ONTARIO ELECTRICITY FINANCIAL CORPORATION

Financial Statements
for the year ended March 31, 2018

Financial Statements

Responsibility for Financial Reporting

The accompanying financial statements of OEFC have been prepared in accordance with Canadian public sector accounting standards and are management's responsibility. The preparation of financial statements necessarily involves the use of estimates based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to July 20, 2018.

Management maintains a system of internal controls designed to provide reasonable assurance that the assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. The Ontario Internal Audit Division of the Treasury Board Secretariat independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to management and the Audit Committee of the Board.

The Board is responsible for ensuring management fulfills its responsibilities for financial reporting and internal controls. The Audit Committee assists the Board in carrying out these responsibilities. The Audit Committee periodically meets with management, the internal auditors and the external auditors to deal with issues raised by them, and to review the financial statements before recommending Board approval.

The financial statements have been audited by the Auditor General of Ontario (the external auditor). The Auditor's responsibility is to express an opinion on whether OEFC's financial statements fairly present OEFC's financial position in accordance with Canadian public sector accounting standards. The Auditor's Report, which appears on the following page, outlines the scope of the Auditor's examination and opinion.

On behalf of management:

Gadi Mayman
Vice-Chair and Chief Executive Officer

Ken Kandeepan
Chief Financial and Risk Officer

Auditor’s Report

Office of the Auditor General of Ontario
Bureau du vérificateur général de l’Ontario

Independent Auditor’s Report

To the Ontario Electricity Financial Corporation and to the Minister of Finance

I have audited the accompanying financial statements of the Ontario Electricity Financial Corporation, which comprise the statement of financial position as at March 31, 2018, and the statements of operations and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian public sector accounting standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Ontario Electricity Financial Corporation as at March 31, 2018, and the results of its operations, and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Toronto, Ontario
July 20, 2018

Bonnie Lysyk, MBA, FCPA, FCA, LPA
Auditor General

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Ontario Electricity Financial Corporation

Statement of Financial Position

As at March 31, 2018 ($ millions)

	2018	2017
ASSETS		
Cash	$ 3	$ 3
Investments	4,068	2,556
Accounts receivable (Note 4)	163	290
Interest receivable	26	26
Due from Province of Ontario (Note 5)	3,426	3,577
Notes and loans receivable (Note 6)	10,607	11,375
	$ 18,293	$ 17,827
LIABILITIES		
Accounts payable and accrued liabilities (Note 7)	$ 24	$ 93
Interest payable	371	372
Debt (Note 8)	19,112	20,413
Power purchase contracts (Note 10)	104	178
	19,611	21,056
NET DEBT	(1,318)	(3,229)
NON-FINANCIAL ASSETS		
Deferred costs on hedging	35	27
UNFUNDED LIABILITY (Notes 1, 3, 12)	$ (1,283)	$ (3,202)
Contingencies (Note 13)		

Approved on behalf of the Board:

Scott Thompson
Chair

Gadi Mayman
Vice-Chair and Chief Executive Officer

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation

Statement of Operations and Change in Unfunded Liability

For the year ended March 31, 2018 ($ millions)

	2018	2017
REVENUE		
Debt retirement charge (Notes 1, 12)	$ 593	$ 621
Payments-in-lieu of tax and provincial corporate taxes (Notes 1, 12, 15)	494	364
Interest (Note 6)	642	703
Power supply contract recoveries (Note 10)	185	838
Net reduction of power purchase contracts (Note 10)	74	129
Electricity sector dedicated income (Notes 5, 12)	815	302
Financial benefit from the Province related to the disposition of Hydro One and Hydro One Brampton Shares (Notes 5, 12)	531	411
Other	5	14
	$ 3,339	$ 3,382
EXPENSE		
Interest on debt	$ 1,112	$ 1,216
Power supply contract costs (Note 10)	191	838
Debt guarantee fee	102	122
Operating	7	7
Industrial electricity incentive program costs (Note 11)	8	8
	1,420	2,191
Excess of revenue over expense	1,919	1,263
Unfunded liability, beginning of year	(3,202)	(4,393)
Unfunded liability, end of year	$ (1,283)	$ (3,202)

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation

Statement of Cash Flows

For the year ended March 31, 2018 ($ millions)

