2016/2017 MPI General Rate Application
Undertaking #35 (CAC/MB)
Transcript Page 1518
October 20, 2015

Undertaking #35

CAC to provide what Dr. Simpson produced relative to the difference between MPI's selected interest rate floor and the alternative suggested.

RESPONSE:

I have criticized the use of the monthly minimum 10 year GoC rate from 1989 to the present because it is inconsistent with the DCAT calculations and simulations, which are annually based over a 4-year horizon. The minimum monthly rate would appear to be designed to produce the lowest interest rate possible (other than a daily or weekly rate) and apply it to the simulated annual DCAT results over a 4-year period. I would argue that, to be consistent with the DCAT exercise, we should consider only the lowest annual (12-month) interest rate or, since the horizon is 4 years, the lowest 48-month interest rate for the series from 1989 to the present. Using Cansim series v122543 (selected GoC benchmark bond yields: 10 years), the minimum monthly interest rate is 1.32% for February of 2015, while the minimum 12-month average is 1.60% for the period ending September, 2015 and the minimum 48-month average interest rate is 1.99% for the period ending September, 2015. These rates are 0.28% and 0.67% higher than the minimum monthly rate, respectively.

I would note, however, that the choice of an arbitrary interest rate floor, whether based on a monthly, annual or 4-year minimum of some interest rate series, calls into question the validity of the interest rate and combined DCAT scenarios as exercises based on historical evidence (since historical evidence of such a low interest rate period does not exist).