



**OKLAHOMA STATE AND EDUCATION EMPLOYEES  
GROUP INSURANCE BOARD**

(A Component Unit of the State of Oklahoma)

Basic Financial Statements

December 31, 2010 and 2009

(With Independent Auditors' Report Thereon)

**OKLAHOMA STATE AND EDUCATION EMPLOYEES  
GROUP INSURANCE BOARD**  
(A Component Unit of the State of Oklahoma)

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KPMG LLP  
210 Park Avenue, Suite 2850  
Oklahoma City, OK 73102-5683

## Independent Auditors' Report

Members of the Board  
Oklahoma State and Education Employees  
Group Insurance Board  
Oklahoma City, Oklahoma:

We have audited the accompanying balance sheets of the Oklahoma State and Education Employees Group Insurance Board (OSEEGIB), a component unit of the State of Oklahoma, as of December 31, 2010 and 2009, and the related statements of revenues, expenses and changes in fund equity, and cash flows for the years then ended. These financial statements are the responsibility of OSEEGIB's management. 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of OSEEGIB's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Oklahoma State and Education Employees Group Insurance Board as of December 31, 2010 and 2009, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 27, 2011, on our consideration of OSEEGIB's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The accompanying management's discussion and analysis on pages 3 through 9 is not a required part of the basic financial statements, but is 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.

KPMG LLP

April 27, 2011

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**Overview of the Financial Statements**

The Oklahoma State and Education Employees' Group Insurance Board's (OSEEGIB) basic financial statements are prepared on the basis of accounting principles generally accepted in the United States of America for governmental entities and insurance enterprises where applicable. The primary purpose of OSEEGIB is to provide group health, dental, life, and disability insurance for employees of state agencies, school districts, and other governmental units as set forth in Title 74 of the Oklahoma Statutes. OSEEGIB is a component unit of the State of Oklahoma.

The three financial statements presented within the basic financial statements are as follows:

**Balance Sheets** – This statement presents information reflecting OSEEGIB's assets, liabilities, and fund equity. Fund equity represents the amount of total assets less total liabilities. The balance sheet is classified as to current and noncurrent assets and liabilities. For purposes of the financial statements, current assets and liabilities are those assets and liabilities with immediate liquidity or which are collectible or becoming due within twelve months of the statement date. OSEEGIB's investment balances are considered current assets, as OSEEGIB has historically experienced a high portfolio turnover rate.

**Statements of Revenues, Expenses, and Changes in Fund Equity** – This statement reflects OSEEGIB's operating revenues and expenses, as well as nonoperating revenues during the year. The major source of operating revenue is premium income and the major sources of operating expenses are health, dental, life, and disability benefits. The change in fund equity for an enterprise fund is similar to net profit or loss for a private sector insurance company.

**Statements of Cash Flows** – The statements of cash flows are presented on the direct method of reporting which reflects cash flows from operating, capital and related financing, and investing activities. Cash collections and payments are reflected in this statement to arrive at the net increase or decrease in cash for the fiscal year.

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**Financial Highlights**

The management of the Oklahoma State and Education Employees' Group Insurance Board (OSEEGIB) offers readers of OSEEGIB's financial statements this narrative overview and analysis of the financial activities of the entity for the years ended December 31, 2010, 2009, and 2008.

	<b>December 31</b>			<b>2010 v. 2009</b>
	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>Change Amount</b>
Cash and investments	\$ 306,453,926	259,205,958	217,007,595	47,247,968
Premiums receivable, net	44,250,802	30,454,967	24,966,549	13,795,835
Other current assets	10,085,146	13,809,260	8,091,122	(3,724,114)
Total current assets	360,789,874	303,470,185	250,065,266	57,319,689
Office equipment, net	631,066	609,442	710,218	21,624
Total assets	\$ 361,420,940	304,079,627	250,775,484	57,341,313
Policy and contract claim reserves	\$ 95,620,000	107,617,000	98,479,000	(11,997,000)
Disability reserves (current only)	2,921,000	2,846,000	2,747,000	75,000
Premium deficiency reserves	1,754,000	—	11,915,000	1,754,000
Other current liabilities	19,068,764	22,608,838	16,638,908	(3,540,074)
Total current liabilities	119,363,764	133,071,838	129,779,908	(13,708,074)
Total noncurrent liabilities	16,056,061	10,963,000	10,552,000	5,093,061
Total liabilities	135,419,825	144,034,838	140,331,908	(8,615,013)
Invested in capital assets	631,066	609,442	710,218	21,624
Unrestricted fund equity	225,370,049	159,435,347	109,733,358	65,934,702
Total fund equity	226,001,115	160,044,789	110,443,576	65,956,326
Total liabilities and fund equity	\$ 361,420,940	304,079,627	250,775,484	57,341,313

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	Year ended December 31,			2010 v. 2009
	2010	2009	2008	Change Amount
Premium revenue	\$ 844,510,757	861,781,691	761,944,652	(17,270,934)
Pass-through grant revenue	4,988,061	—	—	4,988,061
Other operating revenues	15,956,831	14,729,837	14,382,892	1,226,994
Total operating revenues	<u>865,455,649</u>	<u>876,511,528</u>	<u>776,327,544</u>	<u>(11,055,879)</u>
Incurring claims expense	773,896,816	820,375,131	789,028,273	(46,478,315)
Change in premium deficiency reserves	1,754,000	(11,915,000)	(12,712,000)	13,669,000
Pass-through grant expense	4,988,061	—	—	4,988,061
Administrative and claims processing expense	38,415,484	38,423,432	38,717,310	(7,948)
Total operating expenses	<u>819,054,361</u>	<u>846,883,563</u>	<u>815,033,583</u>	<u>(27,829,202)</u>
Operating income (loss)	46,401,288	29,627,964	(38,706,039)	16,773,324
Net investment income	19,555,038	19,973,249	(22,340,582)	(418,211)
Change in fund equity	65,956,326	49,601,213	(61,046,621)	16,355,113
Fund equity, beginning of year	<u>160,044,789</u>	<u>110,443,576</u>	<u>171,490,197</u>	<u>49,601,213</u>
Fund equity, end of year	<u>\$ 226,001,115</u>	<u>160,044,789</u>	<u>110,443,576</u>	<u>65,956,326</u>

OSEEGIB's total assets for the year ended December 31, 2010 increased by approximately 19% from the previous year, just slightly less than 2009, which showed an increase of 21%. Cash and investments increased by approximately \$47.2 million or 18% during 2010 due to favorable claims experience, very similar to the \$42.2 million increase or 19% during 2009.

During 2010, OSEEGIB earned approximately \$5.2 million in interest and dividend income. OSEEGIB realized investment gains of \$10.5 million and experienced \$4.4 million in unrealized gains. Investment expenses were approximately \$524,000 resulting in a total net gain on investments of \$19.6 million. In 2009, OSEEGIB earned approximately \$6.2 million in interest and dividend income, experienced \$2.9 million in realized losses and \$17.1 million in unrealized gains, and paid \$438,000 in investment expenses for a net investment gain of \$20.0 million. OSEEGIB's investment allocation at December 31, 2010 is comprised of approximately 46% fixed income securities, 33% equities, and 21% cash equivalents compared to approximately 53% fixed income securities, 24% equities, and 23% cash equivalents at December 31, 2009.

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Premiums receivable at December 31, 2010 increased by \$13.8 million over December 31, 2009, primarily due to an increase in the monthly premium for 2010. At December 31, 2009, premiums receivable had increased by \$5.5 million. The decrease in other current assets in 2010 of \$3.7 million is primarily due to a \$3.8 million decrease in the receivable for pending investment sales. The increase for other current assets in 2009 of \$5.7 million is primarily due to a \$3.2 million increase in the receivable for pharmacy rebates as well as an almost \$2.0 million increase in a receivable for pending investment sales.

Total liabilities as of December 31, 2010 decreased \$8.6 million from December 31, 2009. Policy and contract claim reserves including noncurrent disability reserves decreased by \$11.9 million from reserves reported at December 31, 2009. This was a result of an overall decrease in incurred claims partially due to a decrease in the number of participants in the plan and partially due to the effect of changes in benefits. In 2010, the office visit copayment was raised from \$25 to \$50 resulting in a significant decrease in utilization. At December 31, 2009, total claim reserves were \$9.1 million more than reserves at December 31, 2008 due to an overall increase in incurred claims in 2009. A pass-through grant liability of \$5.0 million for funds received from the Early Retiree Reinsurance Program was booked at December 31, 2010. These funds will be used to reduce premiums for the 2012 plan year. This liability will be amortized in 2012 as it is used. There was no pass-through grant liability in 2009.

