Research Update:

Public Sector Pension Investment Board Issuer Credit Ratings Affirmed At 'AAA/A-1'; Outlook Remains Stable

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Overview

- The Public Sector Pension Investment Board's (PSPIB or the fund) key credit strengths are its large net asset position and ongoing strong investment returns that support the fund's mandate and reduce risks to debt holders.
- We are affirming our 'AAA' long-term and 'A-1+' short-term issuer credit ratings on the PSPIB; 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 PSP Capital Inc.
- The stable outlook reflects our expectation that the fund will continue to realize good medium-term investment returns, liquidity will remain more than adequate, and leverage will remain below 40% of total assets in the next two years.

Rating Action

On Oct. 17, 2019, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term issuer credit ratings on the Public Sector Pension Investment Board. 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 PSP Capital Inc.

Rationale

The ratings on PSPIB and subsidiary PSP Capital Inc. reflect the PSPIB'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.

This year marks the PSPIB's 20th year since its foundation. In that time, the fund has developed into a large, sophisticated global investor. Its net assets have grown rapidly (to C$167.9 billion in fiscal 2019 from C$2.5 billion in fiscal 2001). In the early years, the PSPIB's asset growth was fueled by annual contributions from the fund's government sponsor; however, investment returns now propel asset growth and account for about 75% of the PSPIB's annual increase in net assets. We expect the PSPIB's growth in net assets to slow as the fund nears maturity. In recent years, the fund's focus has shifted to rebalancing its portfolio from rapid deployment of funds.

We view the PSPIB as a sophisticated pension investment manager with a large net asset position and strong fundamentals. The SACP reflects our view of the fund's operational independence from the Government of Canada, well-diversified portfolio, and low-to-moderate leverage; as well as strong institutional and financial position, corporate governance, management, and liquidity. We believe the fiercely competitive investment environment will continue to challenge the PSPIB, along with peers, as the fund strives to meet its long-term return objective without undue risk of loss, as required under its mandate.

We believe that the PSPIB enjoys a strong institutional position because of its statutory role as the pension investment manager for four of the Government of Canada's pension funds. While it invests the funds of four pension plans, the PSPIB is a pension investment manager with no legal responsibility for the plans' underlying funding liabilities. The PSPIB has grown rapidly since its inception and is now one of Canada's largest pension managers. We expect the fund to maintain its strong financial position for the foreseeable future.

We consider the PSPIB operationally independent from the Government of Canada. The government has established a governance framework that supports the fund's independent functioning, while establishing a clear framework for transparency and accountability. The PSPIB operates at arm's length from the Government of Canada, and we expect this to continue. Moreover, we believe the fund would be financially resilient to political intervention, given its legal ownership of the investment assets. We consider the board of directors to be independent and highly qualified. Furthermore, we expect no significant changes to the governance framework over the next few years.

In our opinion, the PSPIB benefits from strong management and a comprehensive risk management framework. We believe management maintains a clear and comprehensive set of operating principles, objectives, and strategies, and that it performs well against its targets. The fund's 10-year annualized nominal net return is 10.7%, compared to return objectives of 5.8% for the same period as of March 31, 2019. Audit and control systems are extensive and improving. Moreover, the board has formal enterprise risk management policies in place.

The PSPIB also benefits from adequate diversification. Its assets are diversified geographically, and by asset class, credit quality, and sector. Its top 10 investments account for about 27% of total investments, up slightly from about 26% in 2018 and they remain concentrated in high-quality government bonds that support the fund's liquidity. The fund's largest asset class is equities (both private and public at 44.4% of assets under management), followed by fixed income (17.8%), real estate (14%), and infrastructure (10%). The largest geographic exposure is to the U.S., followed by Canada, and then Europe. The PSPIB is also diversified by currency and credit risk.

The PSPIB also has low-to-moderate leverage, in our opinion. The board of directors has established a limit for capital markets debt, equal to 10% of net investments. Total leverage was 15.7% of total assets as of March 31, 2019, consistent with the year before, a level we consider low to moderate.

Public Sector Pension Investment Board -- Leverage

(%)	2019	2018	2017	2016	2015
Total liabilities/total assets	15.7	14.6	14.7	11.3	10.2
Secured funding*/total assets	8.5	7.6	7.8	4.5	4.1
Capital market debt/total net assets	8.4	8.0	8.0	7.6	6.6

* Investment liabilities.

