PG&E – IBEW – ESC
2011 Joint Benefits Education Committee Report

The Joint Benefits Education Committee was informed on the following key information.

Health Care

- Despite the fact that Americans spend more on health care than other countries, the current health care system falls short of expectations. Examples include:
  - ✓ Receiving more care does not equate to better care. According to a landmark study, the states that spent the most money received lower quality of care.
  - ✓ Across multiple health conditions, only 55% of recommended care is prescribed to patients once diagnosed properly. Even more disconcerting, when lack of diagnosis and non-compliance with treatment is factored into the equation, only about 9% of individual with chronic conditions actually get recommended care.

- Although PG&E continues to spend more each year on health care, employees are not getting healthier, they are not becoming more productive and PG&E is not seeing a valuable return on investment for its health care expenditure.

- The total cost of health care coverage is $288 million today. This translates into a cost of about $22,000 for each family covered. If medical plan costs increase at the historical rate of 8%, the cost of family coverage will be $37,000 in 2018. This large cost increase will be shared with employees through higher premium contributions. Major federal health care reform changes will occur in 2014 and 2018. If the growth rate of the medical plans is not dampened, both PG&E and its employees will share in the cost of large excise taxes beginning in 2014. Excise taxes are calculated to be $195 million for 2018 through 2022.

- Without fundamental changes to reduce cost, PG&E risks inadequate funding through the GRC, unaffordable coverage and lower productivity from employees not being at work. Employees also risk unaffordable coverage and having a lower quality of life due to poor health.

- Three alternative paths with different impacts can be taken to reduce cost:
  1. Reduce plan value – shift costs aggressively to employees through higher deductibles and copayments with little effort to improve quality of health care or health status.
  2. Enhanced accountability – have more moderate increases in employee costs than path 1 and have more focus on improved health.
  3. Transformation to a culture of health - change plan design to support both better quality of care and better health outcomes and increase wellness support to prevent disease.

- Towers Watson, a human resource consulting firm, and PG&E provided an overview of Health Savings Accounts (HSAs). HSAs are bank accounts that are defined by federal law that allow both companies and employees to set aside pretax funds to pay for current and future qualified medical expenses. HSAs are required by the IRS to be coupled with high deductible medical plans. In 2009, the Company and Unions negotiated a new HSA Medical Plan with a company funded HSA option for employees. Towers Watson research show that account based medical plans including HSA plans and another type of medical plan, a Health Reimbursement Account medical plan, encourage better use of health and positively impact costs.

- Dr. Hank Gardner, M.D., of HCMS Group discussed the impact of medical plan design on quality and cost of care. Dr. Gardner is managing partner of HCMS Group, a health care data analytic company, and has 40+ years experience in the healthcare delivery and health information business. Dr. Gardner stated:
  - ✓ Traditional health plan models such as HMO and PPO/POS do not independently fix the problem of quality and costs of health care.
  - ✓ Dr. Gardner provided a comparison of Health Savings Account medical plans and Health Reimbursement Account (HRA) plans. HRA medical plans are similar to HSA medical plans but do not have IRS restrictions on plan design. HRA medical plans can have a better focus on chronic care and quality care than HSA medical plans. Like HSAs, with HRAs, companies can also establish accounts that can be used to pay current medical plan expenses or pay for future medical plan expense, although HRA accounts are notional.
  - ✓ If quality health care is to be obtained, providers and consumers must be meaningfully engaged. Dr. Gardner felt that if all parties worked together to build a new health care model using an HRA platform and all parties supported changes to achieving a culture of health including premium incentives for non-tobacco users and wellness participation, costs could be curbed without significant cost shifting.

Retirement

The Company reviewed the Retirement Plan and Retirement Savings Plan (401k) plans.

- ✓ Key retirement metrics have increased significantly over time – the number of retirees has almost doubled over the last 20 years, the average monthly pension payment has increased from $875 to over $3,400 a month over the last 30 years, and pension funding costs have increased from close to zero in the 1990's to a 2010 contribution of $245 million.
- ✓ Employee RSP participation, contribution rates, and account balances are higher than the average for Fidelity benchmarks. An improvement was made to the Retirement Savings Plan (RSP) effective January 1, 2011.

- The Company explained that there is a risk in future recovery of high pension contributions.
  - ✓ The Company's 2011 GRC request for total benefit plan costs was $987 million compared to $769 million in 2007, $427 million in 2003 and $353 million in 1999.
  - ✓ CPUC has denied pension recovery before.
  - ✓ The Retirement Plan faces significant downside risk of huge contributions.
  - ✓ Forecasts show even higher annual pension trust contributions will be required by 2015 – with 1 in 4 chances of an annual contribution of $750 million, and 1 in 20 chances of an annual contribution of close to $1 billion. By comparison, the total GRC request for all pension and benefits totaled $987 million for 2011.
  - ✓ DRA recently recommended recovery of $53 million vs. SCE's requested $168 million (a 68% disallowance).
  - ✓ DRA argues that SCE needs to explore other options for its employees' retirement needs including "eliminating the pension program for new employees and switching those new employees entirely to a 401(k) plan, splitting pension expense between ratepayers and shareholders, and having employees fund a portion of their own pensions, as many State and other employees do."

- In the private sector, utilities are one of a very few industries where defined benefit plans remain common. Among utility companies, two-thirds have cash balance or defined contribution programs for newly hired union employees.

- AonHewitt, an outside consultant working with PG&E, made a presentation on the retirement landscape, retirement study, benchmarking and a preliminary retirement plan design for consideration. Glossary of Terms from the presentation:
  - ✓ Defined Benefit – Traditional Pension: Employee receives a fixed amount pension based on final pay, years of service and multiplier.
  - ✓ Defined Benefit – Cash Balance: Employee receives annual pension credits equal to a percentage of pay, plus annual interest credits, to a notional employee account. The account balance can be paid as an annuity, rolled over to an IRA or paid in a lump sum at termination or retirement.
  - ✓ Defined Contribution: Employee receives a stated Company contribution – for example a Company match – to an employee account. The employee controls investment of all account holdings. A 401k plan is a type of defined contribution plan.

- In describing the current climate for pension plans, Aon Hewitt noted that many employers are moving from traditional pension plans to cash balance and defined contribution plans.

- Underfunding in public sector defined benefit pension plans is making headlines.
  - ✓ Taxpayers are experiencing "pension envy" and demanding changes.
  - ✓ State and local pension underfunding has become a priority to newly elected leaders.
  - ✓ Some evidence that state and local government entities are beginning to alter plan designs for new hires.

- Retirement Platform Study Objectives:
  - ✓ Attract workforce of the future, while retaining current workforce.
  - ✓ Keep retirement benefits simple and easy to understand.
  - ✓ Develop sustainable program for the future.
  - ✓ Reduce balance sheet liability and funded status sensitivity to interest rates.
  - ✓ Reduce volatility of pension contributions.

- Preliminary Plan Design for Consideration: Cash Balance Pension plus 401(k):
  - ✓ Cash Balance credits of 4% - 8% of base pay; applicable percentage based on points (age plus service).
  - ✓ Annual Interest credits based on 30-year Treasury rates.
  - ✓ No change in 401(k) match.

Examples illustrating retirement income from total cash balance pension, 401(k) savings (employee and employer) and Social Security, showed final pay replacement between 94% to 109% at age 62, and between 116% and 139% at age 65.

Transition alternatives include apply to new hires only, apply to new hires plus choice for current employees, or apply to all employees with a grandfather for current pension formula or one-time choice for specific employee groups.