PUBLIC SECTOR PENSION INVESTMENT BOARD
2010 ANNUAL REPORT

2010

PSP INVESTMENTS

WHO WE ARE AND WHAT WE DO

CORPORATE PROFILE

The Public Sector Pension Investment Board ("PSP Investments") is a Canadian crown corporation established to invest the amounts transferred by the federal government equal to the proceeds of the net contributions since April 1, 2000, for the pension plans of the Public Service, the Canadian Forces and the Royal Canadian Mounted Police, and since March 1, 2007, for the Reserve Force Pension Plan (the "Plans").

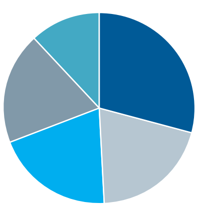
Its statutory objectives are to manage the funds entrusted to it in the best interests of the contributors and beneficiaries of the Plans and to maximize investment returns without undue risk of loss, having regard to the funding, policies and requirements of the Plans and their ability to meet their financial obligations.

TABLE OF CONTENT

FINANCIAL HIGHLIGHTS

ASSET MIX

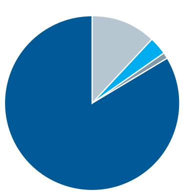
As at March 31, 2010 (percent)



Canadian Equity	29.2
Real-Return Assets	20.2
Foreign Equity	19.8
Nominal Fixed Income	19.1
Private Equity	11.7
	100.0

NET ASSETS PER PENSION PLAN

As at March 31, 2010 ($ millions)



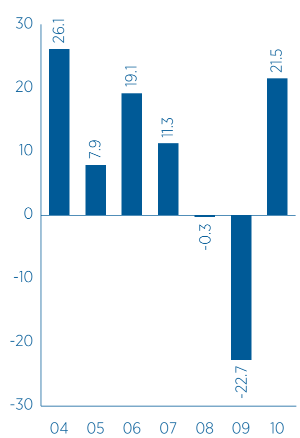
Public Service	33,661	72.7%
Canadian Forces	9,107	19.7%
RCMP	3,271	7.1%
Reserve Force	231	0.5%
Net Assets	46,270	100.0%

HIGHLIGHTS

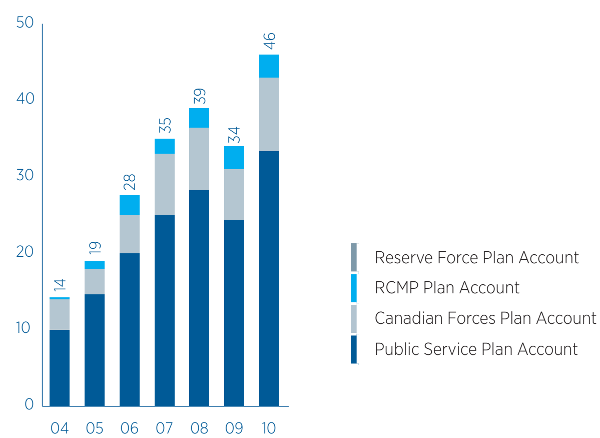
FISCAL YEAR 2010

- Consolidated net assets increase 37% to $46.3 billion, a new high.
- Investment income of $7.6 billion represents a total portfolio return of 21.5%.
- Purchase of additional $3.5 billion in public equities contributes to a robust total fund return.
- Public Markets Equity portfolios achieve returns of 20.1% to 47.4%.
- Private Equity portfolio earns investment income of $1.2 billion for a return of 28.8%.
- Infrastructure and Real Estate portfolios generate positive results.
- Assets managed internally and through direct and co-investment transactions increase from 62% to 67% of total assets.

ANNUAL PERFORMANCE
As at March 31, 2010 (percent)



CHANGES IN NET ASSETS
(CONSOLIDATED)
As at March 31, 2010 ($ billions)



CORPORATE OBJECTIVES

FISCAL YEAR 2010

REFINE POLICY PORTFOLIO ALIGNMENT

Define a Policy Portfolio, within an asset-liability framework, taking into account the liabilities of the Plans and optimizing the Policy Portfolio structure. Develop asset-liability capabilities and model.

STATUS: ONGOING

Key accomplishments include:

- Implemented asset-liability modeling capabilities that enable a more thorough understanding of the link between the investment strategies and the Plans' liabilities;
- Refined modelling and analysis with regard to the attainment of targeted long-term returns as well as the expected volatility of returns, and their impact on the funding status of the Plans;
- Collaboration with Treasury Board Secretariat and the Office of the Chief Actuary of Canada to improve understanding of Plans' liabilities and funding requirements.

CONTINUE IMPLEMENTING ACTIVE INVESTMENT MANAGEMENT PHILOSOPHY

Continue to achieve a high level of effectiveness in the management of PSP Investments' direct and co-investments by expanding relationships with top-performing business partners in Private Markets. Increase the proportion of internal active management in Public Markets and implement Value Opportunity Investing Strategy.

STATUS: ONGOING

Key accomplishments include:

- Expanded PSP Investments' network of partners and contacts to provide increased access to attractive direct and co-investment opportunities;
- Active investor in funds and direct investments, providing input and guidance with regard to strategic direction, senior leadership changes and debt restructuring;
- Increased the proportion of assets managed internally and in direct and co-investment transactions from 62% to 67%.

ENHANCE RISK MANAGEMENT

Continue implementing a comprehensive risk management plan (investment, enterprise and operational risk management) to ensure timely and ongoing risk monitoring and reporting. Enhance risk analysis and risk parameters based on experience from recent financial crisis and resulting changes to market risk practices.

STATUS: ONGOING

Key accomplishments include:

- Realigned and enhanced the Risk Management Group capabilities by consolidating valuation, market and credit risk functions to improve focus on the specific risk profile of PSP Investments' asset classes;
- Refined risk limits and formalized the attribution of active risk across asset classes through a structured risk budget process;
- Improved capabilities in sensitivity analysis and stress testing to complement value-at-risk (VaR) measurement and provide a more comprehensive measure of investment risk;
- Enhanced monitoring and reporting of leverage activities, treasury activities and liquidity risk.

FISCAL YEAR 2011

KEY CORPORATE OBJECTIVES

Corporate objectives for fiscal 2011 are a built on the foundation of the previous year's achieved objectives. They are directed to achievement of PSP Investments' long-term strategy.

IMPLEMENTION OF THE INTERNAL ACTIVE MANAGEMENT STRATEGY

The level of direct investments and internal active management will be increased. Access to direct and co-investments transactions will be enhanced through an expansion of our international network of partners and contacts in key markets. Implementation of Value Opportunity Investing Strategy in Public Markets will be completed. The business plan for tactical asset allocation will be developed.

