Consumers Council of Canada and the Vulnerable Energy Consumers Coalition (CCC) and (VECC) INTERROGATORY #18 List 1

Interrogatory

Ref: B1/T3/S1 p. 44

Issue 4.0
Issue: Cost of Capital/Capital Structure

Topic: Beta Estimation

Request:

a) Can Ms. McShane confirm that in using five year estimation windows to estimate betas she implicitly assumes that all risks materialise during that five year window;

b) Alternatively can Ms. McShane confirm that if a risk does not materialise during a five year estimation window that the use of a five year window means that she will not estimate that risk in her beta estimates?

c) Does Ms. McShane believe that estimation procedures require the use of judgment in for example looking at sample periods?

Response

a) For the beta to be a meaningful measure of risk (which is forward looking), there would be an underlying assumption that all the possible non-diversifiable risks materialize in order for the beta to measure the forward-looking risks.

b) If the non-diversifiable risks that the beta is intended to capture do not materialize during that window, they will not be measured. Moreover, if the single beta does not capture the risks that do materialize, they will not be measured.

c) Yes; moreover judgment must be used to interpret the results for any given periods.