Board Staff Interrogatory #307

Interrogatory

Reference:
Exhibit F4 / Tab 3 / Schedule 2 / p. 6

Preamble:

OPG stated that many of the pension assumptions used for accounting purposes are the same as those used in the actuarial valuations for funding purposes.

Question(s):

a) Please identify the pension assumptions used for accounting purposes that differ from those used in the actuarial valuations, please identify the assumptions.

b) For each of the assumptions identified in part (a), please explain why a different assumption was used for accounting purposes and what the impact of that has on the accrual costs.

Response

a) and b)
As key assumptions for solvency valuations are prescribed under the *Pension Benefits Act* (Ontario), OPG interprets the question to be in relation to actuarial assumptions used for accounting purposes versus those used for going concern valuation purposes. As discussed below, such differences for OPG relate to the discount rate, expected rate of return and provision for adverse deviation ("PfAD") set of assumptions, as well as certain interrelated impacts on other assumptions.[1]

The discount rate used to determine the current service cost and interest cost components of accrual costs is based on AA corporate bond yield curve as required by US GAAP and as provided by an independent actuary.[2] US GAAP also requires that accrual pension costs include an expected return on assets component, which utilizes an expected long-term rate of return. The expected long-term rate of return on the pension fund assets is based on calculations prepared by Aon, based on the

[1] Additionally, the accounting annual salary escalation assumptions reflect expected salary increases by each representation of employees (as described in Ex. L-F4-03-Staff-309, part b), whereas the funding annual salary escalation assumptions use a single blended rate to reflect the same representation-specific increases. Aon expects the impact of this difference to be immaterial.
[2] Ex. F4-3-2, p. 6, lines 27-31 and p. 8, footnote 15.

pension fund asset mix and capital market expectations of future risk and return for each asset class within the fund portfolio as determined by Aon. As further discussed in Ex. L-F4-03-Staff-309, part a), Aon provides a range of returns from their model that Aon considers to be within an acceptable range, from which OPG determines the expected long-term rate of return assumption in consultation with Aon, as appropriate considering the effects of active investment management and overall stability of the assumption.

As noted in Ex. F4-3-2, p. 17, lines 12-13, the going concern benefit obligation and associated funding requirements are determined using a discount rate representing Aon's best estimate expected long-term rate of return on pension plan assets. This discount rate is therefore similar to the rate used to calculate the expected long-term rate of return component of the accounting costs, with differences including the setting of the funding discount rate net of passive investment management expenses and to exclude any assumed active investment management effect, in accordance with actuarial standards of practice. Currently, the accounting assumption for the expected long-term rate of return of 6.0% is higher than the going concern discount rate of 5.65% per the January 1, 2020 actuarial valuation for funding purposes.

As noted at Ex. F4-3-2, p. 17, lines 12-22, the funding valuation also incorporates a required PfAD as required by Ontario pension legislation, which serves to increase funding requirements. There is no similar requirement under US GAAP.

[redacted]

Given the interrelated nature of the above differences in assumptions and constructs, OPG considers the aggregate impact of these differences on accrual costs relative to the going concern valuations. The difference between accrual pension costs and funding amounts can be found at Ex. F4-3-2, Chart 3, as attributed to the nuclear facilities.