

Canada Pension Plan Investment Board

January 25, 2022

This report does not constitute a rating action.

Credit Highlights

Overview

Key strengths

Strong returns, growing assets, positive net contributions, and good management continue to support the Canada Pension Plan Investment Board's (CPP Investments) stand-alone credit profile (SACP).

CPP Investment's low-to-moderate leverage, strong liquidity, and well-diversified portfolio also support the fund's credit profile.

Although CPP Investments operationally independent from the federal government, we believe there is a moderately high likelihood of the fund receiving extraordinary government support, if necessary.

Key risks

Similar to peers, a competitive investment environment will continue to challenge the fund as it strives to generate strong returns on its growing net assets without undue risk of loss.

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Despite a turbulent year amid the ongoing COVID-19 pandemic, CPP Investments posted its strongest net return to date, at 20.4% in 2021. The fund's investment income and net positive contributions propelled net assets to half a trillion Canadian dollars by yearend. The fund's strong returns, net asset growth, and good management support its creditworthiness. Its credit profile is further supported by low-to-moderate leverage, strong liquidity, and a well-diversified portfolio. Like other pensions and pension fund investment managers, CPP Investments faces a competitive investment environment in which to deploy its growing assets.

Outlook

The stable outlook reflects our expectation that CPP Investments will continue to realize good medium-term investment returns, liquidity will be more than adequate, and leverage will remain low-to-moderate in the next two years. We expect that the fund will continue to be independent of federal and provincial governments. As well, we expect the fund will expand and refine its risk management systems, to ensure that its investments remain diversified; and maintain strong management and governance

practices. In addition, we do not anticipate any change to our assessment of a moderately high likelihood that the Canadian government would provide extraordinary support to the fund in the event of financial distress.

Downside scenario

We could lower the ratings if there were a substantial increase in liabilities, such that total liabilities exceeded 40% of total assets in the next two years. We could also lower our ratings if there were a dramatic drop in liquidity or we believed the quality of management (including risk management) had deteriorated significantly and was therefore unable to evolve in tandem with the growing size and sophistication of CPP Investments' investment portfolio. We consider these scenarios unlikely during our two-year outlook horizon.

Rationale

The long- and short-term issuer credit ratings on CPP Investments are 'AAA' and 'A-1+', respectively. The ratings reflect the fund's SACP, which S&P Global Ratings assesses at 'aaa'. The ratings also reflect our opinion of a moderately high likelihood that the Canadian government would provide extraordinary support in the event of financial distress. The SACP on CPP Investments reflects our assessment of the fund's low-to-moderate leverage; strong liquidity; history of strong investment returns; independence in day-to-day operations; and strong corporate governance and management, including risk management. The fund's need to appropriately scale up investment strategies and operations as assets continue to grow rapidly in a competitive investment environment somewhat mitigates these strengths. In fiscal 2021, CPP Investments posted an exceptional return of 20.4% after a smaller return of 3.1% in the previous year. The fund's 2021 net income was propelled by its public and private equities investments. The fund's 10-year return is 10.8%. We believe the fund's medium-term investment returns will continue to exceed the required rate of return and that it has sufficient liquidity to meet near-term debt obligations.

We consider CPP Investments's low-to-moderate leverage levels to be a credit strength. Total liabilities stood at C\$102.2 billion at the end of fiscal 2021 (year ended March 31), consisting of investment liabilities, payables, pending trades, and accrued liabilities. Total liabilities represented 17.1% of total assets, which declined from 24.6% a year earlier.

Canada Pension Plan Investment Board -- Leverage

(%)	Fiscal 2021	Fiscal 2020	Fiscal 2019	Fiscal 2018	Fiscal 2017
Total liabilities/total assets	17.1%	24.6%	21.7%	17.6%	16.9%
Secured funding*/total assets	10.0%	15.6%	14.4%	11.2%	10.6%
Unsecured debt/net assets	7.3%	9.4%	7.9%	6.8%	6.3%

*Secured funding includes repos, short selling of securities, amounts related to derivatives positions, and short-term secured debt.

