

# MOODY'S

## INVESTORS SERVICE

### CREDIT OPINION

13 January 2022

Update

✓ Rate this Research

#### RATINGS

##### Canada Pension Plan Investment Board

Domicile	Canada
Long Term CRR	Not Assigned
Long Term Issuer Rating	Aaa
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Canada Pension Plan Investment Board

Stable and strong liquidity with an exclusive legislative mandate

### Summary

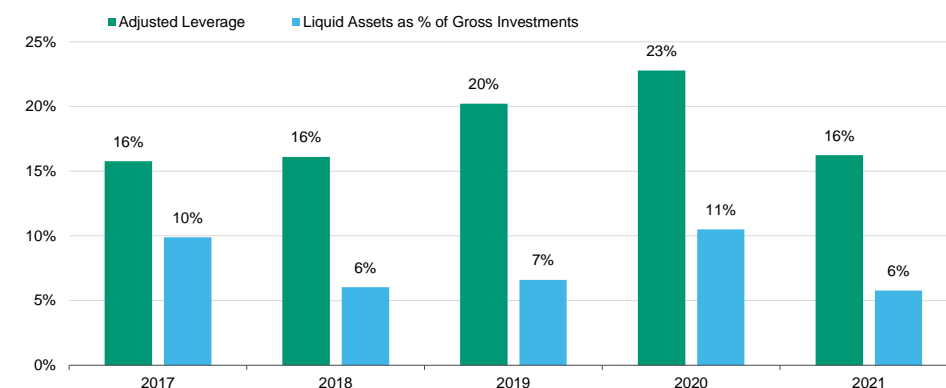
CPPIB's aa2 baseline credit assessment (BCA) reflects the pension manager's strong liquidity and predictability of future cash flows, as well as sound financial policies. The BCA is further supported by our positive view of its funding profile because as a pension manager, in contrast to a public pension plan, it does not have a direct funding obligations to pensioners. These credit strengths are constrained by a high proportion of high risk assets, growth in less-liquid investments, and a modest degree of leverage.

For the first fiscal six months ending 30 September 2021, CPPIB posted a 7.5% return net of investment costs and the fund increased in size to CAD44 billion; CAD38 billion of which was from investment income.

In the next 3-5 years, we believe the investment characteristics of certain asset classes will change as economies adjust to a post-pandemic recovery. These changes will depend on the length and severity of the economic impact; associated government support measures; and shifting private sector preferences, such as greater employment away from office real estate. That said, CPPIB has weathered the crisis well and has a reputation for strong investment acumen. The fund's long investment horizon is a considerable advantage in this regard as it affords them time to make portfolio shifts, particularly with less-liquid investments.

Exhibit 1

#### Adjusted leverage is moderate and liquid assets offer strong coverage of obligations



Fiscal year ending March 31, Liquid assets represents money market securities, Government of Canada and Provincial government securities and securities purchased under reverse repurchase agreements. Moody's leverage ratio is adjusted for improved comparability between US GAAP and IFRS by deducting nettable, but not offset, repurchase agreements and derivative contracts. Source: Moody's Investors Service, data from issuer reports

CPPIB's Aaa long-term senior unsecured rating is based on its aa2 BCA, our assumption of modest extraordinary support from the Government of Canada, and instrument-level structural support under our assumption that creditors have a priority of claim on net assets, creating high coverage of assets for creditors.

CPPIB Capital Inc., a wholly-owned subsidiary of CPPIB, has a backed commercial paper rating of Prime-1, reflecting the unconditional and irrevocable guarantee of its debt obligations by CPPIB. CPPIB Capital Inc. adds a moderate degree of leverage by issuing commercial paper and term debt guaranteed by CPPIB, with the goal of diversifying funding sources and enhancing overall returns of the fund.

