S&P Global
Ratings

RatingsDirect®

Research Update:

Caisse de depot et placement du Quebec Rating Affirmed At 'AAA'; Outlook Stable

January 13, 2020

PRIMARY CREDIT ANALYST

Jennifer Love, CFA
Toronto
+ 1 (416) 507 3285
jennifer.love
@spglobal.com

SECONDARY CONTACT

Bhavini Patel, CFA
Toronto
(1) 416-507-2558
bhavini.patel
@spglobal.com

Overview

- We are affirming our ratings on Caisse de depot et placement du Quebec (CDPQ or the fund) and subsidiary CDP Financial Inc., including our 'AAA' long-term issuer credit rating on Caisse.
- The ratings reflect our view of the fund's operational independence from the Province of Quebec, comprehensive risk management policies, high operational effectiveness, low financial leverage, and ample liquidity.
- The stable outlook reflects our expectation that Caisse's financial leverage will continue to be low and manageable, risk management practices will remain sound, liquidity levels will not materially weaken, and investment returns will generally outperform benchmarks.

Rating Action

On Jan. 13, 2020, S&P Global Ratings affirmed its ratings on Caisse de depot et placement du Quebec and subsidiary CDP Financial Inc., including its 'AAA' long-term issuer credit rating on the fund. The outlook is stable.

Rationale

The ratings reflect our view of the fund's operational independence from the Province of Quebec, comprehensive risk management policies, high operational effectiveness, low leverage, and ample liquidity. We assess Caisse's stand-alone credit profile (SACP) at 'aaa'.

Caisse is a well-established and venerable organization, and we view it as operationally and financially independent of Quebec. While an agent of the province, the fund is a legally separate and autonomous entity with natural person powers, including legal ownership of its assets. It also possesses strong governance standards, including a largely independent board with a strong fiduciary spirit. We believe it would be financially resilient to political intervention, given ownership of its assets, large net asset position, and ability to limit withdrawals to C$50 million per month per depositor if required. Moreover, Quebec has long taken a hands-off approach in its dealings with the fund and has had no involvement in investment strategy development or day-to-day operations. We expect that the Coalition Avenir Quebec (CAQ) government will maintain this approach.

We believe the fund has very sound management. The board of directors, whose members are prominent professionals with complementary skill sets, is responsible for developing and reviewing Caisse's guiding policies and strategic orientation. The senior management team, led by the president and CEO, implements the fund's investment strategies and runs the day-to-day operations.

Risk management policies and practices are comprehensive. The fund has a very strong risk management culture focused on integrating risk and investment functions throughout the organization, and a thorough understanding of its operational and investment risks. The risk organization is involved at multiple points during the investment process. At the heart of its risk framework is the integrated risk management policy, which defines Caisse's risk governance and sets limits for risk tolerance, transaction authorizations, and overall concentrations. We expect the fund will continue enhancing its risk systems and procedures in tandem with its evolving market, credit, and liquidity exposures.

As part of its risk management practices, Caisse diversifies its investment portfolio. The portfolio is diversified by geography, credit quality (fixed income), and sector, including single-name concentration. Because Caisse is domiciled in Quebec, it has significant exposure to Quebec-based investments in a number of sectors. The reason for this is twofold: Caisse has extensive knowledge of the local market; and it is mandated to contribute to the province's economic development. At the end of 2018, the fund's Quebec-based assets totaled C$63.8 billion, or 19% of its total investments. However, about C$18.5 billion (or 5% of total investments) of that exposure is to provincial and agency bonds, which are held as part of liquidity risk management. As well, significant investments in certain large Quebec companies with large global operations mitigate the exposure somewhat.

Caisse has a record of high operational effectiveness. The five-year average annualized return was 8.4% in 2018, down thanks to a lower-than-normal return in 2018 but still ahead of the benchmark average of 7.1%. In 2018, the fund generated a net overall investment return of 4.2%, the lowest level in many years. The lower result was due to the downturn in equity markets in the last quarter of 2018. Nevertheless, Caisse surpassed its benchmark for the seventh consecutive year, thanks to strong performances by the real assets class (real estate and infrastructure). Despite the strong returns by real assets, the asset class did not surpass its benchmark despite a very strong return by infrastructure. However, both fixed income and equities did, as net assets increased about 4% in 2018 to C$310 billion. Total investments rose about 3% to C$342 billion.

The fund's financial leverage is low and manageable. Total liabilities represented 11.6% of total assets at the end of 2018, virtually unchanged from the previous year. The fund's financial leverage is among the lowest of its Canadian peers. Debt (commercial paper [CP], loans, and term debt) totaled C$15.8 billion or about 4.6% of total investments at Dec. 31, 2018, virtually unchanged from a year earlier. CP outstanding was C$5.9 billion and term debt stood at C$9.6 billion. We do not expect any significant increase in debt or total liabilities in the next two years.