Premium deficiency reserves are required to be recorded when the anticipated cost to settling claims plus policy maintenance costs for the following fiscal year are in excess of the anticipated premium receipts for the following fiscal year. The premium deficiency liability booked as of December 31, 2010 was \$1.8 million. There was no premium deficiency reserve liability at December 31, 2009.

Other current liabilities at December 31, 2010 decreased \$3.5 million from December 31, 2009 primarily due to a \$3.4 million decrease in payables for unsettled investment purchases. Other current liabilities increased \$6 million from December 31, 2008 due in part to a \$1.1 million increase in the payable to a Third Party Administrator as well as a \$2 million increase in the payable for unsettled investment purchases.

OSEEGIB saw a decrease in premium revenue for 2010 of approximately \$17.3 million. Thirteen regional universities moved to another carrier on January 1, 2010 and participation continued to decrease slightly throughout the year as participating employers reduced staff due to budget cuts. In contrast, OSEEGIB saw an increase in net premium revenue for 2009 of approximately \$99.8 million, primarily due to the rate increases necessary for 2009. Payments from the Centers for Medicare and Medicaid Services (CMS), which is included in premium revenue decreased by \$1.2 million in 2010 due to a change in the per member amount paid, after increasing by \$1.4 million in 2009. For the year ended December 31, 2010, OSEEGIB earned approximately \$16.0 million in other operating income, which consisted of \$2.2 million in risk adjustment fee income and \$13.3 million in pharmacy rebates. For the year ended December 31, 2009, OSEEGIB earned approximately \$14.7 million in other operating income, which consisted of \$1.7 million in risk adjustment fee income and \$13.0 million in pharmacy rebates.

Incurred claims comprised 95.3% of OSEEGIB's total expenses for 2010 and 95.5% of total expenses in 2009. Changes in premium deficiency reserves and pass-through grant expenses are not considered in the calculation. Total incurred claims for 2010 decreased by \$46.5 million, or 6% from the year ended December 31, 2009. For the year ended December 31, 2009, total incurred claims increased by \$31.3 million, or 4% over the prior year.

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Health and dental claim costs decreased by approximately \$43.1 million, or 3%, over the prior year, due to a decrease in office visit utilization combined with a decrease in the participating population. For the year ended December 31, 2009, health and dental claim costs increased by approximately \$27.1 million or 4% over the year ended December 31, 2008. The expense for life benefits decreased by approximately \$3.0 million or 13% during 2010. In 2009, life benefits expense increased by approximately \$2.8 million or 13% over the expense reported for 2008. Disability benefits for 2010 increased by \$95,000 or 3% after increasing by \$1.6 million or 7% in 2009.

Administrative expenses decreased slightly by \$8,000 in 2010. In 2009, administrative expenses decreased by \$300,000, or 0.8%, in 2009. Administrative expenses make up 5% of OSEEGIB's total expenses in 2010 and 4% in 2009.

OSEEGIB experienced an increase in fund equity of approximately \$66.0 million, for the year ended December 31, 2010. For 2009, there was an increase in fund equity of approximately \$49.6 million.

The Health and Dental program experienced an increase in fund equity of approximately \$57.8 million, for the year ended December 31, 2010 due to the increase in premiums, improvement in the investment markets, and favorable claims experience. During 2009, the Health and Dental program experienced an increase in fund equity of approximately \$49.0 million. The premium rates adopted for the Health and Dental Fund were based on assumptions that provided for no increase or decrease in fund equity.

The Life program experienced an increase in fund equity of approximately \$4.6 million in 2010 and a decrease of \$2.4 million in 2009. The premium rates adopted for the Life program were based on assumptions that provided for no increase or decrease in fund equity.

The Disability program experienced an increase in fund equity of \$3.6 million in 2010, while in 2009, the Disability program experienced a decrease in fund equity of \$3.0 million. The premium rates adopted for the Disability program were based on assumptions that provided for no increase or decrease in fund equity.

**Economic Conditions**

The insurance industry monitors healthcare costs by establishing a percentage of cost increases known as "trend." According to the Segal Health Plan Cost Trend Survey, trend is the forecast change in health plans' per-capita claims cost determined by insurance carriers, managed care organizations, and third-party administrators. Many factors influence trend, including:

- Price inflation,
- Deductibles and copayments,
- Cost-shifting,
- Utilization increases due to aging, product promotion, and improved diagnostic services,

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- The availability and use of more expensive drug therapies,
- Government mandated benefits and other legislative changes, and
- Technological changes.

For 2010, the overall nationwide health trend for employer sponsored plans, according to AON Consulting, OSEEGIB's actuarial firm, was 10.7% for PPO plans with pharmacy benefits. The national trend for Medicare supplement plans was 7.5% for 2010 and 7.6% for 2009. Historically, OSEEGIB's cost trends have tracked below national averages. As a large self-funded plan, OSEEGIB's cost trends are cyclical in nature, and can vary during a given plan year. OSEEGIB experienced an average medical trend of 7.5% - 8.5% during 2009 and 2010 for active members and retirees under age 65. OSEEGIB's trend for the Medicare supplement plan was a decrease of 1.5%. These figures measured OSEEGIB's paid claims and did not adjust for plan design or provider contracting changes during the measurement period.

Since premium rates are set in August, the rate setting process applies trends experienced through April. The medical trend applied by OSEEGIB's actuaries for calculating 2010 rates was 10.0% for active employees and pre-Medicare retirees and 7.0% for Medicare retirees. The prescription drug trend used for setting 2010 rates was 9.1% for active employees and pre-Medicare retirees and 9.1% for Medicare retirees. The dental trend used for setting 2010 rates was 6.0%. The medical trend applied by OSEEGIB's actuaries for calculating 2009 rates was 9.5% for active employees and pre-Medicare retirees and 7.0% for Medicare retirees. The prescription drug trend used for setting 2009 rates was 7.5% for active employees, pre-Medicare retirees, and Medicare retirees. The dental trend used for setting 2009 rates was 6.0%.

After a dismal year in 2008, OSEEGIB's investment portfolio rebounded in 2009 and continued to experience positive returns in 2010. The return on investment (ROI) on OSEEGIB's investment portfolio was 7.7% in 2010 and 8.5% in 2009.

The Patient Protection and Affordable Care Act (ACA) was signed by President Obama on March 23, 2010 and included wide-sweeping changes to many facets of the nation's healthcare system. ACA provides that plans existing at the time the act was signed may exempt themselves from some requirements as long as they maintain what is called 'grandfathered status.' Grandfathered status is lost by making certain changes to benefits, employer contributions, or premiums that increase the financial burden on the member. OSEEGIB maintained grandfathered status in 2010 because federal guidance on implementation of many ACA plan provisions did not exist, and to allow more time for a future successful implementation of the requirements.

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Although OSEEGIB continued to operate as a grandfathered plan into 2011, it used 2010 to prepare to implement some ACA provisions required for nongrandfathered plans. OSEEGIB already complied with most of the "patient protection" features of ACA, and many other changes will be comparatively minor. As applicable specifically to OSEEGIB, requirements included removing the lifetime pharmacy benefit maximum and increasing the age limit for dependent coverage of a primary member's children from age 25 to age 26. The most costly of the changes to be mandated by ACA is that nongrandfathered plans must provide a very large array of preventive services free of charge to members. OSEEGIB provides the majority of the preventive services free of charge, with others covered applying normal copayments and deductibles. ACA established an Early Retirement Reimbursement Program (ERRP) and allocated \$5 billion to be distributed nationwide to plan sponsors that provide coverage to retirees who are not yet eligible for Medicare. OSEEGIB applied for these funds on behalf of its participating groups and received approximately \$5 million in December 2010. The ERRP is discussed further in the notes to the financial statements.

In the commercial health insurance industry, "medical loss ratio" (MLR) measures how much of each premium dollar is spent on providing healthcare to their customers versus administrative costs. The medical loss ratio is a basic indicator of an insurer's efficiency in delivering services and of its financial condition. ACA establishes a minimum loss ratio of 80% for the individual and small group health insurance segments, and 85% for the large group segment. This requirement does not apply to self-insured plans such as those offered by OSEEGIB. However OSEEGIB is interested in operating at a MLR that is competitive with other plans, both fully insured and self-insured. OSEEGIB's MLR was 94% in 2009 and fell slightly to 92% for 2010 due to very favorable claims experience.