## Credit strengths

- » Governing legislation that mandates CPPIB as the exclusive asset manager for the national social retirement plan without responsibility for the underlying pension obligations; as such we view the plan as effectively fully-funded
- » Creditors have an effective priority over pension obligations and benefit from strong asset coverage by high quality liquid assets
- » Sound financial policies and an investment profile that immunizes currency mismatches with debt obligations.
- » CPPIB Capital Inc.'s issued instruments are unconditionally and irrevocably guaranteed by CPPIB

## Credit challenges

- » Execution risk associated with the transition to a higher allocation of private market investments
- » Higher level of secured borrowings relative to peers
- » Maintaining effective risk management as CPPIB continues to grow, particularly with respect to the Additional CPP

## Outlook

The stable outlook reflects our expectations that CPPIB's credit fundamentals, specifically its strong and stable liquidity and level of high risk assets, will remain within current ranges over the next 12 to 18 months. It also reflects the stable outlook of its government extraordinary support provider, the [Government of Canada](#) (Aaa stable). The stable outlook on CPPIB Capital Inc.'s ratings reflect the outlook of CPPIB.

## Factors that could lead to an upgrade

- » An upgrade in the ratings is not possible.
- » CPPIB's aa2 BCA could be upgraded if we were to assess a material and sustained decrease in high risk assets.

## Factors that could lead to a downgrade

- » The BCA could be downgraded if there was a material reduction in CPPIB's liquid assets or if a change in CPPIB's governing legislation or a legal precedent that casts doubt on the status of CPPIB's obligations as having preference over pension obligations. However, a downgrade in the BCA would not likely result in a downgrade of the long-term issuer rating because of our expectation of extraordinary support.
- » A material increase in leverage above 25% for a sustained period of time
- » A deterioration in the creditworthiness of the Government of Canada
- » The supported ratings of CPPIB Capital Inc. could be downgraded if we were to assess a change in the guarantee from CPPIB.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Key indicators table

Exhibit 2

### CPP Investments [1][2][3][4][5]

Statistics for Canada Pension Plan Investment Board	2021	2020	2019	2018	2017
Gross Assets (C\$ millions)	599,385	543,144	500,547	431,941	381,413
CPPIB Net Assets (C\$ millions)	497,187	409,588	391,980	356,134	316,677
Fixed Income % Investments	24%	29%	25%	22%	27%
Public Equity % Investments	29%	22%	28%	34%	31%
Private Equity % Investments	23%	20%	19%	18%	17%
Real Estate % Investments [4]	6%	8%	9%	10%	10%
Infrastructure % Investments	7%	6%	7%	6%	7%
Other Investments % Investments	10%	15%	11%	9%	7%
Total Funding % Gross Assets [5]	16%	23%	21%	17%	16%
Unsecured borrowing (CPPIB Capital; C\$ millions)	36,449	38,395	30,861	24,056	19,873
Unsecured borrowing (CPPIB Capital; % Gross Assets)	6.1%	7.1%	6.2%	5.6%	5.2%
Derivative Notionals (C\$ millions)	436,688	396,476	336,532	195,878	205,530
Annual Reported Return (%)	20.4%	3.1%	9.3%	11.9%	12.2%
Benchmark return (%)	30.4%	-3.1%	6.6%	9.8%	14.9%

[1] 2017-2021 information based on IFRS financial statements [2] Includes unrealized gains and losses on investments [3] Fiscal year ending 31 March [4] Data is net of debt on real assets [5] Data excludes debt on real assets

Source: Moody's Financial Metrics, data from company report

## Profile

CPP Investments was established by the Canadian government to invest the assets of its national pension system (excluding the province of Québec), the Canada Pension Plan (CPP). CPPIB uses CPPIB Capital Inc. to add a moderate degree of leverage by raising both short-term and medium-term borrowings.

## Detailed credit considerations

### Funded Status - Pension reserve fund does not have responsibility for the obligation of the underlying pension liability

As an asset manager, CPPIB is not responsible for the administration of benefits, nor in setting actuarial assumptions of the underlying obligation; both which are the responsibility of the sponsoring government. In contrast to a pension fund, CPPIB is the legal and beneficial owner of its assets. As such, we consider CPPIB to be fully funded and assign a aaa-score to its Funding Ratio score.