Caisse de depot et placement du Quebec -- Leverage

(%)	2018	2017	2016	2015	2014
Total liabilities/total assets	11.6	11.5	14.3	14.7	17.2
Secured funding*/total assets	6.4	6.4	9.0	9.4	11.3

Caisse de depot et placement du Quebec -- Leverage (cont.)

(%)	2018	2017	2016	2015	2014
Capital market debt/total investments	4.6	4.3	4.7	4.8	5.3

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

In accordance with our government-related entity criteria, we base our view of a moderate likelihood of extraordinary government intervention on our assessment of the fund's important role for Quebec and its limited link. We base this assessment on Caisse's management of the assets of most public-sector pension and insurance plans in the province, including those covering the government's own employees. Contributing to Quebec's economic development is part of Caisse's legislated mandate. Our assessment of a limited link reflects Quebec's long track record of non-interference in the fund's operations. Caisse is rated above Quebec. We believe the fund has solid governance standards, sizable net assets, and strong liquidity. We feel Quebec's willingness and ability to materially impair Caisse's credit standing in periods of stress are limited and, ultimately, if the province were to default, there is a measurable likelihood that the fund would not. Moreover, unlike pension funds, Caisse does not administer, nor is it liable for, its depositors' diverse array of pension benefit obligations.

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 Caisse'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 of Jan. 13, 2020, we no longer use "Counterparty And Debt Rating Methodology For Alternative Investment Organizations: Hedge Funds" and "Rating Private Equity Companies' Debt and Counterparty Obligations" as our basis for analyzing CDPQ's liquidity and leverage, as we retired these criteria articles. However, our analysis of the fund's liquidity and leverage remains largely unchanged. 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

Caisse maintains a considerable liquidity cushion that is robust under a variety of stress scenarios, in our view. Net contributions and cash investment income more than comfortably exceed operating expenses and annual debt service costs (including full repayment of loans and CP). Furthermore, the fund has a liquidity risk management policy that requires it to hold highly liquid securities that can be sold very quickly to meet cash calls rapidly. In keeping with policy, Caisse held highly liquid and highly rated government bonds totaling C$37 billion as of the end of 2018, as well as a committed credit facility totaling US$4 billion to meet its contractual commitments and financial obligation. These holdings are composed of the debt of the federal governments of Canada and the U.S., provincial governments and their agencies, and a minor amount of cash and other liquid assets. In addition, the fund held another C$28 billion of somewhat less-liquid government and corporate bonds, and more than C$120 billion of publicly traded domestic and international equities, compared with capital market debt of about C$16 billion. The fund can also resort to a credit facility or CP issuance. Caisse monitors its liquidity position daily. Liquidity levels have remained relatively steady despite the deployment of some of its liquidity holdings into higher-yielding investments.

Caisse's depositor funding profile is very predictable. Depositors generally have long-term investment horizons and legislative requirements to invest their money with the fund that would preclude them from withdrawing even for poor investment performance. Caisse also has procedures that we believe mitigate the potential effect of unexpected depositor withdrawals on its liquidity and investment strategies. Of note, the fund generally permits depositors to withdraw or deposit funds once per month, with longer lock-up periods for its less-liquid investment portfolios, such as real estate. It has the ability if required to limit withdrawals to C$50 million per month. Furthermore, we note that the fund has been adding depositors over the long term.

Outlook

The stable outlook reflects our expectation that in the next two years Caisse's financial leverage will continue to be low and manageable, risk management practices will remain sound, liquidity levels will not materially weaken, investment returns will generally outperform benchmarks, and net assets will continue to increase. It also reflects our belief that Caisse will remain independent of the provincial government.

We could lower the ratings if we came to expect the fund to materially increase its financial leverage such that total liabilities were greater than 40% of total assets, to substantially weaken its liquidity cushion or portfolio diversification levels, or to erode its commitment to its risk management framework. Although unlikely, we could also lower the ratings if we came to expect Quebec to deviate from its hands-off approach through legislative changes that undermined Caisse's operational or financial independence. In this instance, we could revise our assessment of the fund, which could lead us to lower the Caisse ratings.

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
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Governments | U.S. Public Finance: Public Pension Funds, June 27, 2007

Ratings List

Ratings Affirmed	
Caisse de depot et placement du Quebec	
Issuer Credit Rating	AAA/Stable/A-1+

Ratings Affirmed

CDP Financial Inc.	
Senior Unsecured	AAA
Commercial Paper	A-1(HIGH)
Commercial Paper	A-1+