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Balance Sheets

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<b>Assets</b>	<b>2010</b>	<b>2009</b>
Current assets:		
Cash and cash equivalents	\$ 87,436,790	83,857,770
Investments	219,017,136	175,348,188
Receivables:		
Interest and dividends receivable	429,514	383,621
Unsettled investment sales	1,884	3,833,553
Premiums, net of allowance of \$240,000 and \$800,000 at December 31, 2010 and 2009, respectively	44,250,802	30,454,967
Pharmacy rebate	8,813,534	8,594,904
Other, net	840,214	997,182
Total current assets	<u>360,789,874</u>	<u>303,470,185</u>
Noncurrent assets:		
Office equipment	4,177,236	4,163,900
Less accumulated depreciation	<u>(3,546,170)</u>	<u>(3,554,458)</u>
Office equipment, net	<u>631,066</u>	<u>609,442</u>
Total assets	<u>\$ 361,420,940</u>	<u>304,079,627</u>
<b>Liabilities</b>		
Current liabilities:		
Health and dental reserves	\$ 90,880,000	102,804,000
Life reserves	4,740,000	4,813,000
Disability reserves	2,921,000	2,846,000
Premium deficiency reserve	1,754,000	—
Premiums due to health maintenance organizations and other insurers	9,561,017	9,246,824
Payable for investment purchases	514,640	3,878,548
Other accrued liabilities	8,993,107	9,483,466
Total current liabilities	<u>119,363,764</u>	<u>133,071,838</u>
Noncurrent liabilities:		
Disability reserves	11,068,000	10,963,000
Prepaid premiums	4,988,061	—
Total liabilities	<u>135,419,825</u>	<u>144,034,838</u>
Commitments and contingencies (note 14)		
<b>Fund Equity</b>		
Invested in capital assets	631,066	609,442
Unrestricted	225,370,049	159,435,347
Total fund equity	<u>226,001,115</u>	<u>160,044,789</u>
Total liabilities and fund equity	<u>\$ 361,420,940</u>	<u>304,079,627</u>

See accompanying notes to basic financial statements.

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Statements of Revenues, Expenses and Changes in Fund Equity  
Years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Operating revenues:		
Premium revenue	\$ 844,510,757	861,781,691
Other operating revenues	15,956,831	14,729,837
Pass-through grant revenue	4,988,061	—
Total operating revenues	<u>865,455,649</u>	<u>876,511,528</u>
Operating expenses:		
Incurred claims expense	773,896,816	820,375,132
Change in premium deficiency reserve	1,754,000	(11,915,000)
Administrative and claim processing	38,415,484	38,423,432
Pass-through grant expense	4,988,061	—
Total operating expenses	<u>819,054,361</u>	<u>846,883,564</u>
Operating income	46,401,288	29,627,964
Nonoperating revenues:		
Net investment income	<u>19,555,038</u>	<u>19,973,249</u>
Change in fund equity	65,956,326	49,601,213
Fund equity, beginning of year	<u>160,044,789</u>	<u>110,443,576</u>
Fund equity, end of year	<u>\$ 226,001,115</u>	<u>160,044,789</u>

See accompanying notes to basic financial statements.

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Statements of Cash Flows

Years ended December 31, 2010 and 2009

	<b>2010</b>	<b>2009</b>
Cash flows from operating activities:		
Premiums collected	\$ 808,577,793	830,462,048
Premiums collected on behalf of health maintenance organizations and other insurers	122,951,075	120,025,897
Pass-through grant revenue	4,988,061	—
Payments collected from Centers for Medicare and Medicaid Services	23,958,020	25,172,614
Risk adjustment premium collected	2,192,501	1,708,628
Pharmacy rebates collected	13,126,229	9,979,237
Benefits paid	(785,713,816)	(810,727,132)
Premiums paid to health maintenance organizations and other insurers	(124,457,773)	(118,826,141)
Payments to employees for services	(9,811,583)	(10,181,591)
Payments to suppliers for goods and services	(28,898,230)	(25,622,234)
Other operating cash received	576,439	265,515
Net cash provided by operating activities	27,488,716	22,256,841
Cash flows from capital and related financing activity:		
Acquisition of office equipment	(217,654)	(132,124)
Net cash used in capital and related financing activity	(217,654)	(132,124)
Cash flows from investing activities:		
Purchases of investments	(389,113,372)	(194,426,040)
Proceeds from sales and maturities of investments	360,792,118	187,166,476
Investment income received	4,629,212	5,752,146
Net cash used in investing activities	(23,692,042)	(1,507,418)
Net increase in cash and cash equivalents	3,579,020	20,617,299
Cash and cash equivalents, beginning of year	83,857,770	63,240,471
Cash and cash equivalents, end of year	\$ 87,436,790	83,857,770
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 46,401,288	29,627,964
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	192,198	232,900
Loss on disposal of fixed assets	3,832	—
Change in operating assets and liabilities:		
Premium receivable	(13,795,835)	(5,488,418)
Prepaid premiums	4,988,061	—
Other receivables	(61,662)	(2,776,458)
Claim reserves	(11,997,000)	9,138,000
Disability reserves	180,000	510,000
Premium deficiency reserves	1,754,000	(11,915,000)
Premiums due to health maintenance organizations and other insurers	314,193	541,145
Other liabilities	(490,359)	2,386,708
Total adjustments	(18,912,572)	(7,371,123)
Net cash provided by operating activities	\$ 27,488,716	22,256,841

See accompanying notes to basic financial statements.

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**(1) Description of OSEEGIB**

The Oklahoma State and Education Employees Group Insurance Board (OSEEGIB) is a special purpose state and local government engaged solely in business-type activities. OSEEGIB is a legal trust, which administers, manages, and provides group health, dental, life, and disability insurance for active employees and retirees of state agencies, school districts, and other governmental units of the State of Oklahoma (the State). OSEEGIB is self-insured and is financed through premiums collected from employers and employees. OSEEGIB provides insurance solely to eligible employees, dependents, and retirees. OSEEGIB is a component unit of the State.

The following brief description of OSEEGIB is provided for general information purposes only. Participants should refer to Title 74 of the Oklahoma Statutes, Sections 1301 et seq. as amended, for more complete information.

In accordance with Title 74, OSEEGIB maintains three separate programs, the Health and Dental program, the Life program, and the Disability program. There is no statutory restriction that would prevent assets accumulated in one program from paying benefits due from another program.

The eight-member board which administers OSEEGIB (the Board) is comprised of two members appointed by the governor, two members appointed by the speaker of the House of Representatives, and two members appointed by the president pro tempore of the Senate, the commissioner of the Oklahoma Insurance Department, and the director of the Office of State Finance. The Board has a fiduciary responsibility to manage the funds and invest the assets of OSEEGIB. This moral and legal obligation establishes a trustee relationship whereby OSEEGIB's funds are held for the ultimate benefit of those who obtain insurance from OSEEGIB.

**(a) General**

In 1968, OSEEGIB was formed by the State Legislature to provide group health, dental, and life benefits to participants of the Oklahoma Public Employees Retirement System (OPERS) and active employees of the State. Subsequently, other groups became eligible for participation, including persons covered under the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), survivors and certain local government employees. COBRA allows temporary continuance of insurance coverage under certain circumstances. Survivors are individuals who were covered eligible dependents of a participant in OSEEGIB at the time of the participant's death. OSEEGIB was created by the State Legislature and could be terminated by the same body.

In 1978, OSEEGIB became self-insured. Beginning in 1985, participants were given the option of electing health coverage from certain health maintenance organizations (HMOs). Plans similar to HMOs provide dental coverage for those participants who elect to participate in them (DMOs). In 1986, the State added a self-insured disability program to OSEEGIB.

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In 1989, participants of the Teachers' Retirement System of Oklahoma (TRS) and active employees of school districts became eligible to enroll in OSEEGIB (educational participants). House Bill No. 1731, which provided TRS participants the option to enroll in OSEEGIB, required the TRS to transfer \$39,600,000 to OSEEGIB. The educational participants receive the same health and dental coverage options provided to state and local governmental participants. Life coverage was made available to active educational participants beginning July 1, 1991. Disability coverage is not available to educational participants.

Effective July 1, 1993, the Oklahoma State Employee Benefit Council (EBC) began contracting with HMOs and DMOs on behalf of state employees to provide health and dental coverage for those participants who elect such coverage.

Effective January 1, 2006, OSEEGIB became a Medicare Part D Prescription Drug Plan pursuant to the *Medicare Prescription Drug Improvement and Modernization Act of 2003*.

**(b) Premiums and Participants**

The health, dental, life, and disability benefits for governmental participants are funded by monthly premiums paid by the State, local governmental units, OPERS, and individuals. The health, dental, and life benefits for educational participants are funded by monthly premiums paid by school districts, the TRS, and individuals. A participant may extend coverage to dependents for an additional monthly premium based on the coverage requested. Premiums for active state employees and their dependents are collected by EBC and remitted to OSEEGIB or other insurer elected by the employee.