AUGMENTATION OF ENTERPRISE RISK MANAGEMENT

Implement the next steps in the rollout of the Enterprise Risk Management framework, measured by ensuring a common understanding across the organization of the enterprise risks to which PSP Investments is exposed. Expand the breadth and depth of enterprise risk coverage, measured by ensuring that emerging risks are appropriately identified, assessed, managed, and monitored through the development of key risk metrics and early warning indicators.

IMPLEMENT TALENT MANAGEMENT STRATEGY

Implement human resource development plans, measured by increased capabilities and competencies of high potential employees. Determine and implement the next steps in building a cohesive internal corporate culture, measured by a high level of employee engagement across the organization. Implement core process automation to maximize employee effectiveness and efficiency.

REFINE POLICY PORTFOLIO ALIGNMENT

Extend and deepen Plans' liabilities structure in asset-liability framework analysis. Refine integration of asset-liability conclusions into each Policy Portfolio annual review.

CHAIR'S REPORT

PAUL CANTOR
Chair

IN LAST YEAR'S ANNUAL REPORT, WE REMINDED STAKEHOLDERS OF THE IMPORTANCE OF REMAINING PATIENT AND PRAGMATIC AS WE NAVIGATED THE WORST FINANCIAL CRISIS SINCE THE GREAT DEPRESSION, WHILE WORKING TO TAKE MAXIMUM ADVANTAGE OF PSP INVESTMENTS' LIQUIDITY. FISCAL YEAR 2010 DEMONSTRATED THE WISDOM OF THIS APPROACH, WHICH ENTAILS ADHERING TO OUR LONG-TERM GOALS AND OBJECTIVES.

As we can see from the latest results, a substantial portion of the unrealized losses from a year ago have been recuperated, which demonstrates the solid long-term value of PSP Investments' assets. The fiscal 2010 results also reflect initiatives taken to benefit from the remarkable turnaround of markets.

New investment opportunities will arise as global markets continue to normalize. Given our expected annual cash inflows of approximately $4 billion, PSP Investments is in a favourable position to seize those opportunities. But risk is the handmaiden of opportunity, and we will still need to grapple with the inevitable challenges of future markets.

For PSP Investments, keeping a long-term perspective means remaining faithful to the orientation of a highly diversified portfolio that includes a significant portion of private equity and inflation-hedging real estate and infrastructure assets. Such investments increase the probability of meeting or exceeding the targeted 4.3%-above-inflation level of returns, without an unwarranted increase in risk and provide for a better match with the Plans' liabilities.

We are mindful that PSP Investments' legislated mandate is to "maximize returns without undue risk of loss". The events of fiscal year 2009 made evident the need to more clearly define this notion of undue risk with our stakeholders. The Board has been addressing this question, and will be proposing a comprehensive framework in fiscal year 2011. Beyond that, internally, one of the Board of Directors' on-going priorities entails working with management to further enhance risk management practices. Our aim is to use what we have learned from the recent crisis to further refine both our quantitative and qualitative parameters for evaluating, monitoring and mitigating risk.

EXECUTIVE COMPENSATION

During fiscal year 2010, PSP Investments completed a thorough analysis of its overall compensation practices and procedures and evaluated their compliance with the recommendations of the G20 Working Group which are based on the Financial Stability Forum Principles for Sound Compensation Practices. This self assessment concluded that PSP Investments' compensation programs and policies are consistent with the G20 Recommendations, and that compensation programs are effectively designed to reduce the potential for rewarding excessive risk taking.

In the interest of sound governance and impartiality, the Board and the Human Resources Compensation Committee also mandated Deloitte & Touche LLP to conduct an independent review of PSP Investments' assessment. Deloitte & Touche LLP confirmed PSP Investments' level of compliance with the G20 Recommendations.

10TH ANNIVERSARY

This year marks the 10th anniversary of PSP Investments' founding. Both Bob Baldwin and I have been privileged to sit on the Board since its inception on March 28, 2000. During that time, we have seen PSP Investments grow from start-up to a solid organization with assets exceeding $46 billion, more than 300 employees and investments on every continent north of Antarctica.

PSP Investments came into being at a time when the structure and financing of public pension programs in Canada were undergoing substantive changes. Traditionally, the Plans had been financed by the government on a "book reserve" basis, whereby interest would be credited to the reserves based on the current yield on the long-term debt of the sponsoring government. During the 1990s, it became evident there was a need for new financing arrangements that would ensure the financial sustainability of the Plans over the long term in the face of an ageing population and increased pension benefit payments. The new model that emerged entailed building up actual reserve funds and investing them in a portfolio of assets managed by investment professionals reporting to a Board of Directors with relevant expertise.

The first 10 years of PSP Investments were challenging times for investments. According to a recent *Wall Street Journal* article, the first decade of the 21st century turned out to be the worst ever for US stocks based on records going back to the 1830s. Total returns for the period 2000-2009 amounted to negative 0.5%. That compared with a high of 18% in the 1950s and was even lower than the negative 0.2% return for the 1930s Depression era. Thus, it turned out to be a demanding a time to launch a new fund. Nevertheless, we have grown into a robust, highly diversified fund that will rank among the largest pension investment managers in Canada and internationally.

Providing effective oversight and counsel to a fund of PSP Investments' size and scope requires a Board that knows how and when to act. This calls for expertise in a wide range of disciplines including investment management, corporate finance, risk management, human resources, finance and accounting, economics, public affairs, law and actuarial science in order to fully comprehend the inherent risks and responsibilities entailed in the fulfillment of our mandate. In addition, the Directors must have the will to act when decisiveness is needed, as knowledge without action is fruitless.

As PSP Investments begins its second decade of operations, we are satisfied with the composition of the Board and the quality of governance we have achieved. However, the selection process for Directors, designed to produce a world-class Board, requires everyone's effort to keep the momentum of nominations moving forward. The challenge to promptly fill Board vacancies has taken on added importance given the increased workloads resulting from the recent decision to reduce the number of Directors from 12 to 11.

The Board is pleased with the leadership of our President and Chief Executive Officer, Gordon J. Fyfe, and the team he has assembled. We believe that the excellence of the management team, coupled with the support of a high-calibre Board, positions us to meet our mandate by maximizing returns without undue risk of loss.

ACKNOWLEDGEMENTS

I wish to express my gratitude to fellow members of our Board for contributing so much of their time and expertise and for working diligently to make sure that PSP Investments fulfills its mandate. Special thanks are due to three esteemed former colleagues who have left the Board, Keith G. Martell, Anil K. Rastogi and William A. Saunderson for their outstanding contributions.

I would also like to take this opportunity to welcome new Board members Lynn Haight and William A. MacKinnon, both of whom bring valuable expertise and experience to the table. Ms. Haight is a financial executive and business advisor who has held senior positions with several major financial institutions (Scotiabank, Manulife, Foresters). Mr. MacKinnon is a chartered accountant who spent his entire career with KPMG Canada, where he served as chief executive from 1999 until the end of 2008. I welcome, as well, the reappointments of Cheryl Barker, Anthony R. Gage and Michael P. Mueller for additional four-year terms.

