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July 18, 2016

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: Consultation on the Regulatory Treatment of Pensions and Other Post-Employment Benefit Costs
Board File No. EB-2015-0040

Further to Board Staff's July 12, 2016 email requesting copies of presentations to be made at the upcoming stakeholder forum, Union Gas Limited provides its presentation in PowerPoint and PDF formats with this letter.

Should you have any questions, please do not hesitate to contact me.

Yours truly,

[Original signed by]

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Encl.

Ontario Energy Board Consultation on the Regulatory Treatment of Pensions and Other Post-Employment Benefits (EB-2015-0040)

Stakeholder Forum

Sherri Steingart, Controller, Union Gas
Ashley Witts, Willis Towers Watson
July 19-20, 2016

Union's Positions

- In its July 2015 submission, Union stated that:
  - Long-term stability of pension and other post-employment benefit (OPEB) costs is desirable in order to support intergenerational equity and stability of rates
  - The value of pensions and OPEBs needs to be considered within the benchmarking of total compensation programs
  - A single cost recovery method is inappropriate for all circumstances as pension plan designs and financing arrangements are not consistent among utilities
  - Differences in plan designs and accounting bases among utilities require that the costs and recovery of pensions be considered on a case-by-case basis
- Pension and OPEB costs have not been significant issues in Union's rate applications
- Upon reviewing the May 2016 KPMG report, Union's positions remain unchanged

Pension and OPEB Program Design and Governance

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- Union provides a competitive total compensation program that includes pensions, benefits and other post-employment benefits
- Union’s total compensation program is designed to be competitive across its comparator companies in the utility industry and its P&OPEB programs are designed to be responsive to and reflect Canadian pension and benefit trends
- Union has implemented extensive P&OPEB governance policies and procedures in order to fulfil its fiduciary duties to plan members and other stakeholders
- Beginning in 1999, Union closed its legacy Defined Benefit (DB) pension plans and introduced a new pension program providing core non-contributory DB and Defined Contribution (DC) options, with additional DC and DB options requiring employee contributions:
  - This pension program applies to all employees, having been collectively bargained with unionized employees
  - Nearly 50% of participants have elected DC options

Pension and OPEB Program Design and Governance (cont'd)

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- Beginning in 2004, Union closed its legacy DB OPEB plans and introduced a redesigned OPEB program based on a DC Health Spending Account
  - This OPEB program applies to all employees, having been collectively bargained with unionized employees

- The May 2016 KPMG Report notes that the formation of jointly-sponsored pension plans (JSPPs) is being encouraged in Ontario and implies that this may result in more companies adopting a cash basis rather than accrual accounting to determine pension costs
  - We are not aware of any significant increase in the formation of single employer JSPPs in Ontario
  - Whereas multi-employer JSPPs are accounted for on a cash basis, accrual accounting applies to single employer JSPPs

Pension and OPEB Program Design and Governance (cont'd)

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- As a single employer, Union recognizes and recovers the costs of both DC and DB pensions and OPEBs using accrual accounting
  - The same method and assumptions are used for both cost recovery in rates and financial statement reporting purposes
  - The proposals contained in the May 2016 KPMG Report could result in Union having to use as many as three different methods and sets of assumptions to determine costs for pensions, supplemental employee retirement plans (SERPs) and OPEBs, which would result in increased levels of administrative burden and confusion

Regulatory Disclosures
General Concerns

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- The May 2016 KPMG Report proposes extensive additional disclosure requirements, organized under six stated objectives, as follows:
  - P&OPEB costs provide value for money
  - Governance for P&OPEB plans reflects best practices
  - P&OPEB costs include rate-regulated activities only
  - P&OPEB costs are reasonable
  - P&OPEB cost information is reliable
  - P&OPEB costs are recovered over an appropriate time period

Regulatory Disclosures General Concerns (cont'd)

- Union is concerned that these proposals will result in a material increase in compliance activity and costs, as well as a significant duplication of effort
  - For example, several regulatory bodies monitor and oversee pension plan governance requirements, including:
    - Financial Services Commission of Ontario
    - Canada Revenue Agency
    - Canadian Association of Pension Supervisory Authorities

Regulatory Disclosures
General Concerns (cont'd)

- KPMG's concepts include requirements to conduct and disclose the results of total compensation benchmarking studies

- Union believes that benchmarking studies can be a useful tool for comparing total compensation programs, but they can be expensive to conduct and the results of these studies may be misleading
  - Pension and OPEB costs are only one component of total compensation and should not be looked at in isolation
  - A single set of actuarial assumptions and employee population must be used to account for differences in value that are due to differences in employee demographics
  - Other factors such as benefits, hours worked and paid time-off programs must be included in order to ensure a fair comparison

Regulatory Disclosures
General Concerns (cont'd)

- A "one-size-fits all" approach to disclosure may result in additional costs that do not result in value for money
  - Each utility is different and some disclosures that may be helpful to the Board when reviewing a specific utility may be of little use for assessing other utilities

Cost Recovery

- Union Gas has recovered the costs of its pension plans, SERPS and OPEBs on an accrual accounting basis since the introduction of accrual accounting rules in Canada
- Cost recovery from ratepayers has been consistently determined
- Union believes that accrual accounting is a superior method of determining costs compared to cash funding for the following reasons:
  - Under US GAAP:
    - Accrual accounting determines the costs of pensions and benefits in a rational and systematic manner over the periods during which employee services are rendered
    - Amortization of actuarial gains (or losses) is consistently applied across pension plans and OPEBs

Cost Recovery (cont'd)

- DB cash funding is driven by the legislated requirements of the Ontario Pension Benefit Act (PBA) based on issues of benefit security :
  - Requires a theoretical actuarial valuation as if the pension plan were to be discontinued and wound-up
  - Interest rates are based on secure government bond yields, which results in higher pension obligations for DB cash funding
  - The PBA requires the inclusion of certain additional plan wind-up benefits
  - Plan solvency deficits must be funded over 5 years rather than 15 years

- In Union's view, KPMG's Modified Funding Contribution (MFC) concept introduces an additional layer of administrative complexity and regulatory disclosure, and would increase costs to Union's current ratepayers for no apparent benefit

Financial Effects of KPMG's MFC Concept vs. Accrual Accounting

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- Adoption of KPMG's MFC concept for the recovery of registered pension costs would adversely affect Union's current ratepayers in three ways:
  - As solvency liabilities are generally greater than accounting obligations, the net benefit cost to be recovered from ratepayers would increase
  - Ratepayers would no longer benefit from the expected rate of return on assets being in excess of the discount rate using accrual accounting under US GAAP
  - Amortization of experience gains (losses) would generally occur faster under the MFC concept than under accrual accounting

- Union estimates that the net pension costs to be recovered from current ratepayers could increase by \$10 to \$20 million per year for no apparent benefit

Summary

- Pension and OPEB costs have not been significant issues in Union's rate applications
- Differences in plan designs and accounting bases among utilities require that the costs and recovery of pensions be considered on a case-by-case basis
- Union believes that accrual accounting is a superior method of determining costs compared to cash funding or KPMG's MFC concept
- KPMG's MFC concept introduces an additional layer of administrative complexity and regulatory disclosure, as well as a significant duplication of effort
- KPMG's MFC concept would also increase the costs of registered pensions to be recovered from Union's current ratepayers for no apparent benefit

Q&A

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