Premiums remitted to OSEEGIB on behalf of active state employees and their dependents for the years ended December 31, 2010 and 2009 are reported gross of a fee retained by EBC, which is equal to 1.25% of premiums. This fee, which was approximately \$2,997,000 and \$3,062,000 for the years ended December 31, 2010 and 2009, respectively, is included in administrative expenses in the statements of revenues, expenses and changes in fund equity. For the years ended December 31, 2010 and 2009, premiums for local government, education, and inactive participants who have elected an HMO for health coverage or DMO for dental coverage are collected by OSEEGIB and remitted to the HMO or DMO carrier net of a fee retained by OSEEGIB of 1% of premiums. This fee, which was approximately \$1,243,000 and \$1,191,000 for the years ended December 31, 2010 and 2009, respectively, is included as an offset to administrative expenses in the statements of revenues, expenses and changes in fund equity. The premium related to HMOs, DMOs, and vision plans was approximately \$124,772,000 and \$119,367,000 for 2010 and 2009, respectively, and, as OSEEGIB only acts in an agency capacity, the premiums collected on behalf of HMOs, DMOs, and vision plans are not reflected in the statements of revenues, expenses and changes in fund equity.

Pursuant to the authority granted by Oklahoma Statute, the Board has the authority to establish and change premium rates for the members, employers, and other contributing entities each year. An outside consultant advises the Board regarding changes in premium rates. If premium rates are changed, they generally become effective at the beginning of the next calendar year. Each HMO and DMO determines its own premium rates.

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OSEEGIB participants are not subject to supplemental assessment in the event of a premium deficiency. At the time of premium payment, the risk of loss due to incurred benefit costs is transferred from the participant to OSEEGIB. If the assets of OSEEGIB were to be exhausted, participants would not be responsible for OSEEGIB's liabilities.

At December 31, 2010, OSEEGIB provided health coverage to 134 state agency divisions with approximately 21,000 primary participants (not including dependents), 597 educational entities with approximately 47,000 primary participants, 300 local government entities with approximately 8,000 primary participants, and 33 other groups, which include the governmental and educational retirement systems, COBRA, and survivors, with approximately 38,000 primary participants. Approximately 50,000 dependents participated in OSEEGIB as well. In addition, OSEEGIB collected and remitted premiums for approximately 32,000 primary participants and 25,000 dependents who were covered by HMOs. These counts are provided for health coverage only.

At December 31, 2009, OSEEGIB provided health coverage to 133 state agency divisions with approximately 24,000 primary participants (not including dependents), 616 educational entities with approximately 54,000 primary participants, 303 local government entities with approximately 9,000 primary participants, and 33 other groups, which include the governmental and educational retirement systems, COBRA, and survivors, with approximately 39,000 primary participants. Approximately 57,000 dependents participated in OSEEGIB as well. In addition, OSEEGIB collected and remitted premiums for approximately 31,000 primary participants and 23,000 dependents who were covered by HMOs. These counts are provided for health coverage only.

All state agencies in Oklahoma are required to offer to their active employees the coverage selections offered by EBC. All eligible education or local government entities may elect to participate in OSEEGIB. Any education entity or local government entity which elects to withdraw from offering OSEEGIB as an insurance option may do so with 30 days, written notice and must withdraw both its active and inactive participants.

(c) ***Benefits***

A provider network arrangement is available for health and dental benefits. According to this arrangement, network providers agree to accept amounts for covered services that do not exceed the charges allowed by OSEEGIB. Therefore, the network provider can only expect to receive payment from the participant for the charges allowed by the network agreement.

HealthChoice offers a high option and a basic option health benefit plan for non-Medicare participants. A member who elects the high option plan is responsible for a \$50 copayment and no deductible for office visits and preventive care services when using network providers. The same services when using nonnetwork providers are reimbursed at 50% after the member meets a \$500 calendar year deductible. For other services, network provider and nonnetwork provider benefits are generally reimbursed at 80% and 50%, respectively, after the appropriate deductibles of \$500 (\$1,500 per family). OSEEGIB reimburses allowed charges at 100% once the member has reached \$2,800 and \$3,300 per member out-of-pocket maximum for network providers and nonnetwork providers, respectively.

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The basic option plan pays 100% of the first \$500 of allowed charges for covered medical services. The member pays 100% of the next \$500 (\$1,000 per family) of allowed charges. The member and OSEEGIB each pay 50% of the next \$10,000 of allowed charges (\$20,000 per family). OSEEGIB reimburses allowed charges at 100% once the member has reached the out-of-pocket maximum of \$5,500 (\$11,000 per family).

In addition, for both plans, when using non-network providers, the member is responsible for the excess of billed charges over allowed charges.

The HealthChoice S-Account option is a qualified, high deductible health plan that must be used in combination with a Health Savings Account. A member who selects the high deductible plan must meet a deductible of \$1,500 (\$3,000 per family) before any benefits are paid by the plan. Additional deductibles of \$300 for each non-network hospital confinement and \$100 for each emergency room visit apply. After deductibles are met, the member is responsible for the same copayments and coinsurance percentages as the high option plan. There is a network out-of-pocket limit of \$4,000 per individual or \$8,000 per family, after which HealthChoice pays 100% of allowed charges for covered services from a network provider.

A HealthChoice USA option is offered to active participants who work outside Oklahoma and Arkansas for more than 90 consecutive days and to non-Medicare retired participants who live outside those two states. These members have the same benefits as the HealthChoice high option, but they access a nationwide provider network.

Pharmacy benefits are the same for the high option and the basic option plans. Medications are categorized as either preferred or nonpreferred. When purchasing preferred medications from a network provider, the member is responsible for a copayment of up to \$30 for medications costing \$100 or less and up to \$60 for medications costing more than \$100. The maximum copay doubles for nonpreferred medications. Certain prescription medications for smoking cessation are available at a \$5 copayment. In addition, there is a \$2,500 per person annual out-of-pocket maximum for preferred medications. There is no out-of-pocket maximum for nonpreferred medications. For nonnetwork providers, the member is responsible for a copay of up to \$75 for preferred medications and up to \$125 for nonpreferred medications plus a dispensing fee. There is a lifetime maximum pharmacy benefit of \$2,000,000 per covered person.

Allowed expenses for dental benefits are reimbursed at a percentage ranging from 60% to 100%, based on the class of the allowed expense, when using network providers. The same services when using a nonnetwork provider are reimbursed at a percentage ranging from 50% to 100%. There is a \$25 deductible (\$75 per family) when using either network or nonnetwork providers. There is a calendar year maximum dental benefit of \$2,000 per covered person.

Basic life benefits of \$20,000 are provided to active state, education, and local government employees. In addition to the basic life benefit of \$20,000, participants may elect additional coverage in increments of \$20,000 up to the lesser of \$300,000 or five times the participant's salary. Additional dependent life coverage is also available under three separate plans. The low option plan

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offers dependent life coverage of \$6,000 for spouses, \$3,000 for children, and \$1,000 for children less than six months of age. The standard option plan offers dependent life coverage of \$10,000 for spouses, \$5,000 for children, and \$1,000 for children less than six months of age. The premier option offers dependent life coverage of \$20,000 for spouses, \$10,000 for children, and \$1,000 for children less than six months of age.

Retirees may elect to retain the full coverage for basic life benefits held at the time of termination of employment. Coverage thereafter may be decreased in \$5,000 increments to a minimum of \$5,000 or totally terminated. Prior to July 1, 2002, no more than \$15,000 of basic life insurance could be retained after termination of employment. The retiree may retain dependent life coverage in force on eligible dependents in \$500 increments.

Disability benefits are based on the length of employment, base salary limited by a maximum allowable salary, and length of disability. There is a 30-day qualifying period for short-term disability. Long-term disability becomes effective 180 days after disablement. Income from other sources is used to reduce the benefit amount. The duration of the long-term benefit is determined based upon the age of the participant at disablement and length of employment.

A high option and low option Medicare supplement benefit plan is available to those retired participants and their dependents who are eligible to enroll in Medicare, where Medicare is the primary payor. This coverage provides for reimbursement of Medicare-eligible expenses which may not be fully covered by or which exceed the amount allowed by Medicare. Medicare Part A expenses are generally reimbursed at 100% of eligible Medicare expenses not reimbursed by Medicare. The Medicare Part A deductible is also fully reimbursed by OSEEGIB. Medicare Part B expenses are generally reimbursed at 20% of eligible Medicare expenses not reimbursed by Medicare.

OSEEGIB has adopted Plan "J" for medical benefits for both the high option and low option plans in accordance with the National Association of Insurance Commissioners' schedule of Medicare supplement plans, with the addition of a pharmacy prescription program, preventive care benefits, out-of-country benefits, and an at-home recovery benefit.

