

Ontario Teachers' Pension Plan Board

July 25, 2023

This report does not constitute a rating action.

Outlook

The positive outlook on Ontario Teachers' Pension Plan (OTPP) mirrors the positive outlook on its sponsor, the Province of Ontario, whose ratings cap the ratings on related pensions. We also expect that the credit fundamentals supporting our assessment of OTPP's stand-alone credit profile (SACP) are unchanged and that OTPP continues to hold liquidity sufficient to meet near-term guaranteed debt obligations, that the plan will continue to realize medium-term investment returns higher than its discount rate, and that it will preserve its strong net asset holdings over the next two years. Furthermore, we expect OTPP will maintain its independence, strong financial management, and risk management systems. We do not expect any change in the relationship or level of support between OTPP and its sponsors.

Downside scenario

We could revise the outlook to stable or lower the rating if OTPP realizes sustained investment returns below its discount rate, which could lead us to reassess whether its investment strategies are achievable. We could also take a negative rating action if we saw evidence of a material increase in risk appetite or an erosion of risk management systems performance. This could include large and sustained investment losses, an increase in total liabilities such that they exceed 50% of total assets, a marked decline in liquid unencumbered assets relative to liabilities, or a sharp erosion of funded status. In addition, because we cap the rating on OTPP at one rating category (three notches) above that on its sponsor, a revision of the outlook or a downgrade of the Province of Ontario could lead to a similar action on the plan. As well, we could equalize the rating on OTPP with that on Ontario if we saw evidence of provincial involvement (causing us to revise the plan's link with the province to very strong) or negative provincial interference. We consider these scenarios unlikely over our two-year outlook horizon.

Upside scenario

All else equal, we could raise the rating on the plan if we raised the rating on Ontario over the next two years.

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Rationale

We revised the outlook on OTPP to positive from stable on June 15, 2023, following a similar action on the Province of Ontario.

The ratings on OTPP reflect the fund's SACP, which S&P Global Ratings assesses at 'aa+'. The ratings also reflect our opinion of a moderate likelihood that the Ontario government would provide extraordinary support in the event of financial distress. The SACP on OTPP reflects our assessment of the fund's strong financial and operating performance, strong fund management that includes a well-established and comprehensive enterprise risk management framework, and OTPP's independence from its sponsor (the Government of Ontario). We believe the difficult economic and demographic trends of recent years, particularly the negative effects of the pandemic, slower economic growth, low real yields, and increasing longevity, continue to offset some of these strengths.

Because we limit pension fund ratings to one full rating category (three notches) above those on their sponsors, the credit quality of Ontario (A+/Positive/A-1) constrains the ratings on the fund.

OTPP is Canada's largest single-profession pension plan, with C\$247.2 billion in net assets as of Dec. 31, 2022, which it invests on behalf of its two sponsors: the Ontario government and Ontario Teachers' Federation. In addition to managing the assets of the Ontario Teachers' Pension Plan, the fund manages its liabilities, administers the plan, and pays benefits. Since its establishment in 1990, OTPP has generated strong returns for plan members (9.5% net annualized return since inception to Dec. 31, 2022) and developed into a sophisticated long-term global investor. The fund's growing size has benefited from strong management, which has built out OTPP's investment capabilities as well as the fund's risk management in tandem with its assets' increasing size and complexity.

We view OTPP as independent of the Ontario government. The fund was established as a nonshare capital corporation and has legal ownership of plan assets. OTPP's independent board appoints senior management. The fund alone establishes policies for investments, asset allocation, and risk management; and develops and executes its own investment strategies. Independent actuaries effectively determine funding requirements and actuarial assumptions.

OTPP is a strong organization, with an experienced and skilled management team, in our view. Its independent management maintains a clear set of operating and funding principles and has designed an organizational structure that we believe is well aligned with the fund's performance goals. Investment strategies are consistent with the fund's expertise and funding needs, and management has a long track record of exceeding performance benchmarks. Internal controls are what we consider very robust, and include codes of conduct, segregation of duties, and a pre-trade clearance process, among many other safeguards. The enterprise risk framework is very strong, in our opinion, and includes several risk committees and a chief risk officer. Moreover, the fund's risk management practices are consistently evolving in line with OTPP's growth, investment activities, and complexity. We believe OTPP management demonstrates strong operational effectiveness and risk management.

The fund's operating and financial performances are strong, in our opinion. Despite turbulence in capital markets and continued economic uncertainty, OTPP generated a 4% net return in 2022, higher than the 2.3% benchmark rate, but lower than its 4.3% discount rate. OTPP's 2022 returns were lower than the 11.1% net return recorded a year earlier. Inflation-sensitive and infrastructure investments posted notably strong positive returns of 19.2% and 18.7% respectively in 2022; however, public equities, bonds, and real estate had returns of negative 12.5%, negative 5.9%, and negative 3.5%, respectively. The fund is mature and made net payments of \$3.8 billion in 2022; however, owing to investment returns, net assets continued to increase. Also in 2022, OTPP remained fully funded, while maintaining a conservative discount

rate. The fund's total liabilities as a percent of total assets decreased to almost 22% in 2022 from about 25% in the previous year. Along with other pension funds, OTPPP continues to face difficult demographic and economic trends. Life expectancy has risen in the past decade, increasing the net present value of benefit obligations. Furthermore, the fund is a mature plan whose payouts exceed contributions and the ratio of active-to-retired members is 1.2 to 1.

