Total Income (Loss)	130,878	(25,768)	156,646	(607.91)
Fund Equity				
Beginning of Year	19,071	44,839	(25,768)	(57.47)
End of Year	\$ 149,949	\$ 19,071	\$ 130,878	686.27

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Management's Discussion and Analysis

Financial Highlights

- The increase in receivables is primarily due to being approved for an additional reimbursement in December 2011 from the Early Retiree Reinsurance Program for claims costs associated with the 2011 fiscal year.
- As of September 30, 2011, the PEEHIF's investments increased by \$112 million. The implementation of cost saving strategies and premium increases allowed more funds to be available at fiscal year-end. The increase in investments will be used to fund the cost of providing benefits to members in the following fiscal year.
- Premium revenue increased by 12.88% as a result of individual premium increases effective October 1, 2010.
- The PEEHIF received over \$32 million in reimbursements from its participation in the Early Retiree Reinsurance Program. Of these reimbursements, approximately \$21,196,000 was allocated to active members. The remaining amount of approximately \$10,843,000 was allocated to retired members and reported in the Alabama Retired Education Employees' Health Care Trust
- Claims expenses decreased by 4.61% during the fiscal year as a result of increases in the amounts charged to members for medical and prescription drug co-pays and deductibles and as a result of the changes the PEEHIF made in its pharmacy benefit manager (PBM). The change in PBM allowed the PEEHIF to realize significant cost savings from cost improvements in pharmacy network negotiations.
- Administrative expenses decreased by over 18% during the year compared with that of the previous year primarily as a result of increased utilization of technological resources in administering the Plan.
- The positive changes made during the year affecting cash flow increased investment assets and correspondingly also increased the investment income during the year compared to the prior year by 54.58%.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
BALANCE SHEET
September 30, 2011 with comparative amounts shown for 2010

(Amounts in Thousands)

	2011	2010
<i>Assets</i>		
Cash (Note 1)	\$ 5,843	\$ 4,889
Receivables		
Premiums	1,290	1,876
Rebates - Prescription Drug Plan Manufacturer Rebates	3,029	6,071
Early Retiree Reinsurance Program	19,029	-
Interest	23	13
Total Receivables	23,371	7,960
Deposit with Claims-Paying Agents	1,403	3,411
Investments, at Fair Value (Note 3)	192,781	80,723
Total Assets	\$ 223,398	\$ 96,983
<i>Liabilities</i>		
Accounts Payable	\$ 197	\$ 312
Employee Benefits Payable	467	489
Other Postemployment Benefits (Note 5)	364	318
Reported Claims Payable (Note 4)	36,969	34,784
Claims Incurred but not Reported (Note 4)	35,452	42,009
Total Liabilities	73,449	77,912
<i>Fund Equity - unrestricted</i>	149,949	19,071
<i>Total Liabilities and Fund Equity</i>	\$ 223,398	\$ 96,983

See accompanying Notes to the Financial Statements.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND EQUITY
For the Fiscal Year Ended September 30, 2011 with comparative amounts shown for 2010

(Amounts in Thousands)

	<u>2011</u>	<u>2010</u>
<i>Operating Revenue</i>		
Premiums	\$ 862,764	\$ 764,313
Early Retiree Reinsurance Program	21,196	-
Total Operating Revenue	<u>883,960</u>	<u>764,313</u>
<i>Operating Expenses</i>		
Claims (Notes 2 and 4)	750,951	787,216
Administrative	2,587	3,160
Total Operating Expenses	<u>753,538</u>	<u>790,376</u>
Operating Income (Loss)	<u>130,422</u>	<u>(26,063)</u>
<i>Investment Revenues</i>		
Interest Income	456	295
Total Investment Revenues	<u>456</u>	<u>295</u>
Total Income (Loss)	<u>130,878</u>	<u>(25,768)</u>
<i>Fund Equity</i>		
Beginning of Year	19,071	44,839
End of Year	<u>\$ 149,949</u>	<u>\$ 19,071</u>

