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MOODY'S
INVESTORS SERVICE
Credit Opinion: CDP Financial Inc.

Global Credit Research - 26 Jan 2015

Montreal, Quebec, Canada

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Aaa
Bkd Senior Unsecured	Aaa
Bkd Commercial Paper	P-1

Contacts

Analyst	Phone
Jason Mercer/Toronto	1.416.214.1635
Robert M. Callagy/New York City	1.212.553.1653
Yaron Ernst/Paris	33.1.53.30.10.20
Lan Wang/Toronto	1.416.214.1635

Key Indicators

[1][2] CDP Financial Inc.

Statistics for Caisse de dépôt et placement du Québec

	2013	2012	2011	2010	2009
Gross Assets (C\$ millions)	245,001	213,163	191,288	183,197	170,656
Depositors' Net Assets (C\$ millions)	199,447	175,573	158,965	151,742	131,588
Fixed Income % Depositors' Net Assets	35%	37%	37%	37%	40%
Equity % Depositors' Net Assets	47%	47%	46%	48%	44%
Other % Depositors' Net Assets	18%	17%	17%	15%	16%
Liabilities (C\$ millions)	45,554	37,590	32,323	31,455	39,068
Liabilities % Gross Assets	19%	18%	17%	17%	23%
Unsecured Debt (C\$ millions)	12,266	12,907	13,027	12,105	8,358
Unsecured Debt % Gross Assets	5.0%	6.1%	6.8%	6.6%	4.9%
Secured Funding (C\$ millions)	27,732	21,222	15,527	15,702	26,472
Secured Funding % Gross Assets	11.3%	10.0%	8.1%	8.6%	15.5%
Other Liabilities % Gross Assets	2.3%	1.6%	2.0%	2.0%	2.5%
Indebtedness towards Depositors (C\$ millions)	1,791	2,633	534	750	1,076
Net Participation Deposits (C\$ millions)	197,656	172,940	158,431	150,992	130,512
Net Participation Deposits % Gross Assets	80.7%	81.1%	82.8%	82.4%	76.5%
Derivative Notionals (C\$ millions)	178,995	153,570	170,541	199,268	202,104
Annual Reported Return (%)	13.1%	9.6%	4.0%	13.6%	10.0%
Benchmark Return (%)	12.6%	9.3%	4.2%	9.5%	14.1%

[1] Information based on Canadian GAAP financial statements [2] Fiscal year ending December 31

Opinion

SUMMARY RATING RATIONALE

CDP Financial, Inc. (CDP) is a wholly-owned subsidiary of the Caisse de dépôt et placement du Québec (the Caisse). The Caisse uses this subsidiary to add a moderate degree of leverage to increase the return of its investment portfolio, primarily in its real estate operations, by issuing term notes and commercial paper. CDP's debt obligations are unconditionally and irrevocably guaranteed by the Caisse. CDP's Aaa issuer rating and Prime-1 short-term rating are based upon the guarantee provided by the Caisse.

The Caisse is a mandatary (or agent) of the province of Québec (Aa2 stable) and manages institutional funds, primarily from public and private pension and insurance funds in Québec. The assets managed by the Caisse are funded largely by 'participation deposits' from its institutional clients that represent a participation similar to equity in the Caisse's individual funds or investment portfolios. Unsecured obligations of the Caisse, including those related to the guarantee of debt issued by CDP, rank senior in priority to these participation deposits. The Caisse is an asset manager and does not have legal responsibility for the pension or insurance liabilities of its depositors.

CDP's baseline credit assessment is at the highest level of aaa, based on the guarantee from the Caisse. The strength of the guarantor is the product of (1) low leverage; (2) strong coverage of obligations by high quality liquid assets; and (3) a legal framework that mandates the Caisse as the exclusive investment manager for the vast majority of its deposits.

Credit Strengths

- Unconditional and irrevocable guarantee from the Caisse de dépôt et placement du Québec
- Legal and political impediments to withdrawal of participation deposits by pension plan depositors
- Strong coverage of obligations by high quality liquid assets
- Effective integration of risk management within investment strategy

Credit Challenges

- Limited visibility around net depositor contributions or withdrawals
- Dual mandate to optimize return and contribute to the Québec economy brings governance challenges
- Maintaining portfolio liquidity as the Caisse gradually reduces its allocation to fixed income investments

Rating Outlook

The rating outlook is stable

What Could Change the Rating - Down

Moody's noted the following factors could lead to a downgrade of ratings: 1) a change in provincial legislation allowing the Caisse's pension fund depositors to select alternative asset managers; however, given the publicized and political nature of such an act, Moody's views the probability of this outcome to be very low; 2) deterioration in the fiscal position of the province of Québec that could lead to other adverse changes to the legislative framework; 3) liquid assets relative to Moody's liquidity stress assumptions declined measurably.

DETAILED RATING CONSIDERATIONS

LEGAL FRAMEWORK DELIVERS A STABLE CLIENT BASE

The Caisse's client base is exceptionally stable, encompassing a broad range of provincial government and government-related pension plans, insurance plans and other types of funds, the vast majority of which are required by provincial statutes to deposit their assets with the Caisse. As at 31 December 2013, the Caisse managed assets for 31 depositors, including the Government and Public Employees Retirement Plan (a retirement fund for all public sector employees in Québec's public sector), and the Régie des rentes du Québec (the universal retirement pension fund for Québec's residents). The largest eight depositors represented 97% of net assets at 31 December 2013. Each depositor invests its funds in specialized portfolios, which are internal accounts of the Caisse, and receives a return based on the performance of those portfolios.