Finally, on behalf of the Board, I wish to thank Gordon and his team, as well as employees throughout PSP Investments, for their hard work and commitment over the course of another very eventful and challenging year.

Paul Cantor
Chair

PRESIDENT'S REPORT

GORDON J. FYFE
President and Chief Executive Officer

FISCAL YEAR 2010 DEMONSTRATED THE RESILIENCE OF PSP INVESTMENTS' LONG-TERM INVESTMENT STRATEGY THAT BEGAN IN FISCAL YEAR 2004. AT THE TIME, WE IDENTIFIED PSP INVESTMENTS' STRONGEST COMPETITIVE ADVANTAGE TO BE LONG-TERM LIQUIDITY PROVIDED FROM THE LARGE ANNUAL CASH INFLOWS THAT WILL CONTINUE BEYOND 2020.

The past two years saw the worst financial crisis since the Great Depression, demonstrating the risk of leverage and a lack of liquidity. Many investors missed the sharp rebound in asset prices starting in March 2009, having been forced to sell high-quality assets at the most distressed time.

This was not the case for PSP Investments. In fact, during fiscal year 2010 as our assets under management grew, we were able to purchase an additionnal $3.5 billion in public equities (including emerging markets where PSP has a relatively large exposure) at attractive prices. Overall, our public equity portfolios generated an investment return of 37.9%, contributing to a strong investment performance for fiscal year 2010.

We also benefited from the high quality of our Private Market assets. Being in a position to hold on to illiquid assets that had been written down to distress valuations as a result of the liquidity crisis enabled us to generate significant investment returns, as values returned to fundamentals. The most probing example is the 28.8% return achieved in our Private Equity portfolio in fiscal year 2010.

Finally, we were able to rebalance our portfolio, at or near target asset allocation as our confidence in the strength of the rebound in public equities grew.

A STRONG PERFORMANCE

For fiscal year 2010, PSP Investments recorded a total portfolio return of 21.5%, representing $7.6 billion in investment income, a reversal over the investment loss recorded in fiscal year 2009 and reflecting a return to fundamentals from the distressed valuations resulting from the liquidity crisis. Active management added $641 million in value to the fund during the latest fiscal year as the total fund return exceeded the Policy Benchmark return of 19.8%.

Taking into account $5.0 billion of net contributions from the Plans, PSP Investments' consolidated net assets increased by 37% to $46.3 billion as at March 31, 2010. That total exceeds the previous peak of $38.9 billion recorded at the end of fiscal year 2008.

MAINTAINING A LONG-TERM PERSPECTIVE

While we are pleased with our strong performance in fiscal year 2010, one cannot fully judge the effectiveness of a long-term investment strategy like PSP Investments' on the basis of a single year's results — good or bad.

Perhaps the best measure of success is to look back at PSP Investments' performance since fiscal year 2004, when we began implementing our diversification and active management strategy. During this seven-year period, we have achieved a net 5.8% annualized real rate of return (i.e. after subtracting expenses and inflation), exceeding the 4.3% real rate of return objective. This investment return was achieved despite experiencing the worst deterioration of financial markets since the 1930s in fiscal year 2009.

With the prospect of positive net cash flows of more than $4 billion per year in the near future, and positive net contributions expected for the next two decades, PSP Investments' strategy remains sound. Moreover, at a time when some asset classes are still distressed, we are well positioned to capitalize on investment opportunities.

THE NEED TO TAKE MARKET RISK

Understanding and managing risk is the foundation for our investment decisions. According to the latest actuarial valuation reports prepared by the Chief Actuary of Canada, a 4.3% long-term real rate of return is required to be able to sustain the current level of funding requirements and the current level of pension benefits over the long term. Reaching that target necessarily implies that PSP Investments must take market risk. Were we to avoid risk all together, say by investing only in real-return government bonds, the expected real return of such a portfolio would be approximately 2.0%, well below the 4.3% required.

Building a strategy based on our competitive advantages of steady inflow of contributions, PSP Investments has adopted a diversified portfolio expected to be more efficient with better returns for the same or a lower level of market risk than that necessarily required to achieve the 4.3% real rate of return.

PURSUING OUR 2012 STRATEGIC PLAN

In keeping with the corporate objectives identified for fiscal year 2010, set out in our Vision 2012 strategic plan, we continue to implement PSP Investments' active investment-management philosophy.

We have been increasing the proportion of our assets under internal active management and expanding relationships with top-performing partners while broadening our network, looking for direct and co-investment opportunities. At the same time, we are using fewer external managers and investing in fewer funds. The benefits of bringing more investment decision-making inside include better control in terms of total-fund risk, investment cost savings as well as influence over major decisions, resulting in a better alignment with the Plans' contributors' objectives.

As of March 31, 2010, assets managed internally and through direct and co-investment transactions totalled 67% of assets under management, up from 62% at the end of the previous year.

The advantages of this approach are increasingly evident in our Private Markets portfolios, where investments have been performing well both in terms of fundamentals, such as cash flows and earnings, and improved mark-to-market valuations.

Another objective in our strategic plan is to pursue investments in emerging economies. New investment opportunities are being sought in resource-rich markets and in high-growth markets where strong domestic demand offers insurance against market shocks.

TALENT DEVELOPMENT

An on-going priority to successfully implement our 2012 strategic plan has been the recruitment, development and retention of the top talent required to effectively manage a large and complex investment fund.

As we round out the leadership team, PSP Investments' pool of human resources has acquired the critical mass and collective expertise that enable us to shift our primary focus from recruitment to professional development and succession planning. Accordingly, we are conducting talent reviews with middle management, developing formal succession plans and implementing a structured approach to the development of new managers, while continuing to refine our hiring practices.

10TH ANNIVERSARY

April 2010 marked the milestone 10th anniversary of PSP Investments' founding. From relatively modest beginnings, with four employees and assets of approximately $2.5 billion at the end of its first year, PSP Investments has evolved into one of Canada's largest pension investment funds. Net assets reached $19.4 billion after five years and, as noted above, reached a new high of $46.3 billion at the end of the latest fiscal year. The number of employees has grown to just over 300 at the end of fiscal year 2010.

Initially, PSP Investments invested exclusively in publicly traded stocks and bonds, primarily in Canada and the United States. Significant changes to the Policy Portfolio have steadily led to increased diversification since 2004. This diversification strategy will continue as we strive to deliver on our mandate to the greatest possible extent and fulfill the pension needs of the many thousands of Canadian men and women who work in the Public Service and serve in the Canadian Forces - Regular and Reserve Force, and the Royal Canadian Mounted Police.

ACKNOWLEDGEMENTS

In closing, I would like to thank the members of our Board of Directors for their unstinting support — in particular our Chair of the Board, Paul Cantor, and Bob Baldwin, who joined the PSP Investments Board at its inception in March 2000, and have been instrumental in helping oversee its growth and development over the past decade.

