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Research Update:

Public Sector Pension Investment Board 'AAA/A-1+' Issuer Credit Ratings Affirmed; 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, operational independence from the federal government, stable depositor base, and prudent risk management function.
- We are affirming our 'AAA' long-term and 'A-1+' short-term issuer credit ratings (ICRs) 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 Jan. 13, 2020, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term ICRs 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'. We also believe there is a moderately high likelihood that the Canadian government would provide extraordinary support in the event of financial distress.

We view the PSPIB as a sophisticated pension investment manager with a large net asset position and strong fundamentals. In fiscal 2019, the fund's net assets reached C$167.9 billion, supported by a good investment return of 7.1% and continued net positive contributions. The SACP reflects our view of the fund's operational independence from the Government of Canada, well-diversified portfolio, and low 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 will 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 will 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 with return objectives of 5.8% for the same period as of March 31, 2019. The fund's risk management is strong, with extensive and improving audit and control systems. The board has formal enterprise risk management policies in place. As part of the fund's risk management practices, the PSPIB diversifies its investment portfolio geographically, 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 PSPIB also has low 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 previous year, a level we consider low.

The PSPIB issues debt through PSP Capital, its wholly owned, fully guaranteed subsidiary. PSP Capital was set up to issue debt in response to the fund's increasing borrowing needs and desire to leverage its private markets portfolio. The guarantee conforms to our guarantee criteria and PSP Capital debt issues take the same ratings as those on the PSPIB accordingly.

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 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," and "Rating Government-Related Entities: Methodology And Assumptions," 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 assign short-term ratings as well as our "Guarantee Criteria" as the basis for the rating on the debt of the PSPIB'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 PSPIB's liquidity and leverage, as we retired these criteria articles. However, our analysis of PSPIB'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

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 level of debt. Contributions to the fund are required by federal statute, and we believe its funding profile is very predictable. It receives monthly net plan contributions, which we expect will 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. The fund 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 will maintain its strong management, liquidity management, and risk management systems. We further expect the fund's leverage will remain relatively low. 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 the 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 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 | Governments | U.S. Public Finance: Public Pension Funds, June 27, 2007

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)
(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.