UNDERTAKING J16.5

Undertaking

To provide an explanation for how Willis Towers Watson arrives at 30% for the 2015 pension and benefits (excluding statutory benefits) benchmarking results.

Response

The following response was prepared in consultation with Willis Towers Watson (WTW):

Similar to the methodologies of other providers of benefits and human capital services, the WTW methodology helps organizations estimate the employer-provided value of a pension and benefits program for their most prevalent employee demographics. Based on a set of actuarial assumptions, the estimated employer-provided value of a program depends on many factors, including the design of the plan, employee age, service, pay and choices that employees make. This helps companies make decisions about the elements of the programs that provide value to their employees.

The purpose of benchmarking the value of programs is to present an apples-to-apples benchmark comparison of programs.

To achieve an apples-to-apples comparison, WTW uses a standard, common set of actuarial assumptions to determine the average value of each program for a given population or employee profile, and expresses the result as a single percentage of pay. In order to estimate this value for OPG, WTW used these assumptions and applied the most prevalent OPG demographic profiles (age, years of service, pay) within each group (PWU, Society, and Management) to derive the value of the plan provisions applicable to those groups. The resulting values were then expressed as a percentage of OPG salaries on an incumbent weighted basis within each group. The aggregate average value of OPG's pension and benefits expressed as a percentage of base salary at OPG is approximately 30%. WTW then used the same standard assumptions and OPG demographic profiles to examine and value the pension and benefits plan design of comparator organizations. WTW then derived a market median for these organizations. The estimated value of the median market plan value was expressed as a percentage of base salary at OPG. The median value ranges between 20% and 23% of base salary.

The common set of actuarial assumptions applied in determining the employer-provided value of both OPG and comparator organizations' plan provisions were not specific to OPG or any other organization.

It is important to note that the value of an employer-provided benefit to an employee is different than its cost. Program costs are based not only on program design but also vendor costs, utilization factors and other actuarial assumptions, funding policies and other aspects that vary from one company to another.

Here are some specific examples to illustrate the difference between value and cost:

- The benchmark value of a pension plan is determined assuming each company has the same return on the assets in their pension fund. The cost of the same pension plan will be higher for a company whose pension investments are expected to earn 5% annually than one whose pension investments are expected to earn 7%. Differences in actual investment earnings on pension investments also would impact cost. Differences in investment returns may be a function of differences in the cash flow profile of the liability, strategic asset allocation, or risk management approaches, for example.

- The benchmark value of a pension plan is determined assuming employees' future salaries increase by the same percentage at all organizations, while the benchmark value of all post-retirement benefits is determined using a common mortality table. In practice, different organizations will have different assumptions regarding future salary increases and may apply different mortality assumptions, depending on their particular circumstances including characteristics of employee (and retiree) populations, labour market and compensation expectations, and actuaries' judgement. These and other differences in key actuarial assumptions can lead to significant variability in cost levels.

- The benchmark value of a benefit plan is determined using average medical, dental and disability claims. The cost of a benefit plan will be higher for a company whose employees require relatively more expensive drug therapies or have generally higher utilization rates, have more dependent children (e.g., requiring orthodontics), or experience higher rates of disability.

- The benchmark value of a flexible benefit plan is determined assuming employees elect the most common benefit option. The cost of a benefit plan is based on actual employee elections, recognizing that some options are more expensive to the company than others.

Companies like WTW benchmark "value" as opposed to "cost" as it enables an apples-to-apples comparison of the plan provisions, keeping all other variables constant. Costs reflect plan provisions and many other plan-specific variables such as pension fund returns, population age, population health and employee elections, and actuaries' judgement regarding assumptions of future events. In addition, underlying assumptions used for benchmarking or costing purposes will differ from actual experience. Experience gains or losses are reflected as part of costs in subsequent periods.

Therefore, actual cost for OPG in a given period can be higher or lower than the 30% of base salary benchmark value and the actual cost for comparator organizations can be higher or lower than the 20-23% of base salary median value. As such, pension and benefits benchmarking provides a reasonable basis for comparing the relative percentage-of-pay value for a company's pension and benefits program, but not its accounting or funding cost. For the reasons outlined above, there is no industry standard basis for carrying out "cost" benchmarking. In WTW's judgement, it would not be practical to attempt "cost" benchmarking and we do not expect that such an exercise would yield meaningful results.

OPG consulted with Aon Hewitt, its independent actuary, who shared the view that cost benchmarking of pension and benefits plans would not achieve meaningful results.