Finally, I would like to thank all our employees for their hard work and commitment throughout fiscal year 2010.

Gordon J. Fyfe
President and Chief Executive Officer

MANAGEMENT'S DISCUSSION OF

FUND PERFORMANCE AND RESULTS

ECONOMIC OVERVIEW AND BACKGROUND

Following the worst recession of the post-war period and worst financial meltdown since the Great Depression, the global economy began to pull itself back up on its feet during fiscal year 2010. The extraordinary efforts of the world's central banks – the US Federal Reserve in particular – and massive fiscal stimulus put in place by governments around the globe served to revive economic activity. Similarly, the extreme level of risk aversion that gripped investors during the worst of the crisis has subsided and financial markets have rebounded from the depressed levels recorded in early calendar year 2009. Equities have posted significant gains, commodity prices have clawed their way back from last year's depths and corporate credit spreads have narrowed to levels that are typical at the end of a recession. The flight to quality that sent bond yields sharply lower and pushed the US dollar higher against virtually all other major currencies reversed course. At the same time, however, markets remain below their pre-crisis peaks and the downturn has left numerous scars on the economic and financial landscape: policy interest rates remain at record lows, credit conditions remain tight, labour market conditions have yet to truly turn the corner and enormous fiscal deficits have become the norm. Significant doubts remain as to the ability of the developed economies – the United States in particular – to grow in the absence of continued massive policy support. In turn, these factors have caused markets to remain nervous.

MAJOR ECONOMIES

While the global recession appears to have ended in the third quarter of calendar year 2009, there has been a significant divergence between the strength of the recovery in the developed economies and the performance of emerging markets. In most developed economies, the pace of growth, while respectable, has fallen far short of the growth spurts normally experienced after such a long and deep downturn. The recovery in emerging economies has been much more forceful: for example, as of December 2009, emerging economy industrial production had already risen 5% *above* its pre-crisis peak, while industrial production in developed economies was still nearly 15% *below* its pre-crisis level. The emerging Asian economies have been particularly strong, with China leading the way.

CANADA

Although Canada's economy could not escape the impact of the recession in the U.S., it has managed to pull through the downturn in better shape than most other industrialized economies. While Canadian gross domestic product (GDP) growth fell short of US growth in the second half of calendar year 2009, looks are deceiving – the domestic side of the economy did noticeably better than what could be inferred by the headline GDP result. Particularly notable was the performance of Canada's housing market, which managed to recoup all of the decline in sales recorded during the downturn. Job growth also resumed in early calendar year 2010. To Canada's advantage is the fact that the country's banking system has continued to function normally and credit has continued to flow, in stark contrast to the lingering effects of the credit crisis in the United States.

Like the US Federal Reserve, the Bank of Canada cut its overnight lending rate to 0.25% in April 2009, where it remained at this writing. However, use of the extraordinary facilities that the Bank put in place to ensure the normal functioning of credit markets during the worst of the crisis has waned. Given Canada's relatively solid economic backdrop, expectations are that a Bank of Canada rate hike will come well before the US Federal Reserve makes such a move. With strong economic fundamentals and rising commodity prices kicking in as well, the Canadian dollar gained approximately 24% against its US counterpart during fiscal year 2010.

UNITED STATES

The longest and deepest US recession of the post-war period has come to an end, with the economy posting positive growth rates in both the third and fourth calendar quarters of 2009. However, the economy continues to face strong headwinds, and as a result, the recovery to date has appeared weak and hesitant. Notably, job losses continued throughout the year — bringing the cumulative job loss during this downturn to a post-war record of 6.1% — and the labour market only recently started showing signs of stabilizing. The unemployment rate has risen close to a post-World War II high and other measures of labour underutilization look even worse. Credit conditions have yet to improve: household and business credit continued to contract and bank lending standards continued to tighten, albeit at a slower pace. Although household balance sheets improved as financial markets rebounded and house prices stabilized, the massive destruction of wealth during the crisis continued to constrain consumer spending. Meanwhile, signs that the housing market was starting to turn the corner, which emerged during the fall and winter months, proved to be tentative. At best, the market has hit bottom, with little forward momentum.

The US Federal Reserve kept its Fed Funds Rate at between 0% and 0.25% throughout the fiscal year, and has pledged to maintain rates at "exceptionally low levels" for an extended period. However, with financial markets normalizing, the US Federal Reserve has been gradually winding down its exceptional liquidity measures.

EUROPE

The Eurozone has also been lifted by the rising tide of global economic recovery, but the European recovery has been relatively anemic, with GDP growth nearly evaporating as calendar year 2009 drew to a close. While the Eurozone's largest economies were showing signs of renewed momentum in the early part of calendar year 2010, the focus of attention in Europe was shifting to sovereign debt, sparked by concerns over the state of Greece's public finances. The global recession has exposed deep strains within the Eurozone, with peripheral economies such as Greece, Portugal, Spain, Ireland and Italy experiencing severe pressure on their public finances. Although the sovereign debt spreads of the peripheral economies have started to settle down after widening sharply in early calendar year 2010, the Euro has depreciated substantially against the US dollar. The European Central Bank (ECB) lowered its policy rate to 1% in May 2009 and, with inflation subdued, there has been little indication that it is considering raising rates. Unlike the US Federal Reserve, the ECB did not engage in large-scale asset purchases. However, it has started to pare back its extraordinary liquidity provisions to the banking sector.

JAPAN

The Japanese economy was among the hardest hit by the global crisis, as exports collapsed and industrial production tumbled at a rate not previously seen in the post-war period. Both exports and industrial output have snapped back forcefully, thanks in part to the tow China provides to the Asia-Pacific region. However, the downturn exacerbated Japan's deflationary problems, which remain a key concern with annual inflation clocking in at negative 2.5% during the closing months of calendar year 2009.

EMERGING ECONOMIES

In contrast to the advanced economies, the rebound in emerging Asia has been anything but sluggish. After recording significant declines in production and exports, the major Asian economies recouped the bulk of their losses over the course of the year. China, in particular, has played a pivotal role in pulling the region forward. China's economy rebounded forcefully in response to sharply expansionary fiscal and monetary policies that stimulated domestic spending and imports, although exports have been much slower to come back. Inflation concerns have led the Chinese authorities to begin reining in the stimulus.

In Latin America, although the region as a whole has turned the corner, the recovery has been uneven. Economies most heavily exposed to the U.S., like Mexico, have only slowly been clawing their way back. Others, like Brazil, are experiencing stronger recoveries, or like Columbia, managed to avoid a recession altogether.

FINANCIAL MARKETS

After recording the sharpest declines in almost 80 years and hitting bottom in early March 2009, global stock markets roared back during fiscal year 2010. The Morgan Stanley Capital International (MSCI) World Index, which recorded a 37.4% loss in fiscal year 2009, rebounded by 46.3% in fiscal year 2010. Emerging markets also staged a strong rally, with the MSCI Emerging Market Index up by 58.0% in local currency terms. It should be noted, however, that impressive as these percentage gains are, they occurred from very depressed levels. Consequently, almost all major indices remain below their pre-crisis peaks — significantly so in many cases.