Pharmacy benefits for the high option Medicare supplement plan are the same as for the HealthChoice high option plan, with a few minor differences in the formulary. The low option Medicare supplement plan is modeled after the Center for Medicare and Medicaid Services (CMS) standard Part D plan design. Once a participant reaches catastrophic coverage, OSEEGIB pays 100% of the pharmacy cost rather than 95% per CMS' standard Part D plan design.

Health benefits and dental benefits are provided directly by the HMOs and DMOs for all participants who elect such coverage. For each participant who elects HMO or DMO coverage, excluding active state employees, OSEEGIB collects and pays the premiums to each HMO or DMO carrier. For each active state employee who elects HMO or DMO coverage, EBC collects and pays the premiums to each HMO or DMO carrier. The amounts paid by OSEEGIB to each HMO or DMO are in accordance with their respective contracts. Benefits are the responsibility of each HMO or DMO carrier and are subject to the provisions defined in their insurance policies. OSEEGIB has no liability

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for health benefits or dental benefits of participants who elect HMO or DMO coverage; therefore, activity related to HMO, DMO, and vision benefits are not reflected in the basic financial statements of OSEEGIB.

All benefits for OSEEGIB are processed and paid by third-party administrators (TPAs). The fees incurred by OSEEGIB for services performed by the TPAs totaled approximately \$17,700,000 and \$16,400,000 for the years ended December 31, 2010 and 2009, respectively. TPA fees are included in administrative expenses in the statements of revenues, expenses, and changes in fund equity.

A summary of available coverage and eligible groups for the years ended December 31, 2010 and 2009 is as follows:

	<u>State employee</u>	<u>Education employee</u>	<u>Local government employee</u>	<u>OPERS</u>	<u>TRS</u>	<u>COBRA</u>
Health	X	X	X	X	X	X
Dental	X	X	X	X	X	X
Life	X	X	X	X	X	
Disability	X		X			
Medicare supplement				X	X	X

**(2) Summary of Significant Accounting Policies**

**(a) Basis of Accounting**

OSEEGIB has prepared its financial statements in accordance with U.S. generally accepted accounting principles for state and local governments. The Governmental Accounting Standards Board (GASB) establishes the U.S. generally accepted accounting principles for state and local governments. GASB requires that proprietary activities apply all applicable GASB pronouncements and Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, to the extent that they do not conflict with GASB pronouncements. The entity can elect, at its option, to apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. OSEEGIB has adopted this option.

**(b) Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. OSEEGIB adjusts such estimates and assumptions when facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates resulting

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from continuing changes in the economic environment will be reflected in the financial statements in future periods.

**(c) Investments and Investment Income**

Investments are stated at fair value based on quoted prices with changes in fair value included in the statements of revenues, expenses and changes in fund equity. If quoted prices are not available from active exchanges for identical instruments, then fair values are estimated using quoted prices from less active markets, quoted prices of securities with similar characteristics, or by pricing models utilizing other significant observable inputs. Investments in external investment pools, such as commingled funds, are stated at fair value based on actual transaction values. There was no difference in the fair value and the net asset value in the pool of shares in the commingled fund at December 31, 2010 and 2009.

OSEEGIB records investment purchases and sales based upon the trade date. Therefore, OSEEGIB records either receivables or payables for unsettled sales or purchases, respectively. Such transactions are usually settled within a few days after the trade date.

Realized gains and losses are determined on the average-cost method. The calculation of realized gains and losses is independent of the calculation of the change in net unrealized gains and losses. Realized gains and losses on investments that had been held in more than one year and sold in the current year may have been recognized as unrealized gains and losses in prior years.

Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

**(d) Office Equipment**

Office equipment is recorded at cost and depreciated on a straight-line basis over the estimated useful lives of the equipment, which range from 5 to 10 years. Purchases of equipment costing less than \$2,500 are considered to be immaterial and are expensed when purchased.

**(e) Reserves**

OSEEGIB establishes health and dental and life reserves based on the ultimate estimated cost of settling claims that have been reported but not settled, and of claims that have been incurred but not yet reported. Disability reserves are also established based on the estimated ultimate cost of settling claims of participants currently receiving benefits and for disability claims incurred but not yet reported to OSEEGIB. Long-term disability reserves are carried at the present value of expected future benefits. The reserves are determined using OSEEGIB's historical benefit payment experience. These estimates are based on data available at the time of estimate and are reviewed by OSEEGIB's independent consulting actuaries. The health, dental, and life reserves and the disability reserves include liabilities for claim processing expenses associated with paying claims, which have been incurred, but not yet paid. The length of time for which costs must be estimated depends on the coverage involved.

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Although reserves reflect OSEEGIB's best estimates of the incurred claims to be paid, due to the complex nature of the factors involved in the calculation, the actual results may be more or less than the estimate. The claim reserves are recomputed on a periodic basis using actuarial and statistical techniques, which consider the effects of general economic conditions, such as inflation, and other factors of past experience, such as changes in participant counts. Adjustments to claim reserves are recorded in the periods in which they are made. Claims must be filed no later than the last day of the calendar year immediately following the calendar year in which the loss is sustained unless an extenuating circumstance can be shown to exist.

Premium deficiency reserves are required to be recorded when the anticipated costs of settling claims plus policy maintenance costs for the following fiscal year are in excess of the anticipated premium receipts for the following fiscal year.

*(f) Fund Equity*

At December 31, 2010 and 2009, OSEEGIB has no legally required minimum fund equity. However, the Board has elected to set a benchmark for minimum fund equity based upon the National Association of Insurance Commissioners (NAIC), the Managed Care Organizations Risk Based Capital Formula for the Health and Dental program, and the NAIC Life/Health Risk Based Capital Formula for the Life and Disability programs. OSEEGIB utilizes the NAIC Risk Based Capital methodology to establish the fund equity benchmark. The minimum fund equity benchmark by the Board at December 31, 2010 and 2009 is approximately \$149,920,000 and \$154,276,000, respectively.

The NAIC Risk Based Capital Formulas were selected as the basis for determining minimum fund equity primarily due to the following factors:

- Degree and nature of the risks undertaken
- Size of OSEEGIB
- Degree of conservatism inherent in the premium rates
- Degree of safety desired

The primary risks that would threaten OSEEGIB's solvency include the following:

- The risk that claims incurred will exceed premiums collected
- The risk of default or decline in value of OSEEGIB's assets
- The risk of large monetary judgments stemming from possible lawsuits against OSEEGIB

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A comparison of the minimum fund equity benchmark by the Board and unrestricted fund equity at December 31, 2010 as reported in the basic financial statements is as follows (in thousands):

	<b>2010</b>			
	<b>Health and Dental Program</b>	<b>Life Program</b>	<b>Disability Program</b>	<b>Total</b>
Minimum fund equity	\$ 133,154	11,311	5,455	149,920
Unrestricted fund equity	174,687	22,446	28,237	225,370

A comparison of the minimum fund equity benchmark by the Board and unrestricted fund equity at December 31, 2009 as reported in the basic financial statements is as follows (in thousands):

	<b>2009</b>			
	<b>Health and Dental Program</b>	<b>Life Program</b>	<b>Disability Program</b>	<b>Total</b>
Minimum fund equity	\$ 138,818	10,370	5,088	154,276
Unrestricted fund equity	116,886	17,892	24,657	159,435

As part of the rate setting process, the Board considers OSEEGIB's total fund equity in comparison with the minimum fund equity benchmark in setting rates towards achieving the minimum fund equity benchmark. Title 74 of the Oklahoma Statutes, Section 1321C allows that OSEEGIB may adjust rates mid-year if the need is substantiated by an actuarial determination. Consistent with prior years, OSEEGIB does not anticipate the need for a mid-year rate adjustment for 2011.

**(g) Premiums**

Premiums are recognized in the period when the insurance coverage is provided. Premiums are due monthly from the employers or participants based on the rates adopted by the Board.

**(h) Medicare Part D Subsidy**

As a Medicare Part D Prescription Drug Plan (PDP), OSEEGIB receives a monthly payment from Medicare. The effect of these payments is to subsidize premiums for the individuals enrolled in the PDP since they pay a reduced premium rate. This amount is approximately \$23,958,000 and \$25,173,000 for the years ended December 31, 2010 and 2009, respectively, and is included in premium revenue within the statements of revenues, expenses, and changes in fund equity.

