Board Staff Interrogatory #306

Interrogatory

Reference:
Exhibit F4 / Tab 3 / Schedule 2 / p. 8
Exhibit F4 / Tab 3 / Schedule 2 / Attachment 1 / p. 8

Preamble:

OPG stated in Footnote 15 at Exhibit F4 / Tab 3 / Schedule 2 / p. 8 that for the purpose of projecting pension and OPEB costs, OPG may adjust discount rate assumptions from those provided by its independent actuary by a maximum of 25 basis points.

In the Aon Report at Page 8 of Exhibit F4 / Tab 3 / Schedule 2 / Attachment 1 / p. 8, Aon stated that "Other actuarial assumptions are management's best estimate of future events, as determined in consultation with us and as set out in the Reports". These assumptions include the inflation rate and salary scale increase rates.

Question(s):

a) Other than the discount rate, please identify the assumptions used in determining pension and OPEB costs, where OPG applied any discretion or judgement in quantifying the assumption.

b) For the assumptions identified in part (a), please discuss the degree of discretion and judgement OPG applied in quantifying the assumption.

Response

a) and b)

The reference at footnote 15 at Ex. F4-3-2, p. 8, refers to adjustments OPG may make to discount rate assumptions from those provided by an external actuary for projecting pension and OPEB accrual costs. OPG has not exercised such judgement for the projections provided in this application, which reflect the discount rate information provided by an external actuary as of the end of June 2020. OPG does not adjust discount rate assumptions provided by the actuary in determining actual pension and OPEB accrual costs.

With respect to the rest of the actuarial assumptions used to determine pension and OPEB accrual costs, US GAAP requires them to be the best estimate of future events.

Thus, the reference to Ex. F4-3-2, Attachment 1, in the preamble is intended to indicate that the assumptions used in determining the costs meet the US GAAP requirements. For the purposes of management's best estimate assumptions, OPG relies on, and consults with its external actuary and does not adopt any assumptions which the actuary does not support. This applies both to projected and actual costs. Most of these assumptions are the same as those used by the actuary in preparing the pension plan's going concern valuations for funding purposes (see Ex. L-F3-04-Staff-307). Assumptions used to determine actual pension and OPEB costs are subject to review by OPG's external auditors as part OPG's financial statements.

OPG's approach to determining key economic and demographic assumptions for pension and OPEB costs is outlined at Ex. F4-3-2, section 4.0. Below OPG discusses how each of these management's best estimate assumptions is established. The same approach is used to determine assumptions for actual results as reflected in OPG's audited financial statements and for projecting pension and OPEB costs.

The long-term inflation assumption is set based on a long-term outlook view of the consumer price index, informed by economic forecasts and the Bank of Canada's target range of inflation and spreads between nominal and real interest rates. Historically, the assumption was set at 2.0%, but, in consultation with Aon, was lowered to 1.75% as of the end of 2019, in recognition of observed narrowing between nominal and real interest rates. This was also Aon's best estimate assumption in the January 1, 2020 actuarial valuation for funding purposes. Accordingly, the 1.75% inflation assumption was used in developing the pension and OPEB cost projections in this application. Aon advised that the long-term inflation assumption should not be lower than 1.75% since the Bank of Canada inflation control target continues to be centered around 2.0%.

The salary escalation rate continues to build on the long-term inflation assumption, subject to adjustments in the near term for known short-term salary expectations based on collective agreement provisions and any other expectations of salary growth. As in prior applications, the longer term salary escalation rate continues to be equal to the long-term inflation rate plus 0.5%. [redacted] Aon supports the consistent use of this approach to setting the salary escalation assumption and has reflected it in the January 1, 2020 actuarial valuation for funding purposes. The resulting assumptions were used in developing the pension and OPEB cost projections in this application.

The expected long-term rate of return on pension plan assets reflects calculations prepared by Aon, based on the 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. 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. Refer to Ex. L-F4-03-Staff-309, part a) for further discussion.

Expected per capita health care benefit costs and trends rates underpinning the OPEB costs are developed by Aon based on OPG's actual historical experience and the health care trend assumption model published by the Canadian Institute of Actuaries.

For key demographic assumptions, such as base mortality, mortality improvement scale, and normal course termination and retirement rates, OPG relies on the external actuary to recommend the appropriate assumptions in line with the actuarial valuation for funding purposes. Where applicable, these assumptions are based on Aon's analysis of OPG's actual historical experience. [redacted]