CANADIAN EQUITIES

Canadian equities followed global equities upward. However, just as the Canadian market trailed its US counterpart somewhat during the downturn, it fell slightly short in overall performance in local currency terms during the rally, registering a gain of 42.2% over the course of the fiscal year. The strongest gains were in financials, as Canada's banking sector proved to be remarkably resilient during the downturn, partly reflecting its regulatory framework. The Real Estate Index also registered a very strong gain. By contrast, gains in consumer staples and consumer discretionary stocks were weaker.

US EQUITIES

The US equity market rebounded forcefully from the hit it took during the crisis, with the S&P 500 recording a gain of 49.8% in local currency terms for fiscal year 2010. However, in Canadian dollar terms, the return was much lower, only 20.8%, given the strong appreciation of the Canadian currency during the year. The sectors that fared the worst during the downturn fared best during the rally. US financial stocks came back particularly strongly, as did consumer discretionary stocks and other cyclical sectors such as industrials and materials.

EMERGING MARKET EQUITIES

As noted above, while emerging market equities experienced dramatic declines during the crisis, some of the recoveries have been just as eye-opening. The MSCI Emerging Market Index regained almost two-thirds of the near 60% loss incurred during the crisis, and was up by a hefty 58% in fiscal year 2010. Brazil has been among the best-performing markets and is almost back to its pre-crisis peak, having more than doubled in value from the low point reached late in calendar year 2008 and gained 72.0% during fiscal year 2010. In contrast, after posting strong gains through to August 2009, the Chinese equity market has been struggling with the Shanghai Composite Index managing a more modest 32.9% gain for the latest fiscal year.

BONDS

While fiscal year 2010 was not a great one for government bonds, it was not a disaster either. After hitting a low of 2.1% in December 2009, US 10-year yields climbed back more than 150 basis points (bps) as markets normalized. Since the summer of 2009, however, longer-term US Treasury yields have essentially been tracking sideways. Meanwhile, the front end of the curve has been well anchored, given the US Federal Reserve's pledge to keep its policy rate unchanged for an extended period, and, correspondingly, the yield curve is as steep as it has ever been. Most other government bond markets responded to the improved global economic backdrop in a similar manner, although the U.S. and the United Kingdom have suffered bouts of pressure due to mounting concerns over the size of government deficits. Corporate bonds, however, did remarkably well, given the dramatic contraction in corporate yield spreads over the year — Moody's BAA spreads declined from a peak of more than 600 bps over US Treasuries to around 250 bps by the end of the fiscal year.

Overall, bond returns were lacklustre at best. Canadian bonds, as measured by the DEX Universe Index, returned 5.1% during the fiscal year. However, given the appreciation of the Canadian dollar, world government bonds posted a significant 14.7% negative return in Canadian dollar terms.

REAL ESTATE

Real estate markets continued to struggle, with the US housing market showing only tentative and halting signs of recovery. Home sales in the United States appear to have bottomed out, and prices have stabilized, but delinquencies and foreclosures remain at a high level. Still, with the worst now in the rear-view mirror, the MSCI REIT Index managed to chalk up a very strong gain of 107.3%, although it has recovered only part of its losses. However, commercial real estate remains in the doldrums, with little evidence of recovery. While higher-quality commercial mortgage-backed securities (CMBS) spreads have come down, they remain above historical averages, and spreads on lower-rated paper remain very wide.

Canada's real estate market has fared much better than its US counterpart, with home sales recovering dramatically and prices returning to their pre-recession levels.

Similarly, while Canada's commercial real estate market took a substantial hit from the recession, the worst appears to have passed with the market slowly showing signs of stabilizing.

COMMODITIES

Commodities, like all other markets, were hit hard during the downturn but have rebounded significantly from their lows, reflecting rising global demand and continuing strong Chinese imports of basic commodities. The Commodity Research Bureau (CRB) Index is up more than 35% from its low, and has gained 24.0% in fiscal year 2010. Crude oil prices, which had fallen as low as $31 per barrel during the worst of the crisis, have rebounded to more than $80. Most base metal prices have posted strong gains, and copper in particular has climbed back close to its pre-crisis peak. Most agricultural commodities, however, remain depressed.

INVESTMENT OBJECTIVES, INVESTMENT POLICY AND THE POLICY PORTFOLIO

INVESTMENT OBJECTIVES

PSP Investments' mandate is described in Section 4 of the *Public Sector Pension Investment Board Act*:

- To manage funds in the best interests of contributors and beneficiaries under the Plans; and to maximize returns without undue risk of loss, having regard to the funding, policies and requirements of the Plans and the ability of those Plans to meet their financial obligations.

Based on these statutory objectives, PSP Investments' Board of Directors established the following investment objectives:

- Absolute Return: achieve a return (net of expenses) at least equal to the actuarial rate of return used by the Chief Actuary of Canada.
- Relative Performance: achieve a target return exceeding the Policy Portfolio return and operating expenses.

INVESTMENT POLICY

In fiscal year 2010, PSP Investments implemented its asset-liability modeling capabilities, enabling a more thorough understanding of the linkage between its investment policy and the Plans' liabilities. Understanding this link helps ensure that PSP Investments' approach and results not only meet the actuarial rate of return, but also contribute to the long-term sustainability of the Plans and the relative stability of funding requirements. This initiative reflects PSP Investments' desire to improve the overall alignment of interests between all stakeholders.

POLICY PORTFOLIO

At the heart of PSP Investments' approach is the Policy Portfolio.

- PSP Investments developed its Policy Portfolio to achieve a return at least equal to the actuarial rate of return over the long term (i.e. a real return of 4.3% - after inflation).

The actuarial rate is the long-term rate of return used by the Chief Actuary of Canada in his latest actuarial valuation reports of the Plans. It is the rate of return required to maintain funding requirements and pension benefits at their current levels.

Taking on market risk is required to achieve this real rate of return. A risk-free real rate of return could be achieved with Canada Real Return Bonds (RRBs). However, based on PSP Investments' expectations of long-term market conditions, the expected real rate of return resulting from this strategy would be approximatly 2.0%, well short of the required 4.3%.

- In establishing its Policy Portfolio, PSP Investments also took into consideration the unique characteristics of the Plans' liabilities and its contribution to funding risks.

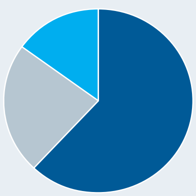
A portfolio composed of public, liquid asset classes could be constructed to achieve the actuarial target. However, it would miss out on opportunities afforded by the unique characteristics of the Plans' liabilities. Because of the young nature of the liabilities, PSP Investments is expected to receive positive net inflows over the next 20 years. This exceptional situation represents a significant competitive advantage in terms of being able to adopt a portfolio diversified into less-liquid asset classes. This provides for capturing illiquidity premiums of asset classes such as private equity. It also enables diversification into asset classes such as real estate and infrastructure that are expected to provide a better match with the inflation-sensitive nature of liabilities. A better match with liability characteristics contributes to reduced funding risks over time.