In accordance with our government-related entities (GRE) criteria, we view the likelihood of the PSPIB receiving extraordinary government support as moderately high, based on our assessment of the fund's important role. The PSPIB operates as a not-for-profit entity that plays an important public policy role by investing the pension assets of four federally sponsored pension plans. We believe the federal government has a strong link with the fund, as evidenced by its direct relationship as sponsor. Moreover, the federal government, via the Treasury Board and Department of Finance, will have more formal ongoing interactions with the fund beginning this year through their participation on the new Asset Liability Committee. This committee will recommend the funding risk targets, including the reference portfolio, indicating the government's risk appetite, but will not be involved in day-to-day investment decisions. The PSPIB is guided by a clear corporate governance setup with independent management and will continue to make its own business decisions.

We have used our "Principles Of Credit Ratings" in conjunction with "U.S. Public Finance: Public Pension Funds," "Counterparty And Debt Rating Methodology For Alternative Investment Organizations: Hedge Funds," "Rating Government-Related Entities: Methodology And Assumptions," and "Rating Private Equity Companies' Debt And Counterparty Obligations" as our criteria foundation for our analysis of the PSPIB's creditworthiness. We also use our "Methodology For Linking Long-Term And Short-Term Ratings" criteria as a basis to provide short-term ratings. In our view, the fund's qualitative credit factors, such as management and independence, are similar to those of rated pension funds and pension fund investment boards, such as Caisse de depot et placement du Quebec and the Canada Pension Plan Investment Board. We also believe the PSPIB's quantitative credit factors, including liquidity, leverage, and portfolio diversification, are more akin to those of alternative asset managers, such as closed-ended U.K. investment trusts.

Liquidity

We believe the fund has strong liquidity owing to its positive contribution cash flows, lack of redemption risk, large pool of liquid assets, and low-to-moderate level of debt. The PSPIB's funding profile is very predictable, in our opinion. It receives monthly net plan contributions, which we expect to remain positive until approximately 2030. The fund maintains a sizable pool of liquid assets with which to meet its funding requirements. It had C$11.9 billion of cash and money market securities, as well as corporate, government, and inflation-linked fixed-income securities of C$40.3 billion as of fiscal year-end 2019. It also has the ability to raise cash quickly through sales of some of its most liquid publicly traded equities (C$31 billion). These well exceed the PSPIB's CP and medium-term note programs, which totaled C$14.1 billion. The PSPIB maintains a revolving C$2 billion credit facility and a C$1 billion demand line of credit, both of which remained undrawn at March 31, 2019.

Outlook

The stable outlook reflects our expectation that the fund will retain its strong institutional and financial position in the next two years and that it will continue to build out investment capabilities and risk management systems in line with its expected growth. In addition, we expect the PSPIB to maintain its strong management, liquidity management, and risk management systems. We further expect the fund's leverage to remain relatively low, well below 40% of total assets. We do not expect any significant changes to the PSPIB's mandate and legislative framework. 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.

We could lower the ratings if we saw evidence of a material increase in risk appetite or erosion in the performance of risk management systems. This could include an increase in PSPIB's total liabilities above 40% of total assets, a relatively large investment loss, or a marked decline in liquid unencumbered assets relative to liabilities. We could also lower the ratings if Canada's creditworthiness deteriorated and the federal government became more involved in the fund's operations or strategy. We consider these scenarios unlikely over our two-year outlook horizon.

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 | Financial Institutions | Other: Rating Private Equity Companies' Debt And Counterparty Obligations, March 11, 2008
- Criteria | Governments | U.S. Public Finance: Public Pension Funds, June 27, 2007
- Criteria | Financial Institutions | Fixed-Income Funds: Counterparty And Debt Rating Methodology For Alternative Investment Organizations: Hedge Funds, Sept. 12, 2006

Ratings List

Ratings Affirmed	
Public Sector Pension Investment Board	
Issuer Credit Rating	AAA/Stable/A-1+
PSP Capital Inc.	
Senior Unsecured	AAA
Commercial Paper	
(Canada scale)	A-1 (High)

Ratings Affirmed

(Global scale)	A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.