

**Undertaking #36**

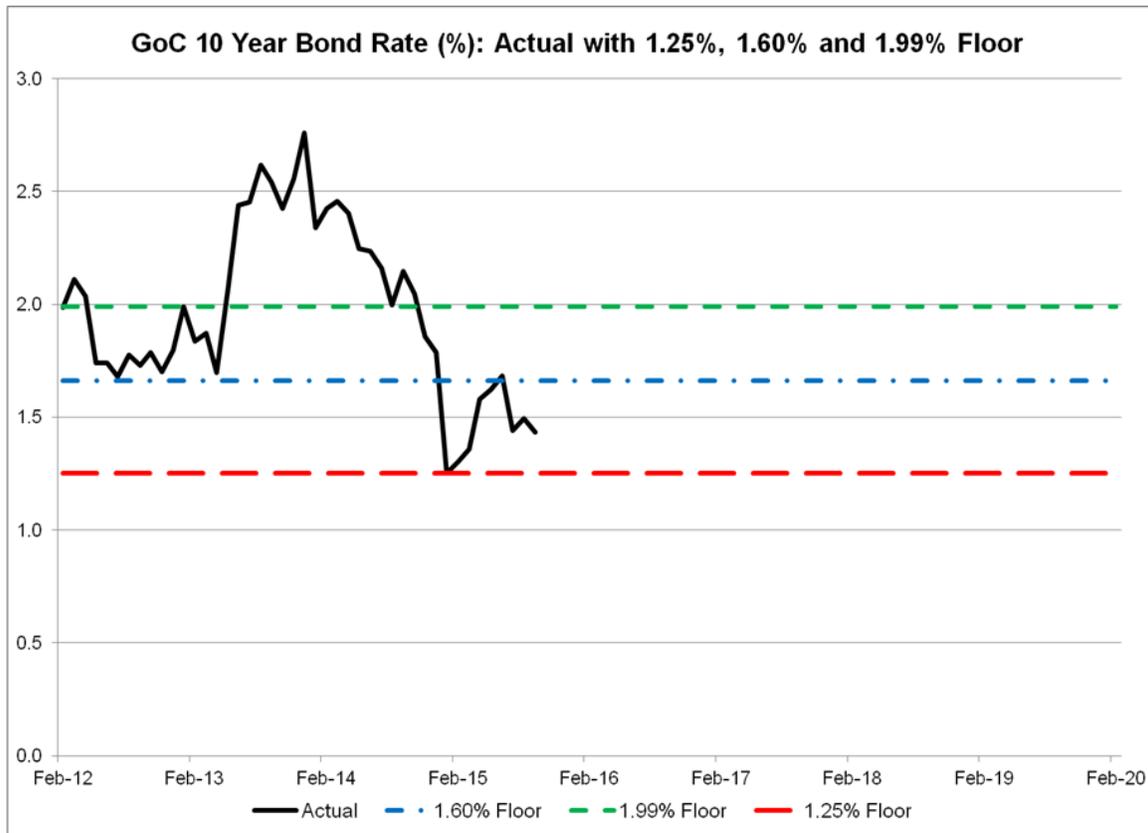
MPI to rerun scenario with a different interest rate floor upon receipt of the information from CAC

**RESPONSE:**

Based on the response to CAC Undertaking 35, the Corporation interpreted that the CAC may consider an interest rate floor of either 1.60% (based on the minimum 12-month average) and 1.99% (based on the minimum 48-month average).

On the assumption that the Corporation has correctly interpreted the CAC position, the CAC is proposing an interest rate floor that is higher than the actual interest rate as at Feb 28, 2015 (1.30%). While the proposed CAC floor methodology might have some merit, specifically if these discussions occurred during the DCAT collaborative process, the Corporation has difficulty understanding how we could set an interest rate floor (i.e. the lowest assumed possible interest rate) that is **higher** than the actual current interest rate. Therefore, we do not propose any change to the modeling assumptions used in the 2015 DCAT. The Corporation has run the CAC interest rate scenarios in response to this undertaking shown below, but we do not support the underlying assumptions of these scenarios.

Based on evidence provided by Dr Simpson in previous hearings, the current interest rate environment would not be considered "valid" because it did not occur in the past. MPI is simply using a forecast based on the current level of interest rates and applying a floor that reflects the current interest rate environment. The Corporation considers such a model to be valid and to have more credibility than a model that selects a floor that is higher than current interest rates. The graph below show the various interest rate floor assumption relative to the recent historical experience.



The following tables show two different interest rate floor assumptions along with the difference in Total Equity from the current methodology in the DCAT. For each of the scenarios the interest rates fall below the floor in Q1 2016/17 and remain below the floor throughout the return period.