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**(i) Pharmacy Rebate**

Effective January 1, 1999, under OSEEGIB's agreement with its pharmacy benefit manager, OSEEGIB receives a guaranteed rebate for each non-Medicare Part D prescription. Effective January 1, 2006, OSEEGIB also receives a specified percentage of manufacturers' rebates received by the pharmacy benefit manager related to Medicare Part D prescriptions. This amount is approximately \$13,345,000 and \$13,060,000 for the years ended December 31, 2010 and 2009, respectively, and is included in other operating revenue within the statements of revenues, expenses and changes in fund equity.

**(j) Risk Adjustment Premiums**

Risk adjustment premiums are received from HMOs based on factors which are applied to premiums remitted to HMOs for all non-Medicare primary members during the plan year; the factors are intended to offset any adverse selection that may occur to OSEEGIB as a result of younger, healthier members electing HMO coverage. This amount is approximately \$2,245,000 and \$1,670,000 for the years ended December 31, 2010 and 2009, respectively, and is included in other operating revenue within the statements of revenues, expenses and changes in fund equity.

**(k) Administrative Expenses**

Administrative expenses are primarily related to employees of OSEEGIB and professional services, including fees paid to TPAs to process and pay benefits.

OSEEGIB does not record deferred acquisition costs since administrative expenses are primarily maintenance expenses and not acquisition expenses. OSEEGIB maintains a budget approved by the Board; however, it is not a legally adopted annual budget.

**(l) Income Taxes**

OSEEGIB obtained its latest determination letter dated March 30, 2005, in which the Internal Revenue Service stated that income from the exercise of the essential governmental functions of OSEEGIB is exempt from federal income taxes under Section 115 of the Internal Revenue Code (the Code).

**(m) Operating Revenues and Expenses**

Balances classified as operating revenues and expenses are those which comprise the OSEEGIB's principal ongoing operations. Since OSEEGIB's operations are similar to those of any other insurance company, most revenues and expenses are considered operating.

**(n) Pass-Through Grant Revenue and Expense**

As part of the Patient Protection and Affordable Care Act, the Early Retiree Reinsurance Program (ERRP) provides reimbursement to participating employment-based plans for a portion of the costs of health benefits for early retirees and early retirees' spouses, surviving spouses, and dependents. All employment-based plans who are accepted into the Early Retiree Reinsurance Program are

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eligible to receive reimbursement for certain incurred claims on or after June 1, 2010, regardless of the date on which the employment-based plan was accepted into the program. The employment-based plan must be able to demonstrate that it used program funds exclusively to reduce or offset increases in plan participants' health benefit premium contributions, copayments, deductibles, coinsurance, or a combination of these costs. OSEEGIB has filed the ERRP application on behalf of the State and participating employers that are the plan sponsors. In the ERRP application, OSEEGIB indicated that the planned use of the reimbursements from the ERRP program received in calendar year 2010 and 2011 would be to lower the premiums beginning in fiscal year 2012. OSEEGIB acting in its capacity is receiving the reimbursement funds on behalf of the plan sponsors, which represents a pass-through grant from the federal government to the State and is recognized as revenue and expense in the period received. OSEEGIB received approximately \$4,988,000 of reimbursement under the program in 2010 and recorded a liability for prepaid premiums in the balance sheet. The prepaid premium will be recognized as premium income monthly in 2012 when the premium reductions are applied to the participant's premium.

**(3) Fair Values of Financial Instruments**

Accounting Standards Codification Topic 820, *Fair Value of Measurements and Disclosures*, requires OSEEGIB to disclose estimated fair values for its financial instruments. Fair value estimates are made at a point in time, based on relevant market data as well as the best information available about the financial instruments. Fair value estimates for financial instruments for which no or limited observable market data is available are based on judgments regarding current economic conditions, credit and interest rate risk, and loss experience. These estimates involve significant uncertainties and judgments and cannot be determined with precision. As a result, such calculated fair value estimates may not be realizable in a current sale or immediate settlement of the instrument. In addition, changes in the underlying assumptions used in the fair value measurement technique, including discount rate and estimates of future cash flows, could significantly affect these fair values. Fair value estimates, methods, and assumptions at December 31, 2010 and 2009 are described below for OSEEGIB's financial instruments. The carrying value of all OSEEGIB's financial instruments approximates fair value.

The carrying amounts reported in the balance sheets are at fair value for investment securities. Fair values for debt securities are based on quoted market prices, where available. If quoted prices are not available from active exchanges for identical instruments, the fair values are estimated using quoted prices from less active markets, quoted prices of securities with similar characteristics, or by pricing models utilizing other significant observable inputs. The fair values for equity securities are based on quoted market prices.

The carrying values of the receivable for unsettled investment sales, premiums receivable, interest and dividends receivable, pharmacy rebate receivable, other receivables, premiums due to HMOs and other insurers, payable for investment purchases, and other accrued liabilities approximate fair value due to the short maturity of these financial instruments and the fact that they do not present undue credit concerns.

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**(4) Cash and Cash Equivalents**

Cash includes amounts on deposit with the Office of State Treasurer (State Treasurer) in a pooled account, which is required by the Oklahoma Statutes to be insured or collateralized. The amount of collateral securities required to be pledged to secure public deposits is established by rules and regulations promulgated by the State Treasurer. In accordance with the State Treasurer's policies, the market value of collateral securities to be pledged by financial institutions through the State Treasurer's Office must be 110% of the carrying value of the amount on deposit, less any federal insurance coverage.

At December 31, 2010 and 2009, cash totaling \$21,913,079 and \$27,219,862, respectively, was deposited with and collateralized by the official bond of the State Treasurer of Oklahoma.

The carrying amount and bank balance of the cash equivalents totaled \$65,523,711 and \$56,637,908 at December 31, 2010 and 2009, respectively, and consists of an investment in a mutual fund composed of short-term investments with an original maturity date of three months or less, which are readily convertible into cash. The duration of the underlying investments in the money market mutual fund at December 31, 2010 and 2009 is approximately 53 and 50 days, respectively.

***Custodial Credit Risk***

Custodial credit risk for deposits is the risk that in the event of a bank failure, OSEEGIB's deposits may not be returned or OSEEGIB may not be able to recover collateral securities in the possession of an outside party. OSEEGIB's cash and cash equivalents include deposits that are insured, registered, or for which the securities are held by a custodian in OSEEGIB's name.

**(5) Investments**

OSEEGIB's investment policy is predicated on a multiple manager structure to provide the benefits of more than one manager's special skills and a diversity of investment styles. Upon approval of OSEEGIB's Board, external managers are appointed to assume the investment management function. The managers, within guidelines determined by OSEEGIB's Board, have full discretion to buy and sell investment assets of OSEEGIB. Authorized investments are defined in Title 36 of the Oklahoma Statutes, as amended, and OSEEGIB's investment policy, and include U.S. government obligations, state and district obligations, corporate obligations, mortgage-backed and assets-backed debt securities, and preferred and common stock. All investments held by OSEEGIB are in compliance with statutes and the investment policy.

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As of December 31, 2010 and 2009, OSEEGIB had the following investments:

<u>Types of investments</u>	<u>2010</u>		<u>2009</u>	
	<u>Fair values</u>	<u>Duration <sup>(1)</sup></u>	<u>Fair values</u>	<u>Duration <sup>(1)</sup></u>
Debt securities:				
Commingled fund	\$ 67,595,887	3.90	\$ 63,935,654	3.85
Asset-backed securities <sup>(2)</sup>	1,298,398	1.44	2,081,509	1.89
Corporate	15,416,612	6.89	13,846,397	6.31
Mortgages	19,594,729	2.88	15,459,450	3.03
Collateralized mortgage obligations <sup>(2)</sup>	788,030	1.68	2,579,167	2.75
U.S. Treasuries	19,861,609	6.60	15,699,981	3.62
Municipals	769,548	16.50	1,189,688	13.51
Collateralized mortgage-backed securities (CMBS) <sup>(2)</sup>	<u>518,719</u>	1.58	<u>4,486,015</u>	2.52
Total debt securities	125,843,532		119,277,861	
Equities:				
Domestic	<u>93,173,604</u>		<u>56,070,327</u>	
Total investments	<u>\$ 219,017,136</u>		<u>\$ 175,348,188</u>	

(1) Interest rate risk is estimated using effective duration (in years).

(2) These include investments highly sensitive to interest rate changes.