CPP Investments issues commercial paper (CP) and term debt through its wholly owned subsidiary, CPPIB Capital. The fund has provided a timely, unconditional, and irrevocable guarantee covering all debt it might issue through CPPIB Capital. The guarantee conforms to our guarantee criteria and the debt issues of CPPIB Capital take the same ratings as those on CPP Investments accordingly. As of fiscal year-end 2021, CPPIB Capital's debt, which is recourse to CPP Investments because of the guarantee, totaled C\$36.4 billion (7.3% of net assets) versus C\$38.4 billion (9.4% of net assets) a year earlier.

CPP Investments posted an exceptional return of 20.4% in fiscal 2021, considerably higher than the 3.1% return recorded a year earlier. The strong returns spurred the fund's long-term returns higher; its five- and 10-year annualized net real rates of return were 11% and 10.8%, respectively, both of which easily exceeded the 3.95% required real rate of return. Net investment income was C\$85.4 billion, which was higher than the C\$13.4 billion in the previous fiscal year. The fund has also posted a strong performance in fiscal 2022. Its net 2022 investment returns in the first and second quarters were 3.5% and 3.8%, respectively.

In 2019, the Canada Pension Plan (CPP) began a process of gradual enhancement of benefits in exchange for higher contributions. The additional CPP funds are being managed in tandem with CPP investments but are held in a separate account with C\$6.3 billion in assets at the end of the fiscal year.

We consider CPP Investments independent, both operationally and financially, from the Government of Canada and participating provinces. These governments have established a governance framework that supports the fund's independent functioning, while establishing a clear framework for transparency and accountability, and have maintained a hands-off approach to CPP Investments' day-to-day operations. We expect no changes to the current governance framework for the foreseeable future.

We view CPP Investment's corporate governance and management as strong. We consider the board of directors independent and highly qualified. The fund has a clearly articulated risk budgeting process and formal enterprise risk management policies in place. We believe management maintains a clear and comprehensive set of operating principles, objectives, and strategies, and that it performs well against its targets. Audit and control systems are extensive.

CPP Investments has what we consider a strong risk management framework. The board of directors approves the reference portfolio, which expresses the investment portfolio's long-term total risk appetite. In turn, the investment planning committee determines each investment unit's active risk budget based on current and planned investments. The fund also adheres to what we view as a straightforward, prescriptive investment decision-making process that requires management to evaluate investment opportunities according to each investment's individual risks and how these fit within the portfolio's risk profile. A centralized risk management function complements CPP Investment's strong investment decision-making procedures. The fund manages its risks under its risk management framework, which looks at five principal categories of risk: market and credit, liquidity and leverage, operational, regulatory and legal, and strategic. In addition, CPP Investments has established an investment risk department to monitor and measure all facets of investment risk across the organization. We believe the fund's risk management framework, although thorough and well organized, should continue evolving as the portfolio increases and incorporates new and potentially more sophisticated investments.

In keeping with its investment risk management practices, the fund diversifies its investment portfolio broadly by geography, asset class, credit risk, and single-name exposure. Liquidity risk management practices have a strong influence on diversification levels, because CPP Investments maintains large holdings of highly rated and highly liquid government securities. CPP Investments invests in public and private equities; government bonds; credit investments; and real assets, such as real estate, infrastructure, energy, and resources, as well as power and renewables.

CPP Investments is the largest investment pool in Canada, with net assets of C\$497.187 billion as of fiscal year-end 2021. Owing to continuing good investment returns and positive net contributions, the fund's assets have increased rapidly in the past 10 years. We believe that rapid growth can introduce investment and operational challenges as investment operations scale up while maintaining average annual returns on investments (over the next 75 years from 2018) of 3.95% for base CPP and 3.38% for the additional CPP as assumed in the 30th Actuarial Report for long-term plan sustainability. In our view, it is crucial that risk management policies and practices increase at the same pace as investment activities to ensure that all risks are understood, managed, and monitored. This is especially important because the fund's total assets are expected to increase to approximately C\$1 trillion in the next 15 years and to C\$3 trillion by 2050.