See accompanying Notes to the Financial Statements.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
STATEMENT OF CASH FLOWS

For the Fiscal Year Ended September 30, 2011 with comparative amounts shown for 2010

(Amounts in Thousands)

	<u>2011</u>	<u>2010</u>
<i>Cash Flows From Operating Activities</i>		
Receipts from Participants	\$ 863,350	\$ 763,914
Receipts from Other Sources	2,167	-
Payments to Suppliers	(389)	(403)
Payments to Employees	(2,288)	(2,376)
Claims Paid	(750,274)	(785,528)
Net Cash Provided (Used) by Operating Activities	<u>112,566</u>	<u>(24,393)</u>
<i>Cash Flows from Investing Activities</i>		
Interest from Investments	445	299
Purchases of Investments	(3,430,742)	(2,650,888)
Sales and Maturities of Investments	3,318,685	2,675,772
Net Cash Provided (Used) by Investing Activities	<u>(111,612)</u>	<u>25,183</u>
Net Increase in Cash	954	790
Cash at Beginning of Year	4,889	4,099
<i>Cash at End of Year</i>	<u>\$ 5,843</u>	<u>\$ 4,889</u>
<i>Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities</i>		
Operating Income (Loss)	\$ 130,422	\$ (26,063)
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided by Operating Activities:		
(Increase)/Decrease in Assets:		
Premium Receivable	586	(399)
Early Retiree Reinsurance Program Reimbursement Receivable	(19,029)	-
Rebates Receivable	3,042	256
Deposit with Claims Paying Agent	2,008	3,186
Increase/(Decrease) in Liabilities:		
Accounts Payable	(115)	287
Employee Benefits Payable	(22)	19
Other Postemployment Benefits	46	75
Reported Claims Payable	2,185	8,868
Claims Incurred but Not Reported	(6,557)	(10,622)
Net Cash Provided (Used) by Operating Activities	<u>\$ 112,566</u>	<u>\$ (24,393)</u>
<i>Noncash Investing Activities</i>		
(Increase)/ Decrease in Interest Receivable	\$ (10)	\$ 4

See accompanying Notes to the Financial Statements.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements For the Fiscal Year Ended September 30, 2011

1) Organization and Summary of Significant Accounting Policies

A. General

The Public Education Employees' Health Insurance Fund (the PEEHIF) was established in 1983 under the provisions of Act 83-455 of the Alabama Legislature to provide a uniform plan of health insurance for employees and retired employees of state and local educational institutions which provide instruction at any combination of grades K-14 (collectively eligible employees), and to provide a method for funding the benefits related to the plan. The four-year universities are eligible and may elect to participate in the plan. At this time, Jacksonville State is the only university that has elected to participate in the plan. Responsibility for the establishment of the health insurance plan and its general administration and operations is vested in the Public Education Employees' Health Insurance Board (the Board). In accordance with the Governmental Accounting Standards Board (GASB), the PEEHIF is considered a component unit of the State of Alabama (State) and is included in the State's *Comprehensive Annual Financial Report*.

In order to comply with the reporting requirements as set out in GASB Statement 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, the contributions (employer, plan member, Medicare Part D Retiree Drug Subsidy, and the Early Retiree Reinsurance Program Reimbursements) and benefit payments related to retirees that are processed through the PEEHIF are segregated from the PEEHIF and reported as part of the Alabama Retired Education Employees' Health Care Trust (the Trust).

The Public Education Employees' Health Insurance Plan (PEEHIP) offers a basic hospital/medical plan that provides basic medical coverage for up to 365 days of care during each hospital confinement. The basic hospital/medical plan also provides for physicians' benefits, outpatient care, prescription drugs, and mental health benefits. Major medical benefits under the basic hospital/medical plan are subject to a lifetime contract maximum of \$1,000,000 for each covered individual.

Plan members also have the option to enroll in a health maintenance organization (HMO) in lieu of the basic hospital/medical plan. The HMO generally provides the same coverage as the basic hospital/medical plan.