Asset-liability studies conducted on behalf of the Board of Directors indicate that the Policy Portfolio is expected to address funding risks by providing returns sufficient and adequate to contribute to the financial sustainability of the Plans and the relative stability of funding requirements. By diversifying beyond public, liquid asset classes, the Policy Portfolio is expected to provide for:

- Better likelihood of meeting the actuarial target rate of return - with greater than 60% probability over the long term;
- Improved funding position of the Plans with similar level of funding requirements.

Building on its competitive advantages, PSP Investments adopted a Policy Portfolio diversified beyond public, liquid asset classes, increasing the probability of achieving the actuarial target while offering a better match with liabilities, thus contributing to the long-term sustainability of the Plans and the relative stability of funding requirements.

POLICY PORTFOLIO
As at March 31, 2010 (percent)



World Equity	**62**
Canadian Equity	30
Private Equity	10
Emerging Markets Equity	7
US Large Cap Equity	5
EAFE Large Cap Equity	5
Small Cap Dev. World Equity	5
Real Return Assets	**23**
Real Estate	10
Infrastructure	8
World Inflation-Linked Bonds	5
Nominal Fixed Income	**15**
Canadian Fixed Income	8
World Government Bonds	5
Cash & Cash Equivalents	2
TOTAL	**100**

The Policy Portfolio is reviewed at least annually to reflect changes, if any, to PSP Investments' long-term expectations of market conditions, changes in the Plans' liability structure or other factors affecting the funding of the pension obligations.

CHANGE IN NET ASSETS AND FUND PERFORMANCE

CHANGE IN NET ASSETS

The net assets of PSP Investments increased by $12.5 billion during fiscal year 2010, a gain of 37% mainly attributable to a strong investment performance. Net assets were $46.3 billion at the end of fiscal year 2010, up from $33.8 billion at the end of fiscal year 2009.

PSP Investments generated net income from operations of $7.5 billion during the year, a significant turnaround over the loss of $9.6 billion reported in fiscal year 2009. This reflects a consolidated rate of return of 21.5% in fiscal year 2010, compared to a rate of return of negative 22.7% in fiscal year 2009. PSP Investments received $5 billion in contributions during fiscal year 2010.

PERFORMANCE MEASUREMENT AND EVALUATION

Based on the Statement of Investment Policies, Standards and Procedures (SIP&P), PSP Investments evaluates its investment strategies, as well as individual investment mandates, through performance measurement. The performance for each respective investment strategy and mandate is compared to an appropriate benchmark.

BENCHMARKS

A combined Policy Portfolio Benchmark ("Policy Benchmark") is constructed using the asset class benchmarks weighted by their allocations, as established in the SIP&P. The return for each asset class is compared to the relevant benchmark return, while PSP Investments' overall return is compared to the Policy Benchmark return.

CONSOLIDATED RETURNS

The 21.5% rate of return recorded by PSP Investments in fiscal year 2010 exceeded the Policy Benchmark rate of return by 1.7% and added $641 million in value over and above Policy Benchmark returns. For the past five fiscal years, PSP Investments recorded a compound annualized rate of return of 4.4%, compared to the Policy Benchmark rate of return of 5.3% over that same period.

The robust overall performance for fiscal year 2010 was driven primarily by strong results in Public Markets equities and the Private Equity portfolio. Investment returns for the equity portfolios ranged from 20.1% for the US Large Cap Equity portfolio to 47.4% for the Emerging Markets Equity portfolio. All the equity portfolios generated returns that significantly exceeded their respective results of the previous year, reflecting the strong performance of global stock markets as outlined on page 10 of the Economic Overview. The overall return was also impacted by PSP Investments' Foreign Currency Hedging Policy, which is intended to mitigate some of its foreign currency exposure in developed markets. Due to the strengthening of the Canadian dollar against the US dollar and the Euro in fiscal year 2010, the Currency Hedging Policy positively impacted the overall rate of return by 4.0%.

The excess return of 1.7% (compared to the Policy Benchmark) achieved during fiscal year 2010 was primarily generated by the Private Equity and Infrastructure asset classes, as well as by absolute-return mandates. Major contributors to excess return in absolute-return mandates included externally managed debt portfolios that benefited from the effect of narrowing credit spreads. PSP Investments' holdings in collateralized debt obligations and asset-backed term notes (referred to as asset-backed commercial paper in last year's annual report) also were contributors to the fiscal 2010 excess return. For the fiscal year ended March 31, 2010, investments in collateralized debt obligations increased overall returns by 1.2%, as a result of $393 million in investment income generated in the fiscal year. Our investment in asset-backed term notes generated investment income of $260 million in the fiscal year, increasing the overall rate of return by 0.9%. Tightening credit spreads and generally favorable market conditions, compared to the previous year, were the primary reasons for the increase in value of these investments. As was mentioned in last year's annual report, the losses recorded in fiscal year 2009 financial statements related to these investments were primarily the result of stressed market conditions and not related to any significant realized credit losses.

PORTFOLIO AND BENCHMARK RETURNS

	Fiscal Year 2010		5-year	
Asset Class	Portfolio Returns %	Benchmark Returns %	Portfolio Returns %	Benchmark Returns %
World Equity				
Canadian Equity	40.4	40.7	7.5	7.6
Foreign Equity				
• US Large Cap Equity	20.1	20.8	-4.0	-1.6
• EAFE Large Cap Equity	24.5	24.5	0.3	0.2
• Small Cap Developed World Equity	29.2	33.5	-2.7	-0.3
• Emerging Markets Equity	47.4	46.0	11.6	11.7
Private Equity	28.8	13.5	-0.9	-6.7
Nominal Fixed Income				
Cash & Cash Equivalents	0.7	0.3	2.9	2.9
World Government Bonds (3 years)	-14.6	-14.7	2.3[1]	2.3[1]
Canadian Fixed Income	5.4	5.1	5.2	5.2
Real Return Assets				
World Inflation-Linked Bonds	-10.0	-9.9	2.0	2.2
Real Estate	0.6	7.4	6.5	7.3
Infrastructure (3.75 years)	7.2	3.7	6.2[1]	3.4[1]
Total Return	21.5	19.8	4.4	5.3

[1] These respective asset classes have existed for less than five years. Their respective returns presented are since inception returns.

Returns have been calculated in accordance with the performance calculation methodology recommended by the CFA Institute.

The internal rate of return methodology is used to calculate the returns for the Real Estate, Private Equity and Infrastructure asset classes.

PSP Investments has identified relevant benchmarking for each asset class. The asset-class benchmark returns are used in evaluating the relative performance of each asset class.