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**Credit Risk**

The credit risk profile as listed by Moody's or Standards & Poor's for debt securities and money market mutual funds at December 31, 2010 and 2009 is as follows:

	2010					
	Aaa	Aa	A	Baa/Ba	Not rated	Total
Debt Securities:						
Commingled fund <sup>(1)</sup>	\$ —	—	—	—	67,595,887	67,595,887
Asset-backed securities	1,298,398	—	—	—	—	1,298,398
Corporate	1,684,723	3,579,112	7,667,468	2,485,309	—	15,416,612
Mortgages	19,594,729	—	—	—	—	19,594,729
Collateralized mortgage obligations	332,449	—	455,581	—	—	788,030
U.S. Treasuries	19,861,609	—	—	—	—	19,861,609
Municipals	—	769,548	—	—	—	769,548
CMBS	373,423	—	145,296	—	—	518,719
Total debt securities	<u>\$ 43,145,331</u>	<u>4,348,660</u>	<u>8,268,345</u>	<u>2,485,309</u>	<u>67,595,887</u>	<u>125,843,532</u>
Money market mutual funds	<u>\$ —</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>65,523,711</u>	<u>65,523,711</u>
2009						
	Aaa	Aa	A	Baa/Ba	Not rated	Total
Debt Securities:						
Commingled fund <sup>(1)</sup>	\$ —	—	—	—	63,935,654	63,935,654
Asset-backed securities	2,081,509	—	—	—	—	2,081,509
Corporate	1,190,296	1,046,102	5,066,575	6,543,424	—	13,846,397
Mortgages	15,459,450	—	—	—	—	15,459,450
Collateralized mortgage obligations	2,509,541	—	69,626	—	—	2,579,167
U.S. Treasuries	15,699,981	—	—	—	—	15,699,981
Municipals	—	1,189,688	—	—	—	1,189,688
CMBS	3,843,098	—	574,175	68,742	—	4,486,015
Total debt securities	<u>\$ 40,783,875</u>	<u>2,235,790</u>	<u>5,710,376</u>	<u>6,612,166</u>	<u>63,935,654</u>	<u>119,277,861</u>
Money market mutual funds	<u>\$ —</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>56,637,908</u>	<u>56,637,908</u>

(1) There is no rating to the commingled fund; however, the average rating of the underlying investments in the commingled fund as provided by the fund manager is Aa at both December 31, 2010 and 2009.

Credit Risk is the risk an issuer or other counterparty to an investment will not fulfill its obligations. The Board's investment policy authorizes OSEEGIB to invest in obligations of the U.S. Treasury, agencies and instrumentalities, bankers' acceptances rated AA or better, commercial paper rated A-1 or P-1 and A-2 or

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P-2, fixed income investments rated investment grade and stocks of companies with a minimum capitalization of \$50,000,000, and other investments of similar risk.

Investments in “restricted securities,” including fixed income securities, preferred stock, common stock, or any common stock acquired upon conversion thereof are prohibited. “Restricted securities” are securities which have not been registered under the Securities Act of 1933 and are subject to restrictions on sale. Engagements in short sales, purchases on margin, or investments in commodities or transactions of a similar or speculative nature are prohibited.

**Custodial Credit Risk**

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, OSEEGIB will not be able to recover the value of its investments or collateral securities in the possession of an outside party. The current master custodian has been approved by OSEEGIB’s Board. OSEEGIB’s investments include investments that are insured or registered or for which the securities are held by a custodian in OSEEGIB’s name. They may also include investments held for the custodian by the Federal Reserve Bank or Depository Trust Corporation in OSEEGIB’s name.

**Concentration of Credit Risk**

An increased risk of loss occurs as more investments are acquired from one issuer. No issuer represents 5% or more of OSEEGIB’s total investments. OSEEGIB’s policy states investments in one issuer shall not exceed 2.5% of the fair value of each manager’s assets, except for obligations of the U.S. government or of any state of the U.S. The policy also restricts investments in the common stock of any U.S. corporation to no more than 5% of each manager’s assets valued at the lower of cost or market value, except where the manager’s benchmark holds more than 5% in a single issue or with prior consent of OSEEGIB’s Board.

**Interest Rate Risk**

Interest rate risk is the risk changes in interest rates will adversely affect the fair value of an investment. Fixed income investments held for longer periods are subject to increased risk of adverse interest rate changes. OSEEGIB’s policy requires that the total fixed income portfolio maintain an average effective maturity of 10 years or less and for average duration to be plus or minus 1 year from the benchmark, which has been identified by management to assess the performance of each manager.

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**Investment Income**

Net investment income for the years ended December 31, 2010 and 2009, is comprised of the following:

	<u>2010</u>	<u>2009</u>
Fixed income securities	\$ 2,010,577	5,094,578
Equity securities	3,183,840	1,091,041
Realized gains (losses)	10,521,049	(2,876,954)
Unrealized gains	4,363,158	17,102,790
Less investment expenses	<u>(523,586)</u>	<u>(438,206)</u>
Net investment income	<u>\$ 19,555,038</u>	<u>19,973,249</u>

**(6) Office Equipment**

The changes in office equipment for the years ended December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Office equipment, at cost:		
Balance, beginning of year	\$ 4,163,900	4,438,752
Additions	217,654	132,124
Retirements	<u>(204,318)</u>	<u>(406,976)</u>
Balance, end of year	<u>4,177,236</u>	<u>4,163,900</u>
Accumulated depreciation:		
Balance, beginning of year	3,554,458	3,728,534
Depreciation expense	192,198	232,900
Retirements	<u>(200,486)</u>	<u>(406,976)</u>
Balance, end of year	<u>3,546,170</u>	<u>3,554,458</u>
Office equipment, net	<u>\$ 631,066</u>	<u>609,442</u>

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**(7) Health and Dental and Life Reserves**

The following represents changes in the Health and Dental and Life Reserves during the year ended December 31, 2010 (in thousands):

	<u>Health and Dental</u>	<u>Life</u>	<u>Total</u>
Reserves, beginning of year	\$ 102,804	4,813	107,617
Incurring claims expense provisions for insured events of the current year	746,466	21,083	767,549
Changes in provisions for insured events of prior years	3,362	(451)	2,911
	<u>749,828</u>	<u>20,632</u>	<u>770,460</u>
Less payments:			
Claims expense insured events of the current year	659,895	17,393	677,288
Claims expense insured events of prior years	101,857	3,312	105,169
	<u>761,752</u>	<u>20,705</u>	<u>782,457</u>
Reserves, end of year	<u>\$ 90,880</u>	<u>4,740</u>	<u>95,620</u>

As a result of changes in estimates of insured events in prior years, the provision for claims increased by approximately \$3,691,000 in the year ended December 31, 2010, due primarily to less favorable than anticipated claims experience.

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The following represents changes in the Health and Dental and Life Reserves during the year ended December 31, 2009 (in thousands):

	<b>Health and Dental</b>	<b>Life</b>	<b>Total</b>
Reserves, beginning of year	\$ 93,771	4,708	98,479
Incurred claims expense provisions for insured events of the current year	782,521	23,219	805,740
Changes in provisions for insured events of prior years	10,425	555	10,980
	<u>792,946</u>	<u>23,774</u>	<u>816,720</u>
Less payments:			
Claims expense insured events of the current year	684,927	19,476	704,403
Claims expense insured events of prior years	98,986	4,193	103,179
	<u>783,913</u>	<u>23,669</u>	<u>807,582</u>
Reserves, end of year	<u>\$ 102,804</u>	<u>4,813</u>	<u>107,617</u>

As a result of changes in estimates of insured events in prior years, the provision for claims increased by approximately \$11,725,000 in the year ended December 31, 2009, due primarily to less favorable than anticipated claims experience.

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**(8) Disability Reserves**

The following represents changes in the disability reserves during the years ended December 31, 2010 and 2009 (in thousands):

	<b>2010</b>	<b>2009</b>
Reserves, beginning of year	\$ 13,809	13,299
Incurred claims:		
Provisions for insured events of the current year	5,348	4,782
Changes in provisions for insured events of prior years	(1,911)	(1,127)
	3,437	3,655
Payments:		
Claims attributable to insured events of the current year	749	584
Claims attributable to insured events of prior years	2,508	2,561
	3,257	3,145
Reserves, end of year	\$ 13,989	13,809

OSEEGIB estimates current and noncurrent reserves for disability reserves based on historical claim experience.

As a result of changes in estimates of insured events in prior years, the provision for disability reserves decreased by approximately \$1,911,000 and \$1,127,000 in the years ended December 31, 2010 and 2009, respectively, due primarily to favorable claims development.

The following is a brief description of the significant assumptions used for disability reserves:

- Actual claim experience for the group, based upon claim lag studies, was used for males and females for short-term disability.
- The 1987 Commissioner's Group Disability Table was used.
- The discount rate was 3.5% for the years ended December 31, 2010 and 2009.