In accordance with our criteria for rating government-related entities, we view the likelihood of CPP Investments receiving extraordinary government support as moderately high. We base this on our assessment of CPP Investment's critical role and limited link with the federal government. CPP Investments has a critical role in investing the assets of the CPP. The plan is an essential component of Canada's social safety net because of the pension, disability, and other programs it delivers. The plan has about 20 million participants for whom benefit payments will represent a significant proportion of their retirement income. The fund has a limited link with the federal government, as evidenced by the federal government's hands-off approach to the fund. Linkages are minor: CPP Investments reports its financial results to Parliament. The provinces are also important stakeholders in the CPP; the federal government has a duty to consult with the provinces in certain circumstances, such as the appointment of a director. Accordingly, the federal government must be careful to limit any unilateral influence on the fund if it is to maintain harmonious relations with provincial stakeholders. For this reason, we do not expect the federal government will negatively intervene in the fund.

We have used our "Principles Of Credit Ratings" in conjunction with "U.S. Public Finance: Public Pension Funds," and "Rating Government-Related Entities: Methodology And Assumptions," as our criteria foundation for our analysis of the CPP Investment's creditworthiness. We also use our "Methodology For Linking Long-Term And Short-Term Ratings" criteria as a basis to assign short-term ratings as well as our "Guarantee Criteria" as the basis for the rating on the debt of the fund's issuing trust. In our view, the fund's qualitative credit factors, such as management (including operational effectiveness and financial risk management) and

independence, are similar to those of rated pension funds and pension fund investment boards. As part of our liquidity analysis, we assess the fund's expected cash flows as well as its ability to sell assets to meet payment obligations when cash shortfalls exist. Our leverage analysis considers various metrics, including the ratio of liabilities to assets.

Liquidity

We believe that CPP Investments has more than adequate liquidity, owing to its net cash inflows from net contributions and investment income and from the strength of its considerable and largely liquid balance sheet. For fiscal 2021, net contributions amounted to C\$3.7 billion and operating expenses were C\$1.4 billion. We expect that the fund will remain cash-flow positive for fiscal 2022, as it has for many years.

CPP Investments held C\$75.4 billion in marketable government bonds in addition to C\$100.8 billion in liquid public equities as of fiscal year-end 2021. These well exceed CPP Investment's CP and medium-term note programs, which totaled about C\$36.4 billion. Total liabilities (including debt) were C\$102.2 billion. The fund also maintains segregated securities in its short-term cash management program to meet CPP benefit payment obligations as they arise.

In general, we consider withdrawal risk remote because of the impediments that a withdrawing province would face in establishing an organization that could invest its share of CPP assets. However, the governing United Conservative Party in Alberta has signaled its intention to explore the establishment of a provincial pension plan and withdraw from CPP. If that happens, we believe that in addition to its share of the assets, Alberta would assume a portion the fund's liabilities, and that the transition would be orderly. Furthermore, we believe that CPP Investments without Alberta would remain largely unchanged. Contributors and beneficiaries cannot opt out of the CPP.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Governments | U.S. Public Finance: Public Pension Funds, June 27, 2007
- Environmental Social And Governance Principles In Credit Ratings, Oct. 10, 2021

Related Research

- S&P Global Ratings Definitions, Nov. 10, 2021
- Canada, Oct 26, 2021

Ratings Detail (as of January 25, 2022)*

Canada Pension Plan Investment Board

Issuer Credit Rating AAA/Stable/A-1+

Issuer Credit Ratings History

04-Dec-2012	<i>Foreign Currency</i>	AAA/Stable/A-1+
26-Mar-2009	<i>Local Currency</i>	AAA/Stable/A-1+

Ratings Detail (as of January 25, 2022)*

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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