	2018	2017
CASH FLOWS USED IN OPERATING ACTIVITIES		
Excess of revenue over expense	$ 1,919	$ 1,191
Adjustments for:		
Decrease in accounts receivable (Note 4)	127	176
Decrease in interest receivable	–	5
Decrease in due from province of Ontario (Note 5)	151	704
Decrease in accounts payable and accrued liabilities (Note 7)	(69)	(11)
Decrease in interest payable	(1)	(21)
Net increase in debt from revaluation	24	22
Net reduction of power purchase contracts (Note 10)	(74)	(129)
(Increase) decrease in deferred costs on hedging	(8)	2
Other items	5	7
Cash provided from operations	$ 2,074	$ 1,946
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (purchase of) proceeds from investments	(1,512)	857
CASH FLOWS FROM FINANCING ACTIVITIES		
Long-term debt issued	$ 800	$ –
Long-term debt retired	(2,119)	(2,978)
Short-term debt issued (retired), net	1	(976)
Note receivable repayment, net	756	1,142
Cash required by financing activities	(562)	(2,812)
Decrease in cash	–	(9)
Cash, beginning of year	3	12
Cash, end of year	$ 3	$ 3
Interest on debt paid during the period and included in excess of revenue over expense	$ 1,113	$ 1,237

See accompanying notes to financial statements.

Notes to Financial Statements

1) Nature of Operations

Effective April 1, 1999, pursuant to the *Electricity Act, 1998* (the Act), Ontario Hydro was continued as a corporation without share capital under the name "Ontario Electricity Financial Corporation" (OEFC or Corporation). The Corporation is one of five entities established by the Act as part of the restructuring of the former Ontario Hydro. It is exempt from federal and provincial income taxes under paragraph 149(1)(d) of the *Income Tax Act* (Canada).

OEFC is a Crown agency whose mandate includes:

- managing the debt and administering the assets, liabilities, rights and obligations of Ontario Hydro not transferred to other successor entities and managing the former Ontario Hydro's non-utility generator (NUG) contracts;
- providing financial assistance to the successor corporations of Ontario Hydro; and
- entering into financial and other agreements relating to the supply and demand management of electricity in Ontario.

These other successor entities are:

- Ontario Power Generation (OPG), an electricity generation company;
- Hydro One, a regulated electricity transmission and distribution company;
- Independent Electricity System Operator (IESO), the regulated, independent system operator responsible for directing system operations, operating the electricity market, planning for and securing resources to meet medium and long-term energy needs, and coordinating conservation efforts; and
- Electrical Safety Authority (ESA), which performs a regulatory function related to electrical inspections.

On April 1, 1999, the Ministry of Finance determined that the estimated value of the assets being transferred to the new entities was $17.2 billion, which was exceeded by the former Ontario Hydro's total debt and other liabilities of $38.1 billion. OPG, Hydro One (and their subsidiaries) and the IESO were transferred assets valued at $8.5 billion, $8.6 billion and $78 million respectively in exchange for debt payable to OEFC. The resulting shortfall of $20.9 billion was determined by the Ministry of Finance to be "stranded debt." After adjusting for $1.5 billion in loans and other assets retained by OEFC, $19.4 billion was the unfunded liability reflected on the OEFC opening balance sheet.

To allow OEFC to service and retire $38.1 billion in total debt including the $20.9 billion in stranded debt, the Province established a long-term plan where debt service and repayment would be through dedicated revenues from electricity-sector companies. This would be broken down for the electricity sector as follows:

- Notes receivable from the Province, OPG, Hydro One and IESO;
- Payments in lieu of taxes (PILs), which are equivalent to the corporate income, property and capital taxes paid by private corporations;

- Debt retirement charge (DRC) paid by electricity consumers; and
- The cumulative combined profits of OPG and Hydro One (proportionate to the Province's ownership share) in excess of the government's annual interest cost of its investments in the two companies.

As of April 1, 1999, the present value of the future PILs and the cumulative combined profits of OPG and Hydro One in excess of the government's $520 million annual interest cost of its investments in the two companies to be dedicated to OEFC was estimated at $13.1 billion. As a result, subtracting the $13.1 billion from the stranded debt of $20.9 billion resulted in an initial estimate of $7.8 billion, for the residual stranded debt.