**(9) Premium Deficiency Reserve**

A premium deficiency reserve is recorded at the end of the year when the anticipated costs of settling claims plus policy maintenance costs for the following year are in excess of the anticipated premium receipts for the following year. Anticipated premium receipts are projected based on the premium rates adopted by the Board for the following plan year and current enrollment levels. Incurred claims for subsequent years are projected based on current year incurred claims, increased for anticipated inflation

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rates and benefit design changes. The Board does not have the intention to change the adopted premium rates after the fiscal year has begun. OSEEGIB determined that reserves for premium deficiency were necessary as of December 31, 2010 in the amount of \$1,754,000, and no premium deficiency reserve was necessary as of December 31, 2009.

**(10) Employee Benefit Plans**

For the fiscal year ended December 31, 2008, OSEEGIB implemented GASB Statement No. 50, *Pension Disclosures – an amendment of GASB Statements No. 25 and No. 27*.

GASB Statement No. 50 amends GASB Statement No. 27 to require employers participating in a cost-sharing plan to include the following in the note disclosure: the required contribution rates and the employer(s) in dollars and the percentage of that amount contributed for the current year and each of the two preceding years, and how the contractually required contribution rate is determined (for example, by statute or by contract, or on an actuarially determined basis) or that the cost-sharing plan is financed on a pay-as-you-go basis.

GASB Statement No. 50 also amends GASB Statement No. 27 to require that if a cost-sharing plan does not issue a publicly available stand-alone plan financial report prepared in accordance with the requirements of GASB Statement No. 25, as amended, and the plan is not included in the financial report of another entity, each employer in that plan should present, as required supplementary information, the schedules of funding progress and employer contributions for the plan (and notes to their schedules). Also, each employer should disclose that the information presented relates to the cost-sharing plan as a whole, of which the employer is one participating employer, and should provide information helpful for understanding the scale of the information presented relative to the employer. OSEEGIB has made all required disclosures under GASB Statement No. 50.

**(a) Retirement Plan**

OSEEGIB contributes to the Oklahoma Public Employees Retirement Plan (the Retirement Plan), a cost-sharing multiple-employer public employee retirement system administered by the Oklahoma Public Employees Retirement System (OPERS). The Retirement Plan provides retirement, disability, and life benefits to Retirement Plan members and beneficiaries. The benefit provisions are established and may be amended by the legislature of the state of Oklahoma. Title 74 of the Oklahoma Statutes, Sections 901-943, as amended, assigns the authority for management and operation of the Retirement Plan to the Board of Trustees of OPERS. OPERS issues a publicly available annual financial report that includes financial statements and required supplementary information for the Retirement Plan. That annual report may be obtained by writing to OPERS, 6601 N. Broadway Extension, Suite 129, Oklahoma City, Oklahoma, 73116 or by calling 800.733.9008.

Retirement Plan members, state employees and OSEEGIB are required to contribute at a rate set by statute. The contribution requirements of Retirement Plan members and OSEEGIB are established and may be amended by the legislature of the state of Oklahoma. Each member participates based on his or her gross salary earned (excluding overtime).

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The contribution rate for OSEEGIB and employees for 2010, 2009, and 2008 is as follows:

	Employee rate		Employer rate
	Salaries \$25,000 or less	Salaries greater than 25,000	
July 1, 2010 – December 31, 2010	3.5%	3.5%	15.5%
July 1, 2009 – June 30, 2010	3.5	3.5	15.5
July 1, 2008 – June 30, 2009	3.5	3.5	14.5
July 1, 2007 – June 30, 2008	3.5	3.5	13.5

OSEEGIB’s contributions to the Retirement Plan for the years ended December 31, 2010, 2009, and 2008 were approximately \$1,192,000, \$1,224,000, \$1,140,000, respectively, and were equal to OSEEGIB’s required contributions for the year. Contributions are included in administrative expenses in the statements of revenues, expenses and changes in fund equity.

**(b) *Deferred Compensation Plan***

The State offers to its own employees, state agency employees, and other duly constituted authority or instrumentality employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 and Chapter 45 of Title 74, Oklahoma Statutes. The Oklahoma State Employees Deferred Compensation Plan (SoonerSave) is a voluntary plan that allows participants to defer a portion of their salary into SoonerSave. Participation allows a person to shelter the portion of their salary that they defer from current federal and state income tax. Taxes on the interest or investment gains on this money, while in SoonerSave, are also deferred. The deferred compensation is not available to employees until termination, retirement, death, or approved unforeseeable emergency.

Under SoonerSave, the untaxed deferred amounts are invested as directed by the participant among various investment options. Effective January 1, 1998, a Trust and Trust Fund covering SoonerSave assets was established pursuant to federal legislation enacted in 1996, requiring public employers to establish such trusts for plans meeting the requirements of Section 457 of the Internal Revenue Code. Under terms of the Trust, the corpus or income of the Trust Fund may be used only for the exclusive benefit of SoonerSave participants and their beneficiaries. Further information may be obtained from the Oklahoma State Employees Deferred Compensation Plan audited financial statements for the year ended June 30, 2010. OSEEGIB believes it has no liabilities with respect to SoonerSave.

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**(11) Compensated Absences**

It is OSEEGIB's policy to accrue compensated absences for annual leave, including the related employer's share of social security and Medicare taxes, in accordance with state statute, not to exceed:

- 240 hours for employees with continuous service of less than five years, or
- 480 hours for employees with continuous service of five years or more.

During 2010, OSEEGIB's liability for compensated absences increased by approximately \$107,000 for 104 employees, decreased by approximately \$133,000 for 59 employees, and did not change for 12 employees.

During 2009, OSEEGIB's liability for compensated absences increased by approximately \$94,000 for 99 employees, decreased by approximately \$85,000 for 65 employees, and did not change for 14 employees.

OSEEGIB's liability for compensated absences at December 31, 2010 and 2009 amounted to approximately \$898,000 and \$924,000, respectively, and is included in other accrued liabilities in the balance sheets.

**(12) Operating Leases**

OSEEGIB has agreements for one-year commitments to lease office space and equipment with options to renew for additional periods. If the leases are renewed in accordance with the options in the agreements, the future minimum rentals for operating leases as of December 31, 2010 are as follows:

2011	\$	568,390
2012		231,807
2013		112,548
		<hr/>
	\$	<u>912,745</u>

Rent expense for office space and equipment for the years ended December 31, 2010 and 2009 was approximately \$606,000 and \$616,000, respectively, and is included in administrative expenses in the statements of revenues, expenses and changes in fund equity.

**(13) Risks and Uncertainties**

OSEEGIB invests in various investment securities. As described in note 5, investment securities are exposed to various risks such as interest rate, market, and credit risks. It is at least reasonably possible that changes in the values of investment securities will occur in the near term, and such changes could materially affect the amounts reported in the balance sheets.

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As described in note 2, the estimates of reserves are determined based on actuarial and statistical techniques, which considers the effects of general economic conditions, such as inflation, and other factors of past experience, such as changes in participant counts, all of which are subject to change. Due to uncertainties inherent in the estimation and assumption process, it is at least reasonably possible that changes in these estimates and assumptions in the near term would be material to the financial statements.

**(14) Commitments and Contingencies**

OSEEGIB's legal counsel has determined that the statute of limitations for claims denied or paid improperly is three years. Typically, all claims are reported within a 24-month period. Currently, OSEEGIB is not aware of any material claims that were denied or paid improperly that should be reserved for in the basic financial statements. To the extent such claims exist, OSEEGIB may be responsible for payment.

During 2003, the Oklahoma Legislature created the Medical Expense Liability Revolving Fund (the Fund), which enacted a fee to cover inmate medical costs. By law, OSEEGIB is the administrator of the Fund. Any person convicted of certain offenses is required to pay a fine of \$10, which goes into the Fund. The monies from the Fund are used when an inmate's medical costs exceed \$8,000 up to a maximum of \$100,000. As of December 31, 2010 and 2009, the Fund has assets and liabilities of approximately \$1,610,000 and \$1,071,000, respectively, which are included in the balance sheets.

During 1995, the Oklahoma Legislature created the Health Insurance High Risk Pool (the Pool), which was designed to provide health insurance for certain state residents who are unable to obtain coverage through other insurers. All insurers and reinsurers providing health insurance or reinsurance in the state of Oklahoma are required to participate in the Pool. With the exception of OSEEGIB, all self-insured plans are exempted from participation. Participating insurers are assessed periodically. OSEEGIB has recorded assessments totaling approximately \$3,569,000 and \$2,101,000 during the years ended December 31, 2010 and 2009, respectively, which is included in administrative expense in the statements of revenues, expenses and changes in fund equity. Participating insurers may also be assessed additional amounts if the Pool experiences adverse claim development.

In the normal course of operations, there are various legal actions and proceedings pending against OSEEGIB. In management's opinion, the ultimate liability, if any, resulting from these legal actions will not have a material adverse effect on OSEEGIB's financial position, results of operations, or liquidity.