Optional plans which may be selected in addition to or in lieu of the basic hospital/medical plan or HMO include: Hospital Indemnity, Cancer, Dental, and Vision. The Hospital Indemnity Plan provides a per day benefit for hospital confinement, maternity, intensive care, cancer and convalescent care. The Cancer Plan provides a per day benefit for each hospital confinement related to cancer only. The Dental Plan covers diagnostic and preventive services as well as basic and major services based on reasonable and customary charges up to \$1,000 per year per person with dependent coverage (\$1,250 per year per person with employee coverage only). The Vision Plan covers annual eye examinations as well as the cost of either eyeglasses or contact lenses.

The State contributes a specified amount (the employer rate) monthly to each respective participating school system. Each participating school system must then pay the employer rate to the PEEHIF each month. That rate was \$752 per participant per month for 2011. In addition to the employer payments each month, the employee pays certain premium amounts. Participants should refer to the PEEHIP's contracts for a more complete description of the PEEHIP's provisions. During fiscal year 2003, the

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements For the Fiscal Year Ended September 30, 2011

A. General, continued

Legislature passed Act 2003-473 (effective October 1, 2003) which requires universities that do not participate in PEEHIP to pay the health insurance costs of its retirees to the PEEHIF.

The monthly employer premium established by the Legislature in the 2011 Budget was paid in accordance with the recommendation by the PEEHIP management. The recommendation was based on the determination made by the third party actuary.

The Teachers' Retirement System of Alabama (TRS) has been appointed as the administrator of the PEEHIF.

B. Basis of Accounting

The PEEHIF is a proprietary fund that operates under the accrual basis of accounting. The PEEHIF has elected to exercise paragraph 6 of GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting." Statement 20, paragraph 6, requires that all proprietary activities should apply all applicable GASB pronouncements as well as any Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure (CAP) issued on or before November 30, 1989, unless such FASB, APB, and CAP pronouncements conflict with or contradict GASB pronouncements. FASB pronouncements issued after November 30, 1989, even if they modify an applicable FASB, APB, or CAP pronouncement, are not applicable unless adopted by a GASB pronouncement. Subsequent events were evaluated by management through the date the financial statements were issued.

C. Cash

Cash consists of deposits held by the State Treasurer in the PEEHIF's name. Deposits are entirely insured by Federal depository insurance or protected under the Security for Alabama Funds Enhancement (SAFE) Program. The *Code of Alabama 1975* requires all State organizations to participate in the SAFE Program. The SAFE Program is a multiple financial institution collateral pool. The SAFE Program requires all public funds to be deposited in a financial institution designated by the State Treasurer as a qualified public depository. Each qualified public depository is required to pledge collateral in accordance with the rules established by the SAFE Board of Directors. In the event that a qualified public depository defaults or becomes insolvent and the pledged collateral is insufficient to satisfy the claims of public depositors, the *Code of Alabama 1975, Section 41-14A-9(3)* authorizes the State Treasurer to make assessments against the other qualified public depositories in the pool so that there will be no loss of public funds. Cash designated for payment of administrative expenses at September 30, 2011 was \$5,843,000.

D. Expense Fund

During the fiscal year ended September 30, 2011, the Board designated \$3,600,000 of premiums received to be used for the payment of administrative expenses. The administrative costs incurred directly for the operation of the PEEHIF are paid from the expense fund. No indirect costs are allocated to the PEEHIF by the TRS.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements For the Fiscal Year Ended September 30, 2011

E. Investments

The Board of Control of the PEEHIF has the responsibility and authority to invest and reinvest available funds, through the secretary-treasurer and investment committee, in bonds, mortgage-backed securities, mortgages, common and preferred stock, and other investment vehicles with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use. All plan assets are carried at fair value except commercial paper and money market funds which are reported at cost, which approximates fair value. U.S. agency obligations and corporate bonds are reported at the last reported sales price. Generally, private placements are valued based on the selling price of similar investments sold in the open market. In those instances where there are no similar investments sold in the open market, an appraisal is performed to determine the fair value of the private placements.

F. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts on the financial statements. Actual results may differ from these estimates.

G. Premiums

Premium revenue is recognized in the period in which the related coverage is provided. Premium payments that have not been received by the end of a coverage period are recorded as a receivable.

H. Medicare Part D

Medicare Part D reimbursements are the result of PEEHIP continuing prescription drug coverage for Medicare beneficiaries and qualifying for the Medicare Part D subsidy. In order to comply with GASB Statement 43, Medicare Part D reimbursements are now reported in the Alabama Retired Education Employees' Health Care Trust.

I. Early Retiree Reinsurance Program Reimbursement

The PEEHIF received funds during fiscal year 2011 from its participation in the Early Retiree Reinsurance Program (ERRP) which was established as part of the Patient Protection and Affordable Care Act. ERRP is a temporary program where by Congress has appropriated \$5 billion in order to provide reimbursements to sponsors for 80% of the claims costs associated with providing health coverage to qualifying early retirees under the age of 65 (and their eligible dependents). While funds can only be received for the claims of qualifying early retirees (and dependents), reimbursements can be used for all plan participants, therefore a portion of the reimbursements has been allocated to PEEHIF and the Alabama Retired Education Employees' Health Care Trust.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2011

J. Unpaid Claims Liabilities

Claims liabilities are established based on the actual cost of claims reported but not settled, and estimates of claims that have been incurred but not reported. Actual claims costs ultimately incurred may vary from estimated claims liabilities should the nature and frequency of actual claims vary from historical claims experience on which the estimates are based. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made.

Unpaid claims liabilities are material estimates that are particularly susceptible to changes in the near term. Management believes the liabilities established for unpaid claims at September 30, 2011 are adequate to cover the ultimate net cost of claims, but the liabilities are necessarily based on estimates and accordingly, the amount ultimately paid will be more or less than such estimates.

K. Employee Benefits

The PEEHIF records a liability and charge to expense for all compensated absences attributable to services already rendered and that are not contingent on specific events outside the control of the employer or employee.

L. Equity

Expense fund equity is allocated for the payment of administrative expenses. Insurance equity is allocated for the payment of insurance benefits. As of September 30, 2011, unrestricted equity was allocated as follows:

Fund Equity - unrestricted	
(Amounts in Thousands)	
Insurance Fund	\$ 145,135
Expense Fund	4,814
Total Fund Equity	\$ 149,949

2) Contract Administrators

Blue Cross and Blue Shield of Alabama (BCBS), under contract with the Board, administered medical claims incurred in accordance with the plan. The BCBS administrative fee was \$10.45 per month per contract. The \$10.45 per member per month fee was charged to the PEEHIF.

BCBS, under contract with the Board, administered participant requests for reimbursement covered under flexible employee benefit plans. BCBS charged the PEEHIF an administrative fee of \$3.00 per month per contract.

MedImpact, under contract with the Board, administered claims under the prescription drug plan. The MedImpact administrative fee was \$0.75 per prescription. The \$0.75 per prescription fee was charged to the PEEHIF.

Southland Benefit Solutions, LLC (Southland), under contract with the Board, administered claims under the optional plans. The PEEHIF paid Southland an amount equal to covered charges plus processing fees. The processing fees per month per contract were \$0.75 for Group Hospital Indemnity, \$0.61 for Group Cancer, \$1.08 for Group Vision, and \$1.40 for Group Dental.

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements For the Fiscal Year Ended September 30, 2011

3) Investments

A. Investment Risks

Investments are subject to certain types of risks, including interest rate risk, custodial credit risk, credit quality risk, and foreign currency risk. The following describes those risks:

Interest Rate Risk – The fair value of fixed-maturity investments fluctuate in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value of those instruments. The fair value of interest sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, and other general market conditions. Certain fixed maturity investments have call provisions that could result in shorter maturity periods.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that an entity will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party if the counterparty fails. The PEEHIF's custodial credit risk policy requires the custodial agent to hold or direct its agents or subcustodians to hold, for the account of the PEEHIF, all securities and other non-cash property other than securities in the Federal Reserve book-entry system, in a clearing agency which acts as a securities depository, or in another book-entry system. The PEEHIF's safekeeping agent holds all investments of the PEEHIF in the PEEHIF's name.