In accordance with our government-related entity criteria, we view the likelihood of the fund receiving extraordinary government support as moderate, based on our assessment of the strong link with the province, which the government's joint stewardship of the plan and the provisions under the fund's enabling statute demonstrate. We believe OTPPP's role is of limited importance to the government because it is a not-for-profit entity that could be replaced by another one without compromising the government's relationship with teachers, in our opinion. In addition, the fund's mandate is to provide pensions to a single profession and is one of many pension plans receiving money from the government.

We rate OTPPP above the province, based on our belief that the fund's SACP is stronger than that of the province. We believe the government's willingness and ability to impair OTPPP's creditworthiness in periods of stress is limited. Moreover, we believe the fund could effectively mitigate negative government intervention through its independence, effective governance structure, and legal ownership of plan assets. In addition, we believe OTPPP's significant financial assets would be sufficient to allow the fund to meet its benefit obligations and debt service payments during periods of stress, including a Province of Ontario default.

Because OTPPP unconditionally and irrevocably guarantees Ontario Teachers' Finance Trust's senior unsecured debt and commercial paper (CP) programs, we equalize the ratings on the debt and the programs with those on OTPPP. In 2022, OTPPP had about \$2.6 billion in CP and \$24.1 billion in term debt outstanding.

We apply a ratings to principles approach, using our "Principles Of Credit Ratings" in conjunction with "USPF Criteria: Public Pension Funds" and "Rating Government-Related Entities: Methodology And Assumptions" as our criteria foundation for our analysis of OTPPP's stand-alone creditworthiness. We believe there is sufficient similarity between U.S. and Canadian pension systems such that the U.S. pension fund criteria are an appropriate methodology for evaluating Canadian public pension funds' credit quality. We also use our "Methodology For Linking Long-Term And Short-Term Ratings" criteria as a basis to provide short-term ratings on the fund.

Liquidity

OTPPP benefits from robust liquidity, in our view. The fund has a policy of maintaining a portfolio of highly liquid assets, including Canadian and U.S. government bonds. It tracks its liquidity position daily and monitors liquidity via coverage ratios and stress testing. The fund held C\$78.6 billion in level 1 fixed income assets and C\$17.5 billion in level 1 equity at the end of 2022. According to OTPPP's calculations, it held C\$59.7 billion of available liquid assets to support fund liquidity as of Dec. 31, 2022. This well exceeds the total guaranteed debt outstanding of C\$26.7 billion at year-end.

Ontario Teachers' Pension Plan Board -- Selected Ratios

	2022	2021	2020	2019	2018
UAAL (mil. C\$)*	41,038	(15,900)	(36,089)	(17,257)	(1,169)
UAAL ratio (%)*	120	94	86	92	99
Return on net investments (%)	4.3	11.3	8.8	10.8	2.8
Return on assets (%)	1.8	7.3	5.2	6.2	0.6
Return on net assets (%)	2.3	9.2	6.7	8.5	0.9
Total margin (%)	41.2	72.5	65.1	69.6	19.5
Pension benefit expense delivery efficiency (%)	89.2	89.4	90.4	90.3	90.8
Pension benefit expense (% of Ontario's adjusted operating revenues)	0.8	1.1	1.0	1.0	1.0
UAAL* (% of sponsor's budget§)	20.68	(10.43)	(23.89)	(11.07)	(0.77)
UAAL* per capita (C\$)§	2,716.05	(1,064.51)	2,433.36	(1,177.13)	(81.62)
Benefit contributions (% of total revenues)	24.5	12.0	15.2	13.8	37.7
Ontario's contributions (% of total revenues) §	12.2	5.9	7.5	6.8	18.7

*Based on S&P Global Ratings' calculations. §Based on Ontario forecast for 2022. UAAL--Unfunded actuarial accrued liability.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- 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

- Outlook On Three Ontario Pension Funds Revised To Positive On Action On Province, June 15, 2023
- Province of Ontario Outlook Revised To Positive From Stable On Strong Budgetary Performance, June 6, 2023
- S&P Global Ratings Definitions, June 9, 2023
- Credit Conditions North America Q2 2023: Coalescing Stresses, March 28, 2023

Ratings Detail (as of July 25, 2023)*

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Issuer Credit Rating AA+/Positive/A-1+

Issuer Credit Ratings History

15-Jun-2023 AA+/Positive/A-1+

17-Jun-2016 AA+/Stable/A-1+

17-Nov-2015 AA+/Stable/--

*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.

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