

Research Update:

# Ontario Teachers' Pension Plan Board 'AA+' Ratings Affirmed; Outlook Is Positive

June 18, 2024

## Overview

- Ontario Teachers' Pension Plan Board's (OTPP or the fund) strong funded position and diversified portfolio will serve the fund well as it navigates current economic conditions and geopolitical tensions.
- S&P Global Ratings affirmed its 'AA+' long-term and 'A-1+' short-term issuer credit ratings on OTPP.
- The affirmation reflects our view of the fund's strong financial and operating performance, strong fund management, and independence from the Province of Ontario government.
- The positive outlook mirrors the outlook on the Province of Ontario. We expect that OTPP will continue to realize good medium-term investment returns and preserve its strong net asset position.

## Rating Action

On June 18, 2024, S&P Global Ratings affirmed its 'AA+' long term and 'A-1+' short-term issuer credit ratings on Ontario Teachers' Pension Plan Board (OTPP or the fund). The outlook is positive. At the same time, S&P Global Ratings affirmed its 'AA+' senior unsecured rating and 'A-1+' global scale and 'A-1(High)' Canada scale commercial paper (CP) ratings on the guaranteed issuance of Ontario Teachers' Finance Trust (OTFT).

## Outlook

The positive outlook on OTPP mirrors the positive outlook on its sponsor, the Province of Ontario; our ratings on the province cap the ratings on related pension funds. 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 it 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

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risk management systems. We do not expect any change in the relationship or level of support between OTPP and its sponsors, the province and Ontario Teachers' Federation (OTF) (together, the 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 could lead to a similar action on the fund. As well, we could equalize the rating on OTPP with that on the province if we saw evidence of provincial involvement (causing us to revise the fund'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 fund if we raised the rating on the province over the next two years.

### Rationale

The ratings on OTPP reflect the fund's SACP, which S&P Global Ratings assesses at 'aa+'. The SACP reflects our assessment of the fund's independence from its sponsors, its strong financial and operating performance, and strong fund management that includes a well-established and comprehensive enterprise risk management framework. In our view, challenges including geopolitical tensions, slower economic growth, and increasing longevity will continue to offset some of these strengths. The ratings also reflect our opinion of a moderate likelihood that the province would provide extraordinary support in the event of financial distress.

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\$247.5 billion in net assets as of Dec. 31, 2023, which it invests on behalf of its two sponsors: the province and OTF. In addition to managing the assets of the Ontario Teachers' Pension Plan, the fund manages its liabilities, administers the pension plan, and pays benefits. Since its establishment in 1990, OTPP has generated strong returns for its members (9.3% net annualized return since inception to Dec. 31, 2023) and developed into a sophisticated long-term global investor. The fund's increasing 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.

In our view, OTPP is independent of the Ontario government. The fund was established as a nonshare capital corporation and has legal ownership of fund assets. Its 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.

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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. The fund entered 2024 with new senior leadership for its investment team with a co-chief investment officer model. It also restructured its real estate arm and established an in-house real estate team that will focus on global real estate investing and portfolio management. Cadillac Fairview, the fund's real estate subsidiary, will continue to focus on growth and diversification of the real estate portfolio in Canada. We believe Ontario Teachers' Cadillac Fairview Properties Trust's (OTCFPT) assets are well aligned with the fund's investment strategy and will remain an important strategy over the medium term. Our view also reflects OTPPB's moderate likelihood of providing extraordinary support to the subsidiary in financial distress. OTPP's investment strategies are consistent with the fund's expertise and funding needs, and management has a long track record of exceeding performance benchmarks. We believe internal controls are 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.