Credit Quality – Nationally recognized statistical rating organizations provide ratings of debt securities quality based on a variety of factors, such as the financial condition of the issuers, which provide investors with some idea of the issuer's ability to meet its obligations. Domestic fixed-maturity investments may consist of rated or non-rated securities. International fixed-maturity investments may consist of securities with a rating of at least A by one of the principal rating agencies at the time of purchase or acquisition, except that up to 2% of the fair value of PEEHIF's total portfolio may be invested in obligations of sovereign countries with a rating of BBB or BAA at the time of purchase. PEEHIF may hedge against the possible adverse effects of currency fluctuations on PEEHIF's portfolio of international fixed income obligations when it is considered appropriate. Short-term investments may consist of commercial paper rated at least A-2 and/or P-2, repurchase agreements, short-term U.S. securities, and other money market investments.

Foreign Currency Risk – The risk that changes in exchange rates will adversely affect the fair value of an investment. In order for an international equity security to be eligible for purchase by PEEHIF, the issuing company must be incorporated in a country whose debt securities are eligible for purchase as discussed above, and the market value of the aggregate outstanding equity of the issuing company must be at least \$100 million.

Concentration of Credit Risk – The investment policies limit the aggregate amount that can be invested in each class of investments. The asset allocation decisions are determined by the set limits along with the following three factors:

- 1) The actuarial projected liability stream of benefits and their cost

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Notes to the Financial Statements
For the Fiscal Year Ended September 30, 2011

A. Investment Risks, continued

- 2) The perception of the prospective risks and returns of eligible asset classes
- 3) Judgments regarding future economic and financial conditions

The policy limits are as follows:

- Domestic Fixed Income – Limited to 50% of the market value of the PEEHIF's aggregate portfolio.
- International Fixed Income – Limited to 10% of the market value of the PEEHIF's total portfolio.
- Domestic Equity – Limited to 65% of the market value of the PEEHIF's aggregate portfolio.
- International Equity – The aggregate market value of international equities is limited to 25% of the aggregate market value of the PEEHIF's total portfolio. Also, the PEEHIF may not purchase or hold more than 5% of any class of the outstanding stock of a company.
- Real Estate – The suggested limit is 15% of the book value of the PEEHIF's portfolio.
- Alternative Investments (mezzanine financing, LBO's, venture capital, limited partnerships, futures, commodities and derivative investments) – Limited to 10% of the book value of the PEEHIF's aggregate portfolio.
- Short-term Investments – Limited to 20% of the market value of the PEEHIF's aggregate portfolio in order to maintain adequate liquidity for payment of member health care benefits.

All investments at the fiscal year-end were held in short-term investments as they will be used to cover cash flow in the short-term.

The following table provides information as of September 30, 2011, concerning the fair value of investments and interest rate risk.

INVESTMENTS						
Maturity in Years at Fair Value						
(Amounts in Thousands)						
Type of Investment	Less Than 1	1-5	6-10	More Than 10	Total Fair Value	Cost
Money Market Funds	\$ 177,995	\$ -	\$ -	\$ -	\$ 177,995	\$ 177,995
Commercial Paper	14,786	-	-	-	14,786	14,786
Total Investments	\$ 192,781	\$ -	\$ -	\$ -	\$ 192,781	\$ 192,781

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Notes to the Financial Statements
For the Fiscal Year Ended September 30, 2011

A. Investment Risks, continued

The following table provides information as of September 30, 2011, concerning credit risk

RATINGS OF FIXED MATURITIES

(Amounts in Thousands)