### Liquidity - Benefits of liquid fixed income portfolio and stable cash flows offset by funding sources that encumber assets

As of CPPIB's latest fiscal year-end of 31 March 2021, CPPIB had improving coverage of its cash obligations by liquid assets. The ratio of discounted liquid asset inflows to recognized obligation outflows was 245%, up from 203% the year prior, largely because of higher levels of publicly-traded equities and fixed income.

That said, CPPIB uses relatively high levels of repo funding and short-sold securities compared to peers, resulting in above-average asset encumbrance and counterparty risk. As of 31 March 2021 the proportion of gross assets funded by repos and short-sold securities was nearly 9%; double the Moody's-rated pension peer average of 4.6% for fiscal years ending 2021 and 2020.

According to the Chief Actuary of Canada's most recent review released in December 2019, the base CPP will receive more in pension contributions than it pays out for pension benefit payments up to and including 2021, after which net outflows will be required to pay benefits. However, Additional CPP will be fully funded and net inflows related to its benefits are expected to be cash flow positive upon implementation until 2060. In aggregate, this results in a net positive contribution cash flow at least until then.

CPPIB has an initial liquidity score of aaa; however, we adjust the score down to aa1 to reflect that CPPIB has higher levels of secured borrowings than its peers.

### Asset Risk - High levels of less-liquid assets, but with broad geographic and sector diversification

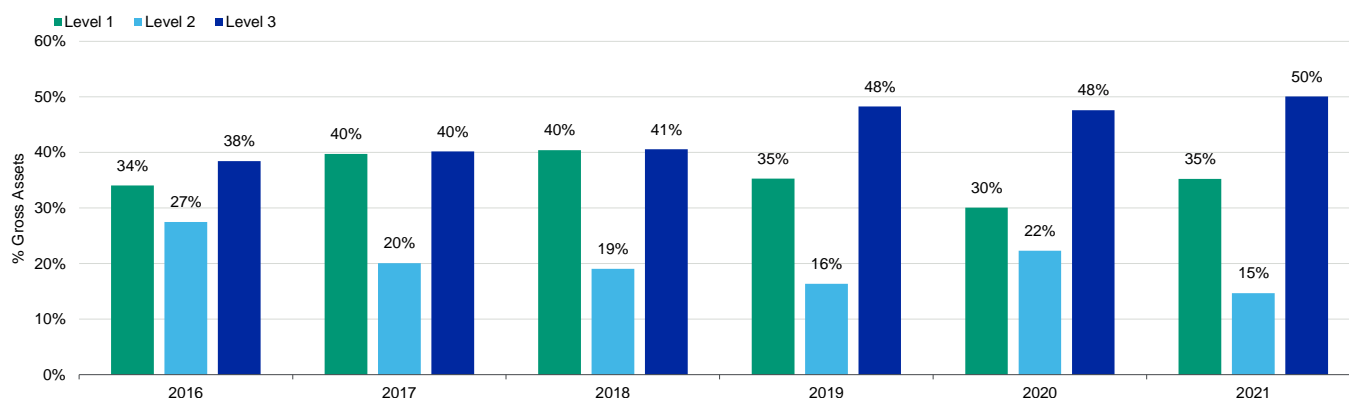
With a ratio of high risk assets to gross assets of 82%, CPPIB has very high asset risk exposure. Less-liquid Level 3 assets, such as real estate, infrastructure and private equity, have grown to 50% of the portfolio as of 31 March 2021 up from 38% in 2016 as highlighted

in Exhibit 3. While these asset classes align to the pension manager's mandate to invest with a long-time horizon and offer attractive risk-adjusted returns, they also add incremental liquidity and operational risks to the fund.