The Act provided for the DRC to be paid by electricity consumers until the residual stranded debt was retired. The DRC from residential users' electricity bills was removed as of January 1, 2016 and the DRC for all other users ended as of April 1, 2018. The *Electricity Act, 1998* was amended in 2015 and all reference to the "stranded debt" and "residual stranded debt" were removed including the removal of the requirement to determine the residual stranded debt from time-to-time.

2) Summary of Significant Accounting Policies

(a) Basis of Accounting

As OEFC is a government organization, these financial statements are prepared in accordance with Canadian public sector accounting standards.

(b) Net Debt Presentation

A statement of changes in net debt is not presented since this information is readily apparent. A comparison between budget and actual has been excluded due to the unique nature of OEFC's revenues and expenses over which the agency has minimal control. OEFC is a passive recipient of revenues that it receives on the basis of either legislation (e.g., DRC, GRC, PILs, recovery of NUG contractual costs) or allocated by the Province at its discretion (ESDI).

(c) Measurement Uncertainty

Uncertainty in the determination of the amount at which an item is recognized in the financial statements is known as measurement uncertainty. Such uncertainty exists when it is reasonably possible there could be a material variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used. Measurement uncertainty in these financial statements exists in the valuation of the power purchase contracts, payments-in-lieu of tax revenue, payments-in-lieu of tax receivable and tax refundable, and allowance for doubtful accounts. Estimates are based on the best information available at the time of preparation of the financial statements.

(d) Investments

Investments primarily consist of term deposits held with the Province recorded at cost and mature within one year.

(e) Revenue Recognition

The main sources of revenue are:

- **Debt retirement charge (DRC)** from ratepayers is recognized in the period earned based on the consumption of electricity.
- **Payments-in-lieu of taxes (PILs) and provincial corporate taxes** are recognized in the period that they are earned from OPG, Hydro One and municipal electric utilities. Also included under PILs are Gross Revenue Charge amounts and amounts allocated by the Province to OEFC equal to provincial corporate income taxes payable by Hydro One Inc. (post – IPO).
- **Interest income** is recognized in the period it is earned on notes receivable from the Province, OPG, IESO, and NUGs.
- **Power supply contract recoveries** are recognized as recovered at the same amount as the costs incurred on the Power supply contracts.
- **Electricity sector dedicated income** is allocated at the discretion of the Province of Ontario, using the cumulative combined net income of OPG and Hydro One Limited (related to the Province's ownership share) in excess of the Province's interest costs of its investment.
- **Provincial allocation related to the sale of Hydro One and Hydro One Brampton** is recognized in accordance with section 50.3 of the *Electricity Act, 1998* where OEFC receives a benefit as a result of the sales of Hydro One shares and Hydro One Brampton shares.

(f) Financial Instruments
The corporation's financial assets and liabilities are accounted for as follows:

- Cash and investments are subject to an insignificant risk of change in value so carrying value approximates fair value.

- Accounts Receivable, Due from Province and Notes and Loans Receivable are recorded at cost. Valuation allowances are made to reflect loan receivable at the lower of amortized cost and net realizable value, when collectability and risk of loss exists. Change in valuation is recognized in the statement of operations and unfunded liability.

- Debt is composed of short, medium and long-term bonds, notes and debentures. Debt denominated in foreign currencies that has been hedged is recorded at the Canadian dollar equivalent using the rates of exchange established by the terms of the hedge agreements. Other foreign currency debt, liabilities and assets are translated to Canadian dollars at year-end rates of exchange and, in accordance with Canadian public sector accounting standards, any exchange gains or losses are deferred and amortized over the remaining term to maturity.

- Discounts, premiums and commissions arising from the issuance of debt or the acquisition of debt prior to maturity are deferred and amortized to operations over the life of the underlying debt. Unamortized debt issue costs are included in total debt.

  Derivatives are financial contracts the value of which is derived from underlying instruments. OEFC uses derivatives for the purpose of hedging and to minimize interest costs. Hedges are created primarily through swaps, which are legal arrangements under which OEFC agrees with another party to exchange cash flows based upon one or more notional amounts during a specified period. Other derivative instruments used by OEFC include forward foreign exchange contracts, forward rate agreements, futures and options. Derivatives are recognized at cost on the date on which derivatives are entered and are not subsequently re-measured at fair value at each reporting date.

(g) Debt guarantee fee

A fee equal to 0.5 per cent is payable to the Province annually based on the principal amount of notes, debentures and other indebtedness of the Corporation owed to the Province or guaranteed by the Province excluding adjustments to debt related to unrealized foreign exchange gains and debt issue costs.