<u>Moody's Ratings</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value as a Percent of Total Fixed Maturity Fair Value</u>
P-1	\$ 14,786	\$ 14,786	7.67%
P-2	177,995	177,995	92.33
Totals	\$ 192,781	\$ 192,781	100.00%

B. Concentration of Investments

As of September 30, 2011, the PEEHIF owned securities that constituted more than 5% of the total fair value of investments in the following issuers:

<u>Issuer:</u>	<u>Percentage of Investments</u>
FMC Technologies, Inc.	13.59%
Liberty Mutual Group, Inc.	12.96
Celgne Corporation	11.83
Nextera Energy Capital Holdings	10.37
South Carolina Fuel Company	10.37
Sempre Energy Global Enterprise	8.04
Nissan Motor Acceptance Corporation	7.78
Oneok, Inc.	7.27
Harris Corporation	5.19

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements

For the Fiscal Year Ended September 30, 2011

4) Unpaid Claims Liabilities

As discussed in Note 1, the PEEHIF establishes a liability for both reported and unreported insured claims, which includes provisions for both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities for the PEEHIF for 2011.

UNPAID CLAIMS LIABILITIES

(Amounts in Thousands)

Unpaid Claims and Claims Adjustment Expenses at Beginning of Year	<u>\$ 76,793</u>
Incurred Claims and Claim Adjustment Expenses:	
Provision for Insured Events of the Current Year	750,966
Decrease in Provision for Insured Events for Prior Years	<u>(15)</u>
Total Incurred Claims and Claim Adjustment Expenses	<u>750,951</u>
Payments:	
Claims and Claim Adjustment Expenses Attributable to Insured Events of the Current Year	678,546
Claims and Claim Adjustment Expenses Attributable to Insured Events of the Prior Years	<u>76,779</u>
Total Payments	<u>755,325</u>
Total Unpaid Claims and Claim Adjustment Expenses at the End of the Year	<u><u>\$ 72,421</u></u>

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

Notes to the Financial Statements For the Fiscal Year Ended September 30, 2011

5) Other Postemployment Benefits

The PEEHIF employees and retirees participate in the State Employees' Health Insurance Plan (SEHIP) administered by the State Employees' Health Insurance Board (Board). The State Employees' Insurance Fund (SEIF) was established in 1965 under the provisions of Act 833 of the Legislature to provide health insurance benefits for employees and retired employees of the State of Alabama. In addition, The *Code of Alabama, Section 36-36-1*, established the Alabama Retired State Employees' Health Care Trust) for the purpose of accumulating assets to fund retiree benefits. The Trust is a single-employer plan.

The Trust issues financial statements that may be obtained by writing to:

State Employees' Insurance Board
P.O. Box 304900
Montgomery, AL 36130

The *Code of Alabama 1975, Section 36-29-7*, authorizes the employer contributions to the plan. Each year, the Legislature sets the premium rate in the annual appropriation bill required to be paid by employers on behalf of each active member.

A portion of the premium is used to assist in funding retiree benefits. The fiscal year 2011 rate was \$805 per active member per month.

The *Code of Alabama, Section 36-29-19.7* authorizes the retiree contributions to the plan. Required monthly contribution rates for FY2011 were as follows:

Required member Rates

- Individual Coverage/Non-Medicare Eligible - \$ 196.00
- Family Coverage/Non-Medicare Eligible Retired Member and Non-Medicare Eligible Dependent(s) - \$ 418.00
- Family Coverage/Non-Medicare Eligible Retired member and Dependent Medicare Eligible - \$317.00
- Individual Coverage/Medicare Eligible Retired Member - \$0
- Family Coverage/Medicare Eligible Retired Member and Non-Medicare Eligible Dependent(s)- \$222.00
- Family Coverage/Medicare Eligible Retired Member and Dependent Medicare Eligible - \$121.00
- For employees that retire other than for disability, for each year under 25 years of service, the retiree pays two percent of the employer premium and for each year over 25 years of service, the retiree premium is reduced by two percent of the employer premium.