**Interest Rate Decline Scenario (1.60% Floor)****Total Equity (in millions)**

Probability	Return Period	2016/17	2017/18	2018/19	2019/20
1-in-200	1 year + base	\$211	\$177	\$141	\$118
1-in-100	1 year + base	\$211	\$177	\$141	\$118
1-in-40	1 year + base	\$211	\$177	\$141	\$118
1-in-20	1 year + base	\$211	\$177	\$141	\$118
1-in-200	2 year + base	\$211	\$177	\$141	\$118
1-in-100	2 year + base	\$211	\$177	\$141	\$118
1-in-40	2 year + base	\$211	\$177	\$141	\$118
1-in-20	2 year + base	\$211	\$177	\$141	\$118
1-in-200	3 year + base	\$211	\$177	\$141	\$118
1-in-100	3 year + base	\$211	\$177	\$141	\$118
1-in-40	3 year + base	\$211	\$177	\$141	\$118
1-in-20	3 year + base	\$211	\$177	\$141	\$118
1-in-200	4 year	\$211	\$177	\$141	\$118
1-in-100	4 year	\$211	\$177	\$141	\$118
1-in-40	4 year	\$211	\$177	\$141	\$118
1-in-20	4 year	\$211	\$177	\$141	\$118
Base		\$257	\$278	\$288	\$318

**Interest Rate Decline Scenario (1.99% Floor)****Total Equity (in millions)**

Probability	Return Period	2016/17	2017/18	2018/19	2019/20
1-in-200	1 year + base	\$229	\$205	\$179	\$167
1-in-100	1 year + base	\$229	\$205	\$179	\$167
1-in-40	1 year + base	\$229	\$205	\$179	\$167
1-in-20	1 year + base	\$229	\$205	\$179	\$167
1-in-200	2 year + base	\$229	\$205	\$179	\$167
1-in-100	2 year + base	\$229	\$205	\$179	\$167
1-in-40	2 year + base	\$229	\$205	\$179	\$167
1-in-20	2 year + base	\$229	\$205	\$179	\$167
1-in-200	3 year + base	\$229	\$205	\$179	\$167
1-in-100	3 year + base	\$229	\$205	\$179	\$167
1-in-40	3 year + base	\$229	\$205	\$179	\$167
1-in-20	3 year + base	\$229	\$205	\$179	\$167
1-in-200	4 year	\$229	\$205	\$179	\$167
1-in-100	4 year	\$229	\$205	\$179	\$167
1-in-40	4 year	\$229	\$205	\$179	\$167
1-in-20	4 year	\$229	\$205	\$179	\$167
Base		\$257	\$278	\$288	\$318

**Interest Rate Decline Scenario (1.60% Floor)****Total Equity – Difference from DCAT (in millions)**

Probability	Return Period	2016/17	2017/18	2018/19	2019/20
1-in-200	1 year + base	\$18	\$27	\$36	\$47
1-in-100	1 year + base	\$18	\$27	\$36	\$47
1-in-40	1 year + base	\$18	\$27	\$36	\$47
1-in-20	1 year + base	\$18	\$27	\$36	\$47
1-in-200	2 year + base	\$18	\$27	\$36	\$47
1-in-100	2 year + base	\$18	\$27	\$36	\$47
1-in-40	2 year + base	\$18	\$27	\$36	\$47
1-in-20	2 year + base	\$18	\$27	\$36	\$47
1-in-200	3 year + base	\$18	\$27	\$36	\$47
1-in-100	3 year + base	\$18	\$27	\$36	\$47
1-in-40	3 year + base	\$18	\$27	\$36	\$47
1-in-20	3 year + base	\$18	\$27	\$36	\$47
1-in-200	4 year	\$18	\$27	\$36	\$47
1-in-100	4 year	\$18	\$27	\$36	\$47
1-in-40	4 year	\$18	\$27	\$36	\$47
1-in-20	4 year	\$12	\$25	\$34	\$44

**Interest Rate Decline Scenario (1.99% Floor)****Total Equity – Difference from DCAT (in millions)**

Probability	Return Period	2016/17	2017/18	2018/19	2019/20
1-in-200	1 year + base	\$37	\$54	\$74	\$96
1-in-100	1 year + base	\$37	\$54	\$74	\$96
1-in-40	1 year + base	\$37	\$54	\$74	\$96
1-in-20	1 year + base	\$37	\$54	\$74	\$96
1-in-200	2 year + base	\$37	\$54	\$74	\$96
1-in-100	2 year + base	\$37	\$54	\$74	\$96
1-in-40	2 year + base	\$37	\$54	\$74	\$96
1-in-20	2 year + base	\$37	\$54	\$74	\$96
1-in-200	3 year + base	\$37	\$54	\$74	\$96
1-in-100	3 year + base	\$37	\$54	\$74	\$96
1-in-40	3 year + base	\$37	\$54	\$74	\$96
1-in-20	3 year + base	\$37	\$54	\$74	\$96
1-in-200	4 year	\$37	\$54	\$74	\$96
1-in-100	4 year	\$37	\$54	\$74	\$96
1-in-40	4 year	\$37	\$54	\$74	\$96
1-in-20	4 year	\$31	\$52	\$72	\$94