(h) Deferred Costs on Hedging

Fees and other costs from debt related derivatives and gains and losses on sale of bonds used to hedge interest rates are deferred and amortized to operations over the life of the underlying debt. Unamortized amounts are classified under non-financial assets.

(i) Accounts payable and accrued Liabilities

Accounts payable relate to normal business transactions with third-party suppliers and are subject to standard commercial terms.

(j) Power Purchase Contracts

The liability for power purchase contracts was originally calculated by a net present value discounting of the estimated losses over the life of the contracts. Under the *Electricity Restructuring Act, 2004*, OEFC began receiving actual contract prices for power from electricity consumers, effective January 1, 2005, and no longer incurs losses on these power purchase contracts. At that time, the decision was made to amortize the liability to revenue over the period when most existing electricity contracts expire with the liability fully eliminated in fiscal 2021–22.

3) Going Concern

OEFC is dependent on the Province to borrow funds to finance maturing debt and to cover any cash shortfalls in the Corporation, and on OPG repaying its outstanding notes receivable. It is also dependent on the government's long-term plan to defease the unfunded liability as described in Note 12.

4) Accounts Receivable

As at March 31 ($ millions)	**2018**	**2017**
Debt retirement charge	$ 75	$ 91
Payments-in-lieu of tax	65	109
Power supply contract recoveries	18	85
Other receivables	5	5
Total	**$ 163**	**$ 290**

5) Due from the Province

As at March 31 ($ millions)	2018	2017
Electricity sector dedicated income	$ 2,871	$ 3,138
Financial benefit related to disposition of Hydro One shares	531	411
Amount equal to Hydro One Inc. provincial income tax	24	28
Total	**$ 3,426**	**$ 3,577**

In 1999, the Province put in place a policy commitment to allocate annually the combined net income of OPG and Hydro One in excess of the Province's interest cost of its investment in its electricity subsidiaries to OEFC. Under these arrangements, the Province recoups all financing costs associated with its investments in electricity subsidiaries on a cumulative basis before any of the combined net income is allocated to and recognized by OEFC.

For the year ended March 31, 2018, for the purposes of Electricity Sector Dedicated Income, the Province's combined net income of OPG and Hydro One Limited was $1,272 million (2017 – $816 million, including Brampton Distribution Holdco Inc.). After deducting the Province's $457 million interest cost of its investment in these subsidiaries (2017 – $514 million), the Province at its discretion allocated to OEFC electricity sector dedicated income of $815 million (2017 – $302 million). During fiscal 2017–18, the Province paid $1,082 million to OEFC (2017 – $1,270 million) which reduced the balance due.

Section 50.3 of the *Electricity Act, 1998* governs the payments to be made to the Corporation in respect of the disposition of any securities of Hydro One and Hydro One Brampton. For fiscal 2017–18, OEFC recognized $531 million from the Province under section 50.3 of the Act in connection with the disposition of Hydro One common shares in May 2017 and Hydro One Brampton common shares in February 2017 (2017 – $411 million). During fiscal 2017–18, the Province settled $411 million of the amount due through a remission of debt that OEFC held with the Province (2017 – $172 million).

In addition, section 91.2 of the Electricity Act requires the Province to pay to the Corporation an amount equal to the amount of tax payable under the *Taxation Act, 2007* by Hydro One Inc. (or subsidiaries). For fiscal 2017–18, OEFC has recognized $23.7 million under section 91.2 of the Act (2017 – $24.8 million).

6) Notes and Loans Receivable

($ millions)					
	Maturity Date	**Interest Rate**	**Interest Payable**	**March 31, 2018**	**March 31, 2017**
The Province	2039–2041	5.85	Monthly	$ 6,902	$ 7,763
OPG	2018–2048	2.96 to 6.33	Semi-Annually	3,520	3,445
IESO	2020	Variable/1.77	Monthly/ Semi-Annually	120	90
				10,542	11,298
Add: Loans receivable from NUGs				71	77
Allowance for doubtful accounts				(6)	–
Net loans receivable from NUGs				65	77
Total				**$ 10,607**	**$ 11,375**

OEFC agreed with OPG and the IESO not to sell notes owing from these successor entities without their prior approval.

