Undertaking #19

MPI to advise of the importance of yield to the conclusions drawn by Aon with reference to slides 36 and 38

RESPONSE:

Slide #36 is an attempt to understand the reasons that the interest rate risk hedging strategy shown on slide #34 with the highest return (duration matching) also has the least risk. This risk-return relationship is counterintuitive because normally earning additional return requires taking additional risk.

As explained on slide #35, Aon Hewitt was attempting to understand the reasons for this by performing a series of tests where they changed one variable at a time. One of the changes made was to assume that each interest rate risk hedging strategy had the same yield.

Slide #11 explained that: "duration matching has the highest yield, the bucket approach has a lower yield and cash flow matching has the lowest yield."

Slide #39 quantifies the yield differences: "…given the assumed yield difference of 20 basis points between the hedging strategies…". Therefore, the yield of the duration matching strategy is assumed to be 20 bps higher than the bucket approach and 40 bps higher than cash flow matching.

The graph on slide #36 shows the results of this test. And slide #38 explains the results by concluding that the difference in the assumed return of each strategy is the main difference between the three interest rate risk hedging strategies as the risk of each is very similar.