The total portfolio return includes the performance impact of asset-allocation and absolute-return strategies and is calculated gross of direct expenses. Hedging investment returns are netted against the return of the respective hedged assets for the Private Market asset classes, or included in Total Return, for the Public Markets.

PUBLIC MARKETS

Public Markets is composed of Canadian Equity, Foreign Equity, Nominal Fixed Income and World Inflation-Linked bonds.

Net assets in Public Markets equities totalled $22.7 billion at the end of fiscal year 2010, an increase of $9.0 billion from the $13.7 billion total at the end of fiscal year 2009.

Public Markets equities earned $5.5 billion in investment income for a return of 37.9% in fiscal year 2010. PSP Investments gradually purchased $3.5 billion in public equities over the course of fiscal year 2010, as confidence in the rebound of global stock markets grew.

The first quarter of fiscal year 2010 saw the beginning of a robust rally in stock markets around the world. As a result, all of PSP Investments' public equities portfolios recorded significant gains: Canadian Equities were up 40.4%; the US Large Cap Equity portfolio was up 20.1%; and the EAFE Large Cap Equity portfolio was up 24.5% — while the Small Cap Developed World Equity and Emerging Markets Equity asset classes posted investment returns of 29.2% and 47.4%, respectively.

Net assets in Canadian Fixed Income, World Government Bonds and World Inflation-Linked Bonds totalled $9.1 billion at the end of fiscal year 2010, up from $8.7 billion at the end of the fiscal year 2009. All fixed income portfolios recorded positive returns in local currencies for the year. The performance of the World Government Bond and World Inflation-Linked Bond portfolios were negatively impacted by the strengthening of the Canadian dollar in fiscal year 2010 against the US dollar and the Euro. Overall, Public Markets fixed income portfolios posted an investment return of negative 3.9% in fiscal year 2010.

External equity and fixed-income managers added $433 million of value. A major factor contributing to the increase in relative value was the effect of decreased credit spreads on the externally managed debt portfolios. External equity managers subtracted $36 million of relative value, while external fixed income and other absolute return market strategies added $469 million. In addition, internal active management added $62 million of value, generated mainly from positions in merger arbitrage and fixed-income strategies.

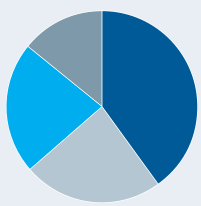
PRIVATE EQUITY

Net assets of the Private Equity portfolio totalled $5.4 billion at the end of fiscal year 2010, an increase of $1.2 billion from $4.2 billion at the end of fiscal year 2009.

Private Equity generated $1.2 billion in investment income for a rate of return of 28.8% for fiscal year 2010, compared to the Policy Benchmark return of 13.5%. The robust Private Equity performance for fiscal year 2010 was driven mainly by the direct and co-investment portfolio, which generated $489 million in investment income during the fiscal year, as well as significant performance from a select number of key partners. On a five-year basis, Private Equity investments generated a negative 0.9% compound annualized return, compared to the Policy Benchmark negative return of 6.7% for the same period.

The Private Equity portfolio has a long-term focus. Investments are held for an average of 5 to 10 years. The Private Equity portfolio is invested globally in collaboration with strategic partners with whom PSP Investments has established relationships. PSP Investments continues to diversify its Private Equity portfolio, with direct and co-investments playing an increasingly important role. As at March 31, 2010, direct and co-investments accounted for 27% of assets of the Private Equity Portfolio, up from 21% at the end of the previous fiscal year. Direct and co-investments amounted to $1.4 billion at the end of fiscal year 2010.

Overall, the Private Equity Portfolio is well diversified both from a geographic and sector perspective. The increase in Canadian and telecom assets is mainly related to the strong performance of Telesat.

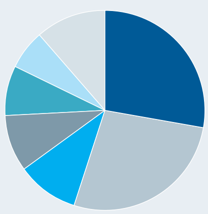


PRIVATE EQUITY– DIVERSIFICATION BY GEOGRAPHY

As at March 31, 2010 (percent)

United States	40.0
Europe	23.8
Canada	22.3
Asia	13.9

The majority of the Private Equity portfolio has North American Exposure.



PRIVATE EQUITY– DIVERSIFICATION BY SECTOR

As at March 31, 2010 (percent)

Consumer Discretionary	27.9
Telecom	27.1
Information Technology	10.1
Health Care	9.2
Materials and Industrial	8.1
Financial	6.3
Other	11.3

The majority of the Private Equity portfolio is in Consumer Discretionary and Telecom.

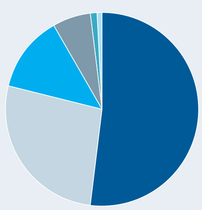
REAL ESTATE

Net assets of the Real Estate portfolio totalled $5.1 billion at the end of fiscal year 2010, an increase of $465 million from the $4.6 billion at the end of fiscal year 2009.

Real Estate earned $28 million in investment income for a return of 0.6% in fiscal year 2010, compared to a Policy Benchmark of 7.4%. The Real Estate portfolio maintained its value during the year despite an extremely adverse market. This is largely attributable to a strategy of investing a large portion of the portfolio in the Canadian market, which has shown more stability than other markets during this period, and the adoption of a defensive asset mix over the past three years, with a significant portion of the portfolio being invested in residential, retirement and long-term-care facilities. On a five-year basis, Real Estate investments have generated a 6.5% compound annualized return, compared to a Policy Benchmark return of 7.3% for the same period.

The year-over-year increase in net assets in Real Estate came mainly from new investments and the deleveraging of the portfolio. During fiscal year 2010, the Real Estate Group continued its investment initiatives in emerging markets with additional investments in Brazil and South Africa and an initial investment in Colombia. To take advantage of market dislocations, the Real Estate Group made several investments in real estate debt instruments in the US, European and Japanese markets. The Real Estate Group also took advantage of historically low interest rates to place approximately $260 million of long-term mortgage financing on directly owned properties.

As at March 31, 2010, direct and co-investments accounted for 72% of the assets in Real Estate, up from 71% at the end of the previous fiscal year.

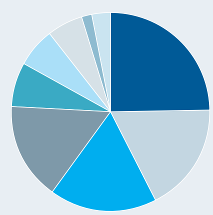


REAL ESTATE– DIVERSIFICATION BY GEOGRAPHY

As at March 31, 2010 (percent)

Canada	52.1
United States	26.9
Europe	12.9
Latin America	6.3
Asia	1.2
Other	0.6

The majority of the Real Estate portfolio exposure is in North America, mainly in Canada.



REAL ESTATE– DIVERSIFICATION BY SECTOR

As at March 31, 2010 (percent)

Retirement	24.8
Office	17.7
Residential	17.5
Long-Term Care	16.0
High-Yield Debt	7.1
Retail	6.6
Hotel	5.7
Industrial	1.7
Other	2.9

The majority of the Real Estate portfolio exposure is in residential rental properties (Retirement, Residential, Long-Term Care).