OEFC's interest income for 2018 of $642 million (2017 – $703 million) included interest from notes receivable of $614 million (2017 – $686 million) and $28 million (2017 – $17 million) from other sources including temporary investments.

<u>The Province</u>

As previously noted above, at the time of restructuring the former Ontario Hydro, the Province received equity of $8.9 billion in OPG and Hydro One in exchange for assuming debt payable to OEFC. During fiscal 2017–18, the Province paid $861 million to OEFC (2017 – $1,122 million) reducing the principal notes outstanding.

<u>OPG</u>

OEFC agreed to provide OPG financing in the form of 10-year and 30-year notes on commercial terms and conditions.

The OEFC agreed to provide up to $800 million for general corporate purposes, including the Darlington refurbishment project, expiring on December 31, 2016 with $100 million advanced under this facility and a $700 million credit facility for the period January 1, 2017 to December 31, 2017. In September 2017, the agreement was amended to increase the credit facility to $2,350 million and extend the expiry date to December 31, 2018. As at March 31, 2018, $1,400 million has been advanced under this credit facility.

Set out below is a summary by year of maturity of OPG's debt to OEFC ($ millions):

Fiscal Year	Amount
2018–19	260
2019–20	505
2020–21	420
2021–22	185
2022–23	130
2023–24	20
2026–27	50
2040–41	150
2041–42	350
2046–47	250
2047–48	1,200
Total	**$ 3,520**

IESO

In April 2017, OEFC refinanced a note receivable with the IESO, originally maturing on April 30, 2017 for an additional term to June 30, 2020. The refinancing increased the principal outstanding from $90 million to $120 million.

In April 2017, OEFC also extended the expiry date of its revolving credit facility to the IESO to June 30, 2020, and increased the credit facility from $95 million to $160 million. The credit facility bears interest at a floating rate equal to the Province's cost of borrowing for a 30 day term plus 50 basis points. The facility will be used for liquidity purposes and to temporarily fund working capital requirements. At March 31, 2018, IESO had not drawn any funds from this credit facility.

NUGs

Loans receivable from NUGs at March 31, 2018 totalled $65 million, net of an allowance for doubtful accounts of $6 million recognized during the year (2017 – $77 million).

7) Accounts Payable and Accrued Liabilities

As at March 31 ($ millions)	2018	2017
Power supply contract costs	$ 18	$ 83
Payments-in-lieu of tax refundable	3	6
Other liabilities	3	4
Total	**$ 24**	**$ 93**

8) Debt

Debt at March 31, 2018, is set out below by maturity and by currency of repayment, expressed in Canadian dollars.

Currency ($ millions)	Canadian Dollars	U.S. Dollars	Other Foreign	2018 Total	2017 Total
Maturing in:					
1 year	$ 1,137	$ 74	$ 165	$ 1,376	$ 2,773
2 years	1,384	–	–	1,384	712
3 years	1,361	–	–	1,361	1,384
4 years	1,804	–	–	1,804	1,361
5 years	1,396	–	–	1,396	1,805
1–5 years	7,082	74	165	7,321	8,035
6–10 years	7,559	–	–	7,559	8,844
11–15 years	929	–	–	929	1,041
16–20 years	1,260	–	–	1,260	846
21–25 years	382	–	–	382	782
26–50 years	1,732	–	–	1,732	875
	$ 18,944	**$ 74**	**$ 165**	**$ 19,183**	**$ 20,423**
Debt issue costs				**(71)**	**(10)**
Total				**$ 19,112**	**$ 20,413**

The effective rate of interest on the debt portfolio was 5.50 per cent after considering the effect of derivative instruments used to manage interest rate risk (2017 – 5.39 per cent). The longest term to maturity is to June 2, 2049. Total foreign currency denominated debt at March 31, 2018 was $0.2 billion, 96 per cent of which was hedged to Canadian funds (2017 – $0.7 billion or 100 per cent). Bonds and notes payable are either held, or guaranteed as to principal and interest, by the Province as set out below:

	March 31, 2018			March 31, 2017		
($ millions)	**Held by the Province**	**Guaranteed by the Province**	**Total**	**Held by the Province**	**Guaranteed by the Province**	**Total**
Short-term debt	$ 655	–	$ 655	$ 654	–	$ 654
Current portion of long-term debt	721	–	721	2,119	–	2,119
Long-term debt	11,426	6,310	17,736	11,330	6,310	17,640
Total	**$ 12,802**	**$ 6,310**	**$ 19,112**	**$ 14,103**	**$ 6,310**	**$ 20,413**

Fair value of debt issued approximates amounts at which debt instruments could be exchanged in a current transaction between willing parties. In valuing OEFC's debt, fair value is estimated using discounted cash flows and other valuation techniques and is compared to public market quotations where available. These estimates are affected by the assumptions made concerning discount rates and the amount and timing of future cash flows.