Surviving Spouse Rates

- Surviving Spouse Non-Medicare Eligible - \$312.00
- Surviving Spouse Non-Medicare Eligible and Dependent Non-Medicare Eligible - \$534.00
- Surviving Spouse Non-Medicare Eligible and Dependent Medicare Eligible - \$443.00
- Surviving Spouse Medicare Eligible - \$131.00
- Surviving Spouse Medicare Eligible and Dependent Non-Medicare Eligible - \$353.00
- Surviving Spouse Medicare Eligible and Dependent Medicare Eligible - \$262.00

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND

**Notes to the Financial Statements
For the Fiscal Year Ended September 30, 2011**

5) Other Postemployment Benefits, continued

PEEHIF employees participate in the State Employees' Health Insurance Plan of Alabama. The following table details the annual required contributions and the percentage contributed (amounts in thousands).

<u>Fiscal Year</u>	<u>Annual Required Contributed</u>	<u>Percentage Contributed</u>
2011	\$ 69	72.70 %
2010	76	87.79
2009	75	57.71

6) Pension Plan for PEEHIF Employees

PEEHIF employees participate in the TRS pension plan, which is a cost sharing plan. Contributions to the plan were made in accordance with actuarially determined contribution requirements. The schedule of Employer Contributions is shown below in thousands.

<u>Fiscal Year</u>	<u>Annual Required Contributed</u>	<u>Percentage Contributed</u>
2011	\$ 206	100 %
2010	220	100
2009	193	100

PUBLIC EDUCATION EMPLOYEES' HEALTH INSURANCE FUND
Required Supplementary Information
September 30, 2011

Claims Development Information

(Amounts in Thousands)

The table below illustrates the ten-year historical trend information designed to provide information on how PEEHIF's earned revenues and interest income compare to related costs of loss and other expenses assumed by PEEHIF as of year-end. The lines of the table are defined as follows: (1) This line shows the total of each fiscal year's earned contribution revenues and investment revenues. (2) This line shows each fiscal year's other operating costs of PEEHIF including overhead and claims expense not allocable to individual claims. (3) This line shows PEEHIF's incurred claims and allocated claim adjustment expense (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year). (4) This line shows the cumulative amounts paid as of the end of successive years for each policy year. (5) This line shows how each policy years incurred claims increased or decreased as of the end of successive years. This annual re-estimated result is from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known. (6) This line compares the latest re-estimated incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for each policy year matures, the correlation between original estimates and re-estimated amounts is commonly used to evaluate the accuracy of estimated incurred claims currently recognized.

	Fiscal and Policy Year Ended									
	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002
1) Net Earned Required Contribution & Investment Revenue	884,416	764,313	806,691	870,330	851,238	1,033,162	873,373	718,716	634,410	595,952
2) Unallocated Expenses	2,587	3,160	2,566	2,731	2,199	2,609	3,343	1,261	1,026	974
3) Estimated Incurred Claims & Expense at End of Policy Year	750,966	790,024	775,205	699,409	636,854	858,906	802,624	743,387	669,578	585,644
4) Paid (Cumulative) As Of:										
End of Policy Year	678,546	713,231	696,658	629,815	585,303	788,907	724,720	652,929	596,616	521,678
One Year Later		790,009	772,397	699,370	636,391	854,905	788,939	725,418	661,598	582,643
5) Reestimated Incurred Claims & Expense:										
End of Policy Year	750,966	790,024	775,205	699,409	636,854	858,906	802,624	743,387	669,578	585,644
One Year Later		790,009	772,397	699,370	636,974	854,323	788,939	725,418	661,598	582,643
6) Increase/(Decrease) in Estimated Incurred Claims & Expenses at End of Policy Year		(15)	(2,808)	(39)	120	(4,583)	(13,685)	(17,969)	(7,980)	(3,002)

2007 was the first year that retirees were segregated from the active employees. As a result, 2007 includes the amounts only attributable to the active employees. This schedule is presented prospectively.