Exhibit 3

### CPPIB's less-liquid Level 3 assets have grown in recent years.

Real estate, infrastructure and private equity align with CPPIB's long time horizon



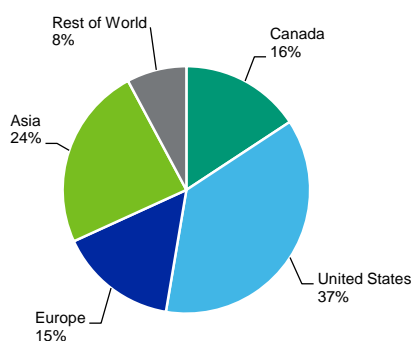
Fiscal year end 31 March

Source: Company Financials, Moody's Investors Service

Over 80% of CPPIB's investment portfolio was invested outside Canada as of 31 March 2021 (Exhibit 4) and is broadly diversified across several asset classes. The benefits of this diversification strategy offsets higher liquidity and operational risks associated with the portfolio's increasing share of Level 3 assets. It also reduces common credit risks with the Canadian economy, providing diversification away from the geographic location of the underlying pension obligation and related contribution cash flows. The effectiveness of these diversification efforts have been evident with the pension manager's positive investment performance during the current economic crisis.

Exhibit 4

### CPPIB's investments are diversified globally.



Data as of 31 March 2021

Source: Company Financials, Moody's Investors Service

CPPIB has an initial asset risk initial score of ba3 but we adjust the score three-notches to Baa3 to reflect the benefits its diverse investment portfolio provides to its credit profile.

### Financial Policy - Conservative financial policies and investment profile is natural hedge to creditor obligations

CPPIB's financial policies are conservative as expressed in our aa-score for Financial Policy. The pension manager has good liquidity and risk management practices that mitigate a modest level of leverage that creates refinancing and counterparty risks. CPPIB has a policy

of not hedging currency exposures within its investment portfolio which has generated volatility in its investment returns. That said, almost 50% of CPPIB's investment portfolio is in USD or CAD which aligns with its creditor obligations, much of which is denominated in USD.

### **CPPIB's governing framework underpins its financial stability**

A system of legislatively mandated and controlled cash flows provides for the overall stability and predictability of CPPIB's financial position. The Canada Pension Plan is funded by mandatory contributions from virtually all Canadian workers and their employers; the exception being workers in the province of Quebec which has its own mandatory pension system. The constituting act of the Canada Pension Plan (CPP Act) mandates that all pension contribution payments, in excess of immediate pension benefit payments, be transferred to the CPPIB.

CPPIB's mandate is to invest the amounts transferred to it with a view to achieving a maximum rate of return without undue risk of loss, having regard to the funding requirements of Canada Pension Plan. In addition, the CPP Act effectively mandates that no claims can be made by the Canada Pension Plan on CPPIB if the effect of such payments is to cause the net assets of CPPIB to fall below zero. This effectively places CPPIB creditors ahead of pension beneficiaries. A change in legislation would be required for CPPIB to lose its mandate to invest for the Canada Pension Plan. Amendments to the CPP Act require the agreement of two-thirds of the provinces of Canada representing two-thirds of the population, an amending formula more stringent than the formula for changing Canada's constitution.

### **ESG considerations**

CPPIB's exposure to environmental risks is low, consistent with our general assessment for the pension funds sector. See our [Environmental heatmap](#) for further information.

CPPIB's exposure to social risks is moderate, consistent with our general assessment for the pension funds sector. Pension funds' social risk exposure is largely driven by: 1) inherent susceptibility to demographic changes such as population ageing, which reduces the number of contributors and increases the number of beneficiaries; 2) employees' specialized investment knowledge which increases risks with talent recruitment and retention; and 3) increasing interconnectedness with the broader financial system which increases interdependency with financial system supply chains. See our [Social risks heatmap](#) for further information.

CPPIB has limited exposure to governance risk thanks to an independent board and management that isolates investment and liability decisions from the political process. There remains a possibility that portfolio investments may become a source of reputational risk for the fund and/or the national government.

### **Support and structural considerations**

#### **High expectation of extraordinary support with a mandate as the exclusive investment manager of Canada's national social retirement program; an essential public service**

Extraordinary support represents the probability that a government owner of a GRI would provide financial support, or other contractual protections, to a GRI to avoid a default on its debt obligations. The expectation of a continuation of ordinary support does not constitute extraordinary support and is instead considered in our assessment of the GRI's BCA.

