Research Update:

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

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Overview

- Caisse de depot et placement du Quebec's (CDPQ or the fund) five- and 10-year investment returns remain solid, its liquidity remains robust, and its leverage remains low.
- We are affirming our 'AAA' long-term and 'A-1+' short-term issuer credit ratings (ICRs) on CDPQ, as well as our 'AAA' senior unsecured debt rating, and 'A-1+' global scale and 'A-1(High)' Canada scale commercial paper (CP) ratings on subsidiary CDP Financial Inc.
- The stable outlook reflects our expectation that CDPQ's liquidity will be sufficient to meet near-term debt obligations and that the fund's medium-term investment returns will remain higher than its depositors' needs despite the global negative economic effects of the COVID-19 pandemic.

Rating Action

On Jan. 15, 2021, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term ICRs on Caisse de depot et placement du Quebec. The outlook is stable. At the same time, S&P Global Ratings affirmed its 'AAA' senior unsecured debt rating, and 'A-1+' global scale and 'A-1(High)' Canada scale CP ratings on subsidiary CDP Financial Inc.

Rationale

The ratings on CDPQ 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 moderate likelihood that the Province of Quebec would provide extraordinary support in the event of financial distress. The SACP on CDPQ reflects our assessment of the fund's independence from Quebec, comprehensive risk management policies, high operational effectiveness, and low leverage. As expected for the overall investment management industry, we believe the negative economic effects of the COVID-19 pandemic will have an impact on the fund's 2020 investment returns. Nevertheless, we believe the fund's medium-term investment returns will remain higher than its depositors' needs and that CDPQ has sufficient liquidity to meet near-term debt obligations.

CDPQ 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 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 CDPQ'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 CDPQ'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, CDPQ diversifies its investment portfolio by geography, credit quality (fixed income), sector, and single-name concentration. Because the fund is domiciled in Quebec, it has significant exposure to Quebec-based investments in several sectors given its extensive knowledge of the local market and its dual mandate to contribute to Quebec's economy while generating optimal returns. At the end of 2019, the fund's Quebec-based assets totaled C$66.7 billion or 17% of its total investments. However, about C$18.2 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 extensive global operations mitigate the exposure somewhat.

CDPQ has a record of high operational effectiveness. It generated a net nominal return of 10.4% in 2019, considerably higher than the 4.2% return recorded a year earlier, as the equity markets bounced back from 2018's downturn. The five-year annualized net nominal rate of return was 8.1%, which exceeded its benchmark of 7.2% and its depositors' needs. Net investment income was C$9.9 billion, which was higher than the C$9.3 billion in the previous year. Net assets increased almost 10% to C$340 billion in 2019 from C$310 billion the year before.

For the first six months of 2020, CDPQ posted a net nominal return of negative 2.3% as a result of the global negative economic effects of the COVID-19 pandemic. Nevertheless, the fund's five- and 10-year annualized net nominal rates of return remained strong at 6.3% and 8.7%, respectively. We expect the fund's medium-term investment returns will remain higher than its depositors' needs.

The fund's financial leverage is low and manageable. Total liabilities represented 13.4% of total assets at the end of 2019, up from 11.6% in 2018, mainly as a result of a 30% increase in investment liabilities. The fund's financial leverage is among the lowest of its Canadian peers. Debt (CP, loans, and term debt) totaled C$21.5 billion or about 6.3% of net assets in 2019, slightly higher than the 5.1% in 2018. CP outstanding was C$8.8 billion and term debt was C$12.3 billion. In 2020, the fund issued US$4.5 billion of senior unsecured notes. 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

(%)	2019	2018	2017	2016	2015
Total liabilities/total assets	13.4	11.6	11.5	14.3	14.7
Secured funding*/total assets	7.2	6.4	6.4	9.0	9.4
Unsecured debt/net assets	6.3	5.1	4.7	5.4	5.6

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

In accordance with our criteria for rating government-related entities, we view the likelihood of CDPQ receiving extraordinary government support as moderate. We base this on our assessment of CDPQ's important role and limited link with Quebec. The fund manages 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 CDPQ's legislated mandate. Our assessment of a limited link reflects Quebec's long track record of non-interference in the fund's operations and independent governance.

We continue to rate CDPQ above the province, based on our belief that its SACP is stronger than that of the government. We believe the fund has solid governance standards, sizable net assets, low debt levels, and strong liquidity. We believe Quebec's willingness and ability to materially impair CDPQ'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, CDPQ does not administer, nor is it liable for, its depositors' diverse array of pension benefit obligations.

Because CDPQ unconditionally and irrevocably guarantees CDP Financial's senior unsecured debt and CP programs, we equalize the ratings on the debt and the programs with those on CDPQ.

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 CDPQ'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

In our view, CDPQ maintains a considerable liquidity cushion that is robust under a variety of stress scenarios. Cash investment income more than comfortably exceeds net withdrawals by depositors, 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, CDPQ held highly liquid and highly rated government bonds totaling C$46 billion as of the end of 2019, as well as a committed credit facility totaling US$4 billion to meet its contractual commitments and financial obligations. 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$29 billion of somewhat less-liquid government and corporate bonds, and C$138 billion of publicly traded domestic and international equities, compared with capital market debt of about C$21.5 billion. The fund can also resort to a credit facility or CP issuance. CDPQ monitors its liquidity position daily.

CDPQ'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. CDPQ 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, the fund has been adding depositors over the long term.

Outlook

The stable outlook reflects our expectation that CDPQ will continue to realize good medium-term investment returns, liquidity levels will not materially weaken, leverage will remain low and manageable, and risk management practices will remain sound in the next two years. It also reflects our belief that CDPQ will remain independent of the provincial government.

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 levels or we believed the quality of management (including risk management) deteriorated significantly. 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 CDPQ's operational or financial independence. In this instance, we could revise our assessment of the likelihood of extraordinary support of the fund, which could lead us to lower the 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
- Criteria | Governments | U.S. Public Finance: Public Pension Funds, June 27, 2007

Related Research

S&P Global Ratings Definitions, Jan. 5, 2021

Ratings List

Ratings Affirmed	
Caisse de depot et placement du Quebec	
Issuer Credit Rating	AAA/Stable/A-1+
CDP Financial Inc.	
Senior Unsecured	AAA
Commercial Paper	A-1(HIGH)
Commercial Paper	A-1+