The estimated fair value of OEFC debt at March 31, 2018, was $22.2 billion (2017 – $24.5 billion). This is higher than the book value of $19.1 billion (2017 – $20.4 billion) because current interest rates are generally lower than the interest rates at which the debt was issued. The fair value of debt does not reflect the effect of related derivative contracts.

9) Risk Management and Derivative Financial Instruments

OEFC operates within strict risk exposure limits to ensure exposure to risk is managed in a prudent and cost-effective manner. A variety of strategies are used including the use of derivative financial instruments ("derivatives"). Derivatives are financial contracts, the value of which is derived from underlying instruments. OEFC uses derivatives for the purpose of hedging and to minimize interest costs. Hedges are created primarily through swaps, which are legal arrangements under which OEFC agrees with another party to exchange cash flows based upon one or more notional amounts during a specified period. This allows OEFC to offset its existing obligations and thereby effectively convert them into obligations with more desirable characteristics. Other derivative instruments used by OEFC include forward foreign exchange contracts, forward rate agreements, futures and options.

<u>Foreign exchange/currency risk</u>

Foreign exchange or currency risk is the risk foreign currency debt principal and interest payments and foreign currency transactions will vary in Canadian dollar terms due to fluctuations in foreign exchange rates. To manage currency risk, derivative contracts are used to convert foreign currency cash flows into Canadian dollar denominated cash flows. The current policy allows unhedged foreign currency debt principal, net of foreign currency holding, to reach a maximum of 5.0 per cent of total debt. At March 31, 2018, the actual unhedged level was 0.1 per cent of total debt (2017 – 0.0 per cent).

<u>Net Interest Rate Resetting Risk</u>

Net interest rate resetting risk is the exposure to changes in interest rates. Exposure to rate changes is reduced by entering into derivative contracts that convert floating interest payments to fixed interest payments. The current policy allows unhedged floating rate debt and fixed rate debt maturing within the next 12 months, net of liquid reserves, to reach a maximum of 35.0 per cent of total debt.

At March 31, 2018, net interest rate resetting risk as a percentage of total debt was minus 17.0 per cent (2017 – minus 3.1 per cent). To minimize interest rate risk, loans to OPG continue to be funded by borrowings on similar terms to maturity, regardless of OEFC's liquid reserve position. The net interest rate resetting risk is negative due to cash and investment balances exceeding the amount of debt that is exposed to changes in interest rates.

Liquidity Risk

Liquidity risk is the risk OEFC will not be able to meet its current short-term financial obligations. As explained in Note 3, OEFC is dependent on the Province to borrow funds to finance maturing debt and to cover any cash shortfalls in the Corporation, and on OPG repaying its outstanding notes receivable.

The table below presents a maturity schedule of OEFC's derivatives, by type, outstanding at March 31, 2018, based on the notional amounts of the contracts. Notional amounts represent the volume of outstanding derivative contracts and are not indicative of credit risk, market risk or actual cash flows.

Derivative Portfolio Notional Value

As at March 31, 2018 ($ millions)

Maturity in years Fiscal year	2019	2020	2021	2022	2023	6–10 Years	Over 10 Years	Total	March 2017
Cross-currency swaps	$ 203	$ –	$ –	$ –	$ –	$ –	$ –	$ 203	$ 873
Interest rate swaps	705	–	–	100	–	600	53	1,458	2,091
Forward foreign exchange contracts	203	–	–	–	–	–	–	203	190
Total	**$ 1,111**	**$ –**	**$ –**	**$ 100**	**$ –**	**$ 600**	**$ 53**	**$ 1,864**	**$ 3,154**

Credit Risk

The use of derivatives introduces credit risk, which is the risk of a counterparty defaulting on contractual derivative obligations in which OEFC has an unrealized gain. The table below presents the credit risk associated with the derivative financial instrument portfolio, measured through the replacement value of derivative contracts, at March 31, 2018.

