Canada Pension Plan Investment Board

January 26, 2023

This report does not constitute a rating action.

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Outlook

The stable outlook reflects S&P Global Ratings' expectation that Canada Pension Plan Investment Board (CPP Investments or the fund) 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 remain 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 liabilities increased substantially, such that total liabilities exceeded 40% of total assets in the next two years. We could also lower the ratings if there were a dramatic drop in liquidity or we believed the quality of management (including risk management) had deteriorated significantly and it was therefore unable to evolve in tandem with the increasing size and sophistication of the 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 stand-alone credit profile (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 increase rapidly in a competitive investment environment somewhat mitigates these strengths. In fiscal 2022, CPP Investments posted a strong return of 6.8% after an exceptional return of 20.4% in the previous year. The fund's 2022 returns were propelled by private equities, real estate, and infrastructure 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' low-to-moderate leverage a credit strength. Total liabilities stood at C$148.4 billion at the end of fiscal 2022 (year ended March 31), consisting of investment liabilities, payables, pending trades, and accrued liabilities. The CPP Investments' board has approved a recourse leverage limit of 45% of net assets, starting in the current fiscal year. If we saw a sustained increase in total liabilities such that they approached 40% of total assets, it could lead to a lower rating. Currently, total liabilities represented 21.6% of total assets, up from 17.1% a year earlier.

Canada Pension Plan Investment Board--Leverage

(%)	Fiscal 2022	Fiscal 2021	Fiscal 2020	Fiscal 2019	Fiscal 2018
Total liabilities/total assets	21.6%	17.1%	24.6%	21.7%	17.6%
Secured funding*/total assets	11.4%	10.0%	15.6%	14.2%	11.1%
Unsecured debt/net assets	9.2%	8.0%	9.4%	7.9%	6.8%

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

CPP Investments issues commercial paper 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, accordingly, the debt issues of CPPIB Capital take the same ratings as those on CPP Investments. As of fiscal year-end 2022, CPPIB Capital's debt, which is recourse to CPP Investments because of the guarantee, totaled C$49.5 billion (9.2% of net assets) versus C$39.9 billion (8.0% of net assets) a year earlier.

CPP Investments posted a strong return of 6.8% in fiscal 2022, compared with the 20.4% return recorded a year earlier. The fund's five- and 10-year annualized net real rates of return were 10% and 10.8%, respectively, both of which easily exceeded the 3.7% required real rate of return. Net investment income was C$34 billion. Amid market turbulence, the fund posted weaker performance in the first half of fiscal 2023. Net returns were negative 4.2% in first-quarter 2023 and returned to positive, at 0.2%, in the second quarter. Despite the market volatility and uncertain investment environment in fiscal 2023, we believe the fund is well positioned to continue to add value over the long term and successfully navigate this turbulence.

In 2019, the Canada Pension Plan (CPP) began a process of gradually enhancing benefits in exchange for higher contributions. The additional CPP funds are being managed in tandem with the base CPP investments but are held in a separate account with C$12 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 Investments' 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 most senior management 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 decision-making process that requires management to evaluate investment opportunities according to individual risks and how these fit within the portfolio's risk profile. A centralized risk management function complements CPP Investments' strong investment decision-making procedures. The fund's risk management framework 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, because CPP Investments maintains 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$539 billion as of fiscal year-end 2022. 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 real rates of returns on investments (over the next 75 years from 2021) of 3.7% for base CPP and 3.3% for the additional CPP as assumed in the 31st 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 2030 and reach C$3.6 trillion in 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 Investments' 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 21 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. Linkages with the federal government 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 Investments' 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 the strength of its considerable and largely liquid balance sheet. For fiscal 2022, net contributions amounted to C$7.7 billion and total expenses were C$1.9 billion. We expect that the fund will remain cash-flow positive for fiscal 2023, as it has for many years.

CPP Investments held C$56 billion in marketable government bonds in addition to C$139.5 billion in liquid public equities as of fiscal year-end 2022. These well exceed CPP Investments' debt financing liabilities, which totaled about C$49.5 billion. Total liabilities (including debt) were C$148.4 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
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

Related Research

- S&P Global Ratings Definitions, Nov. 10, 2021
- Canada, Oct 26, 2022

Ratings Detail (as of January 26, 2023)*

Canada Pension Plan Investment Board		
Issuer Credit Rating		AAA/Stable/A-1+
Issuer Credit Ratings History		
04-Dec-2012	*Foreign Currency*	AAA/Stable/A-1+
26-Mar-2009	*Local Currency*	AAA/Stable/A-1+

*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.