As noted, CPPIB has special legal status as the exclusive asset manager for investments related to the national social retirement program of Canada. We believe the pension manager is a key element of Canada's social retirement program and therefore an important contributor to the Canadian economy. In our view, a default of CPPIB would be politically embarrassing to the Government of Canada and would have implications for the country's own ability to access debt markets. As such, we believe the Government of Canada would provide extraordinary support, financial or otherwise, to CPPIB if necessary.

#### **CPPIB's creditors have an effective priority over pension obligations and benefit from strong coverage by high quality liquid assets**

The legislative acts constituting the Canada Pension Plan and CPPIB do not explicitly define the priority of creditors over pension obligations. Nevertheless, in our view CPPIB's creditors have an effective priority because the CPP Act mandates that no claims can be made by the Canada Pension Plan on CPPIB if it would cause the net assets of CPPIB to be negative. In this instance net assets means assets less liabilities, including debt. As a result, CPPIB's obligations under the guarantee of CPPIB Capital Inc. debt rank senior

to amounts payable to Canada Pension Plan and pari passu with CPPIB's other unsecured obligations. While there have been no precedents set for the settlement of claims for a failed public pension manager in Canada, several private sector failures has resulted in creditors placed before pensioners in liquidation.

On a gross asset base of almost CAD660 billion at 30 September 2021, CPPIB had net assets of CAD542 billion, which is effectively a loss absorbing cushion for the benefit of creditors. CPPIB's assets include CAD235 billion of liquid assets, comprising CAD16 billion of marketable Canadian federal, provincial and agency debt, CAD16 billion of cash and money market securities and CAD190 billion of public equities. This compares to term debt of CAD41 billion. CPPIB maintains the equivalent of CAD3.0 billion in unsecured credit facilities as a liquidity backstop, which was undrawn as of 30 September 2021. CPPIB's liquidity monitoring also incorporates stressed collateral funding requirements. CPPIB has employed greater leverage while reducing its liquidity position in recent years as the fund shifts to a higher proportion of illiquid assets such as real estate and infrastructure.

Adjusting for nettable, but not offset, repurchase agreements, CPPIB's leverage ratio was 16% as at 31 March 2021 (the most recent data available). This level of leverage results in a two-notch upward adjustment to CPPIB's issuer rating at account for strong asset coverage.

## Rating methodology and scorecard factors

Exhibit 5

Enter Obligor Name Here ►		CPPIB Capital Inc.				
Enter Fiscal Year-End Date Here ►		31-Mar-2021				
	Historical			Assigned		
	Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
Funding Ratio*						
Net Assets / PBO	40%	100.0%	aaa	aaa		
Liquidity						
Liquidity Inflows / Outflows	20%	232.0%	aaa	aa1	Asset Encumbrance	
Asset Quality						
High Risk Assets / Gross Assets	20%	77.0%	ba3	baa3	Asset Class Diversification	Geographic Diversification
Financial Policy	20%	aa	aa	aa		
Financial Policy						
Financial Profile Outcome	100%		aa3	aa2		
Qualitative Notching						
Political Independence				0		
Corporate Behavior				0		
Scorecard-Indicated Outcome Before Constraint				aa2		
Consideration of:					Comment	
Sovereign Constraint (Y/N)				Yes		
Sovereign Rating				Aaa		
Sponsor Constraint (Y/N)				Yes		
Sponsor Rating				Aaa		
Scorecard-Indicated Outcome				aa2		

Source: Moody's Investors Service

## Ratings

Exhibit 6

Category	Moody's Rating
CANADA PENSION PLAN INVESTMENT BOARD	
Outlook	Stable
Issuer Rating -Dom Curr	Aaa
CPPIB CAPITAL INC.	
Outlook	Stable
Bkd Senior Unsecured	Aaa
Bkd Commercial Paper	P-1

Source: Moody's Investors Service



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