We believe the fund's medium-term operating and financial performances remain strong, with a 10-year net return of 7.6%. The fund's assets, in our view, are well diversified by asset class and geographically. The fund's 2023 performance, however, was negatively affected by the unfavorable market conditions. OTPP generated a 1.9% net return in 2023, lower than the benchmark rate and the discount rate of 8.7% and 4%, respectively. The returns were also lower than the 4% net return recorded a year earlier. While public equities and credit delivered strong returns of 20% and 9.1%, respectively, in 2023, these were offset by negative returns in infrastructure and real estate. Real asset investment reported a loss of 4.1%, compared with a benchmark return of 5.3%, primarily due to higher interest rates. Real estate, specifically, continued to negatively affect performance for a second year in a row with a reported loss of 5.9% as the asset class faced tough economic conditions, a theme common among other pension funds as well. The fund is mature and made net payments of \$4.3 billion in 2023; however, owing to investment returns, net assets continued to increase. Total liabilities (excluding accrued pension benefits) as a percent of total assets decreased to about 20% in 2023 from about 22% in the previous year. Also in 2023, OTPP remained fully funded, while maintaining a conservative discount rate. Along with other pension funds, OTPP faces difficult demographic and economic trends. Life expectancy has risen in the past decade, increasing the net present value of benefit obligations. 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, reflecting our assessment of the strong link with the province and limited importance for the province. The government's joint stewardship of the fund and the provisions under the fund's enabling statute demonstrate strong link with the province. We believe OTPP'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 continue to rate OTPP 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 OTPP's creditworthiness in periods of stress is limited. Moreover, we believe the fund could effectively

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mitigate negative government intervention through its independence, effective governance structure, and legal ownership of fund assets. In addition, we believe OTPP'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 default by the province.

Because OTPP unconditionally and irrevocably guarantees OTFT's senior unsecured debt and CP programs, we equalize the ratings on the debt and the programs with those on OTPP. In 2023, OTPP had about C\$2.6 billion in CP and C\$25.9 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 OTPP's 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

OTPP benefits from robust liquidity, in our view. It 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\$70.2 billion in level 1 fixed income assets and C\$21.3 billion in level 1 equity at the end of 2023. According to OTPP's calculations, it held C\$56.9 billion of available liquid assets to support fund liquidity as of Dec. 31, 2023. This well exceeds the total guaranteed debt outstanding of C\$28.5 billion at year-end.

### Ontario Teachers' Pension Plan Board -- Selected Ratios

	2023	2022	2021	2020	2019
UAAL (mil. C\$)*	36,120	41,038	(15,900)	(36,089)	(17,257)
UAAL ratio (%)*	117.09	119.90	93.82	85.98	92.32
Return on net investments (%)	2.26	4.34	11.34	8.83	10.76
Return on assets (%)	0.09	7.29	7.29	5.24	6.25
Return on net assets (%)	0.11	2.34	9.19	6.67	8.53
Total margin (%)	3.13	41.18	72.48	65.10	69.63
Pension benefit expense delivery efficiency (%)	89.41	89.24	89.45	90.37	90.25
Pension benefit expense (% of Ontario's adjusted operating revenues)	0.82	0.86	1.08	1.05	1.02
UAAL* (% of sponsor's budget)§	17.94	21.43	(10.43)	(23.89)	(11.07)
UAAL* per capita (C\$)§	2,314	2,710	(1,065)	(2,433)	(1,177)
Benefit contributions (% of total revenues)	37.73	24.53	11.95	15.21	13.77
Ontario's contributions (% of total revenues)§	18.51	12.15	5.90	7.53	6.82

\*Based on S&P Global Ratings' calculations. §Based on Ontario forecast for 2023. 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

- Province of Ontario Ratings Affirmed At 'A+'; Outlook Remains Positive, June 6, 2024
- Credit Conditions North America Q2 2024: Soft Landing, Lurking Risks, March 27, 2024
- Outlook On Three Ontario Pension Funds Revised To Positive On Action On Province, June 15, 2023
- S&P Global Ratings Definitions, June 9, 2023

## Ratings List

### Ratings Affirmed

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**Ontario Teachers' Pension Plan Board**

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

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**Ontario Teachers' Finance Trust**

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Senior Unsecured AA+

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Commercial Paper A-1+

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Short-Term Debt A-1(HIGH)

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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.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. Complete ratings information is available to RatingsDirect subscribers at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.spglobal.com/ratings](http://www.spglobal.com/ratings).

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