The stability of the Caisse's franchise is also supported by regular consultation with depositors and healthy investment returns. As at 30 June 2014, the average annual return over four years was 11.1% compared to 10.9% for the benchmark. In 2013, the eight largest depositors achieved average returns on assets managed by the Caisse in the range of 9.1% to 10.6%.

CREDITORS HAVE A MATERIAL BUFFER AGAINST ANY ASSET VALUE DETERIORATION

On a gross asset base of CAD245 billion at year-end 2013, the Caisse had CAD198 billion in net participation deposits (81% of gross assets) which, in Moody's view, constitute loss absorbing equity because participation deposits rank junior in priority to the Caisse's unsecured creditors, including its obligations under the guarantee of CDP's debt. Secured liabilities (including non-recourse asset level debt) representing approximately 11% of gross assets rank ahead of the Caisse's unsecured creditors. Participation deposits do not bear interest and constitute a participation of their holders in the net equity and net revenues of the fund or portfolio in which they are made. Under provincial law, the


Caisse is explicitly entitled to encumber all of the assets that it manages (except for CAD1.8 billion in demand and term deposits, and net income to be paid to participation depositors). The Caisse therefore has a very high capitalization, which provides creditors with a material buffer against any future asset value deterioration.

POTENTIAL CORPORATE GOVERNANCE CHALLENGES ASSOCIATED WITH THE CAISSE'S DUAL MANDATE

The Caisse has a dual mandate to achieve an optimal return on capital within the framework of depositors' investment policies while at the same time contributing to Québec's economic development. Investments in Québec represented 22% of total assets at year-end 2013. This investment profile reflects the Caisse's natural strengths evaluating investment opportunities in Québec due to their deep understanding of that market. The Caisse manages its investment strategy independently. Nevertheless, in a weaker economy the Caisse could come under political pressure to support Québec in a way that eroded its ability to achieve the optimal return for depositors. The Caisse's rating anticipates that it will be able to balance the requirements of its dual mandate.

STRONG LIQUIDITY OFFSETS LIMITED VISIBILITY ABOUT FUTURE CONTRIBUTION LEVELS

The Caisse has strong asset coverage and liquidity, which offsets the limited visibility around net contribution flows from depositors beyond a rolling three-year horizon. At year-end 2013, CDP's CAD1.5 billion in commercial paper and CAD9 billion in term notes were covered roughly 4x by CAD44 billion of liquid high quality fixed income assets (including Canadian and US government securities, Canadian provincial securities, Canadian bankers acceptances and other highly liquid assets). This level of coverage is likely to weaken slightly as the Caisse reduces fixed income investments in order to support an increase in its target allocation to less liquid private equity, real estate and infrastructure assets to 30% from 25% of the total. However the Caisse also owns substantial amounts of marketable securities in the form of widely traded equities and corporate debt instruments. The Caisse's liquidity monitoring incorporates valuation haircuts and stressed collateral funding requirements.



In January 2015 the Caisse announced an agreement with the province of Quebec to establish a new subsidiary to execute infrastructure projects on behalf of the province, which affirms its long-term strategy to increase investment in less liquid infrastructure assets. However, the Caisse's exposure to infrastructure assets is only about 4% of its total investment portfolio, which is the lowest among Canadian pension asset management organizations, and places it in a relatively better position to absorb the incremental liquidity risk associated with these assets. We expect that, as a result of the time it takes to develop such projects, it will take several years for any new investments to materially change the Caisse's portfolio mix. Accordingly, based on Moody's current understanding of the agreement, it does not impact the rating or outlook of CDP.

RISK CONTROLS HAVE IMPROVED SIGNIFICANTLY SINCE MAJOR 2008 LOSS

We now view the Caisse's risk management framework as a relative strength, reflecting progress made by the institution in strengthening controls since 2008, when it suffered a CAD39.8 billion net investment loss on a starting level of net assets of CAD155 billion. Although the sudden declines in the equity and corporate bond markets drove much of this loss, the Caisse's performance was weaker than peers and revealed significant deficiencies in risk and liquidity management. The Caisse has addressed these through a combination of management changes, leverage reduction, enhanced monitoring and stress testing, as well as closer integration of risk management in the investment decision making process. The Caisse also entered into hedging transactions that materially reduced its exposure to its CAD10 billion Asset Backed Term Notes (ABTNs), which are the assets issued as part of the restructuring of the Canadian asset-backed commercial paper market in January 2009.

Since 2009, CDP has issued CAD8 billion of term notes and reduced its reliance on short-term funding by using the proceeds to repay commercial paper and repos. In November 2013, CDP established a new \$5 billion US commercial paper program in order to improve its funding diversification. At the same time, CDP reduced the size of its existing Canadian dollar / euro commercial paper program to CAD3 billion from CAD7 billion, meaning that the increase in overall program size will be relatively modest.

Extraordinary Support Considerations

As noted above, CDP's baseline credit assessment is at the highest level of aaa. Therefore, CDP's ratings do not incorporate any uplift from Moody's view that the province of Québec would be highly likely to provide the Caisse (and by definition CDP) extraordinary support if needed. The rating of the province, at Aa2, is below CDP's Aaa issuer rating.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on <http://www.moodys.com> for the most updated credit rating action information and rating history.

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