Credit Risk Exposure ($ millions)	March 31, 2018	March 31, 2017
Gross credit risk exposure	$ 22	$ 151
Less: Netting	(22)	(149)
Net credit risk exposure	**$ 0**	**$ 2**

OEFC manages its credit risk exposure from derivatives by, among other ways, dealing only with high credit quality counterparties and regularly monitoring compliance to credit limits. In addition, OEFC enters into contractual agreements ("master agreements") that provide for termination netting and, if applicable, payment netting with most of its counterparties. Gross credit risk exposure represents the loss OEFC would incur if every counterparty to which OEFC had credit risk exposure were to default at the same time, and the contracted netting provisions were not exercised or could not be enforced. Net credit risk exposure is the loss including the mitigating impact of these netting provisions.

10) Power Supply Contracts

Power purchase contracts and related loan agreements were entered into by the former Ontario Hydro with NUGs located in Ontario. As the legal continuation of the former Ontario Hydro, OEFC is the counterparty to these contracts. The contracts, expiring on various dates to 2048, provide for the purchase of power at prices in excess of future market price. Accordingly, a liability was recorded at $4,286 million on a discounted cash-flow (DCF) basis when the former Ontario Hydro was continued as OEFC on April 1, 1999.

Under legislated reforms to the electricity market, OEFC began receiving actual contract prices for power from ratepayers effective January 1, 2005, and no longer incurs losses on these contracts going forward. At that time, the decision was made to amortize the liability to revenue over the period when most electricity contracts expire with the liability fully eliminated in fiscal 2021-22. The table below presents the unamortized liability.

15) Provincial Sales of Hydro One Shares

On November 5, 2015, the Province sold about 16 per cent of the Province's outstanding Hydro One common shares at a price of $20.50 per share, through an IPO and through related share sales to electricity sector union trusts. On November 4, 2015, Hydro One paid a departure tax of $2.6 billion to OEFC as a consequence of leaving the PILs regime. Hydro One also paid a one-time additional PIL of tax payment of $191 million associated with the transaction.

On April 5, 2016, the Province initiated a secondary offering of Hydro One shares, which upon completion, reduced the Province's holdings of Hydro One common shares to approximately 70 per cent. On May 8, 2017, the Province initiated a secondary offering of Hydro One shares selling 120 million common shares at $23.25 per share, which upon completion, reduced the Province's holdings of Hydro One common shares to approximately 49.9 per cent.

On December 29, 2017, the Province completed a sale of about 2.4 per cent of outstanding Hydro One common shares at $18 per share to OFN Power Holdings LP, a limited partnership wholly-owned by Ontario First Nations Sovereign Wealth LP, which is in turn owned by 129 First Nations in Ontario. Upon completion of the sale, the Province's holdings of Hydro One common shares totalled approximately 47.4 per cent.

As a result of the Hydro One IPO, Hydro One and all its subsidiaries are subject to corporate income taxes (CIT). Under the *Electricity Act, 1998* the Minister of Finance must pay the OEFC an amount equal to provincial tax payable under the Taxation Act, 2007 by Hydro One Inc., to continue to help service and pay down the electricity sector stranded debt.

Proceeds related to the book value of the shares sold and the special dividend payment of $800 million paid by Hydro One to the Province are being used to pay down the Province's electricity sector debt and other payables. As noted in Notes 5 and 6, OEFC received $1,943 million (2017 – $2,392 million) from the Province during fiscal 2017–18 related to the book value of Hydro One common shares sold in May 2017, of which the Province applied $1,082 million (2017 – $1,270 million) to reduce its payable related to cumulative electricity dedicated earnings (Due from the Province of Ontario) and $861 million (2017 – $1,122 million) to reduce the principal amount of notes payable to OEFC that the Province had assumed on acquiring the shares of Hydro One.

In accordance with section 50.3 of the *Electricity Act, 1998*, in the year ended March 31, 2018 OEFC recognized a financial benefit from the Province of $531 million (2017 – $411 million) in connection with the disposition of Hydro One common shares in May 2017 and Hydro One Brampton common shares in February 2017. As noted in Note 5, during fiscal 2017–18, the Province settled $411 million related to the 2017 benefit through a remission of debt that OEFC held with the Province (2017 – $172 million related to the 2016 benefit).