Board Staff Interrogatory #309

Interrogatory

Reference:
Exhibit F4 / Tab 3 / Schedule 2 / p. 9
Exhibit F4 / Tab 3 / Schedule 1 / Attachment 1

Preamble:

Chart 4 at Exhibit F4 / Tab 3 / Schedule 2 / p. 9 shows the assumptions OPG used to determine pension and OPEB accrual costs.

Question(s):

a) The expected long-term rate of return on pension fund assets is 6% for the 2016 to 2026 period. Please explain why there has been no change to the rate for the ten-year period.

b) Please further explain the 1.7% weighted average salary schedule escalation rate for the January 1, 2020 to December 31, 2026 period. Please advise whether this escalation rate is reflected in the compensation costs shown at Exhibit F4 / Tab 3 / Schedule 1 / Attachment 1.

Response

a) As noted at Ex. F4-3-2, p. 7, lines 11-13, the expected long-term rate of return assumption reflects calculations prepared by Aon. The calculation is based on the pension fund asset mix and capital market expectations of future risk and return for each assets class within the fund portfolio as determined by Aon. Aon's capital market expectations assume passive investment (i.e. no manager outperformance) where passive investment is possible (e.g. equities and fixed income investments).

The expected long-term returns for each asset class are computed using a Monte Carlo simulation, taking into account current market factors, historical relationships between equities and fixed income instruments, expectations of long-term inflation, current market yields on fixed income instruments, and expected risk premiums above risk-free investment returns. A Monte Carlo simulation is then used to project a best estimate return for the overall asset portfolio, assuming annual rebalancing. From their model, Aon provides a range of returns that Aon considers to be within an acceptable range. In consultation with Aon, OPG determines the expected long-

term rate of return assumption from this range, as appropriate considering the effects of active investment management and overall stability of the assumption.

The above calculations and process are undertaken annually and have supported the use of 6% for calculating OPG's actual pension costs as reflected in its audited financial statements from 2016 to 2020. This methodology also supported the expected long-term rate of return assumption of 6%, as of June 30, 2020, for the projections in OPG's 2020-2026 Business Plan and the pre-filed evidence.

b) As noted in Ex. F4-3-2, p. 10, footnote 22, the salary schedule escalation rate of 1.7% over the January 1, 2020 to December 31, 2026 period is used to represent the application of the following: (i) wage escalation provisions for the remaining term of existing collective agreements at the time the projection was developed (see Ex. F4-3-1, p. 14, lines 3-4 for PWU and lines 6-7 for Society); (ii) requirements of Bill 124 limiting public sector wage increases at 1% per year for a three-year moderation period tied to the expiration dates of the existing collective agreements (see Ex. F4-3-1, p. 14, lines 12-18); and (iii) an assumption of 2.0% per year thereafter. [redacted]