INFRASTRUCTURE

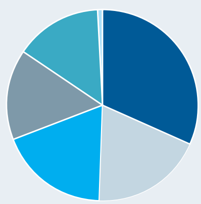
The net assets of the Infrastructure portfolio totalled $2.1 billion at the end of fiscal year 2010, a decrease of $373 million from the $2.5 billion at the end of fiscal year 2009. Although the impact on performance is mitigated by a currency hedging policy, the year-over-year decrease in net assets in Infrastructure is mainly attributable to the strengthening of the Canadian dollar.

Infrastructure earned $158 million in investment income for a return of 7.2% in fiscal year 2010, compared to the Policy Benchmark of 3.7%. A significant portion of the portfolio return was generated by cash distributions (interest and dividends) and realizations from direct or co-investments. Again this year, the performance was largely attributable to direct investments. Since inception (3.75 years), Infrastructure investments have generated a 6.2% compound annualized return, compared to a Policy Benchmark return 3.4% for the same period.

Infrastructure investments generally offer predictable and stable long-term cash flows. Owners of infrastructure investments have been less inclined to sell in the current environment, resulting in few transactions in the sector in fiscal year 2010.

In spite of variable market conditions, the past year's performance has reinforced the current strategy of concentrating on direct investments, mainly in the energy, utilities and transportation sectors. The infrastructure group typically holds a significant ownership position in its assets, in order to be able to influence strategic decision-making. Such investments are intended to be held for relatively long periods of time, generally more than eight years.

As at March 31, 2010, direct and co-investments accounted for 78% of the assets of the Infrastructure Portfolio, up from 76% from the previous fiscal year.

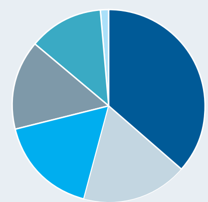


INFRASTRUCTURE– DIVERSIFICATION BY GEOGRAPHY

As at March 31, 2010 (percent)

United States	31.8
Europe	18.9
United Kingdom	18.6
South America	15.4
Canada	14.5
Australia	0.8

The Infrastructure portfolio is diversified mostly across the Americas and Europe.



INFRASTRUCTURE– DIVERSIFICATION BY SECTOR

As at March 31, 2010 (percent)

Oil & Gas Storage and Transport	36.6
Oil & Gas Exploration and Production	17.6
Electric Transmission	17.1
Transportation	15.0
Water Utilities	12.5
Other	1.2

Energy infrastructure and utilities constitute more than 65% of the infrastructure portfolio.

OPERATING EXPENSES

PSP Investments' operating expenses during fiscal year 2010 totaled $92 million, compared to $86 million in fiscal year 2009. These costs amounted to 0.23% of average net assets, the same level as in fiscal year 2009. Although assets under management increased by 37% in the current fiscal year, operating costs in absolute dollars have increased marginally at a rate of 7% compared to fiscal year 2009. This can be attributed to a cost-control initiative implemented in the latter part of fiscal year 2009 that was extended to the first half of the current fiscal year. The cost-control initiative was launched to respond to the market crisis that led to a decline in assets under management in fiscal year 2009. In the current fiscal year, financial markets commenced their recovery from the lows experienced in fiscal year 2009, resulting in a $12.5-billion increase in assets under management, including net contributions, at the end of fiscal year 2010. Operating costs for fiscal year 2011 are expected to increase as a result of the expected growth in assets under management and a continued shift towards internally actively managed assets in Public Markets as well as an increase in direct investments in the Private Market asset classes. This has the effect of increasing internal operating expenses, due to increases in headcount and related expenses, but reducing external investment management fees. Operating expenses exclude external investment management fees and transaction costs, which are applied as a reduction to investment income.

Total costs as a percentage of average net assets under management are affected by the size and complexity of investment activities. Size is the most critical factor that impacts a fund's cost structure, particularly on a percentage-of-assets basis. The larger a given fund, the higher are the economies of scale. Investment activities undertaken by PSP Investments are as complex and diversified as those of larger funds/plans but, as yet, without the critical asset base over which to spread the requisite costs. With assets forecast to continue increasing over the next few years, PSP Investments' expense ratios (as a percentage of assets) are expected to continue to gradually decrease.

PSP Investments conducts a number of benchmarking exercises to ensure that its operating expenses are reasonable and competitive when compared to its peers.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

In February 2008, the Accounting Standards Board (AcSB) of Canada confirmed that Canadian Generally Accepted Accounting Principles (GAAP) for publicly accountable enterprises will converge with International Financial Reporting Standards (IFRS) effective January 1, 2011. In response to this change, PSP Investments has developed a transition plan that would allow it to prepare and present its March 31, 2012 consolidated financial statements under IFRS.

In analyzing the various impacts of its transition to IFRS, PSP Investments concluded that the requirement to consolidate its controlled investments ranked as one of the most significant of such impacts.

In April 2010, the AcSB of Canada issued Section 4600, "Pension Plans" of the Canadian Institute of Chartered Accountants (CICA) Handbook requiring pension plans in Canada to follow this standard rather than convert to IFRS in the same fashion as other publicly accountable enterprises. Under Section 4600, pension plans would continue to account for and report their investments at fair value as was previously done under Section 4100, "Pension Plans" of the CICA Handbook. The provisions of Section 4600 apply to annual financial statements relating to fiscal years beginning on or after January 1, 2011.

Concurrent with the issuance of Section 4600, the AcSB of Canada issued an exposure draft that proposed a scope expansion to include entities, such as PSP Investments, that are separate from pension plans and whose sole purpose is to hold and invest assets received from one or more pension plans, but does not itself have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments. The AcSB has indicated that it anticipates reaching a decision concerning the exposure draft in June 2010.

Management is currently monitoring the outcome of this exposure draft and evaluating its impact on PSP Investments' consolidated financial statements as well as the IFRS transition plan.

RISK MANAGEMENT

ENTERPRISE RISK MANAGEMENT

As the manager of public pension assets, PSP Investments is responsible for acting in the best interest of the contributors and beneficiaries of the Plans and maximizing returns without undue risk of loss. PSP Investments acknowledges that it must take risks to achieve its legislated mandate and that the management of the full spectrum of risks must be integrated on an enterprise-wide basis.

As a result, PSP Investments has established an enterprise risk management framework to provide a structure for identifying, evaluating and managing its various financial and non-financial risks. The framework is a core component of PSP Investments' Enterprise Risk Policy. The policy also defines PSP Investments' responsibilities relating to its enterprise risks from the perspective of the Board and its committees, the management committees, and the investment groups and support groups within PSP Investments. In addition to the Enterprise Risk Management Policy, an Investment Risk Management Policy and an Operational Risk Management Policy have also been put in place to deal with the specific charateristics of these risks.

PSP Investments' enterprise risk management framework is guided by the following principles:

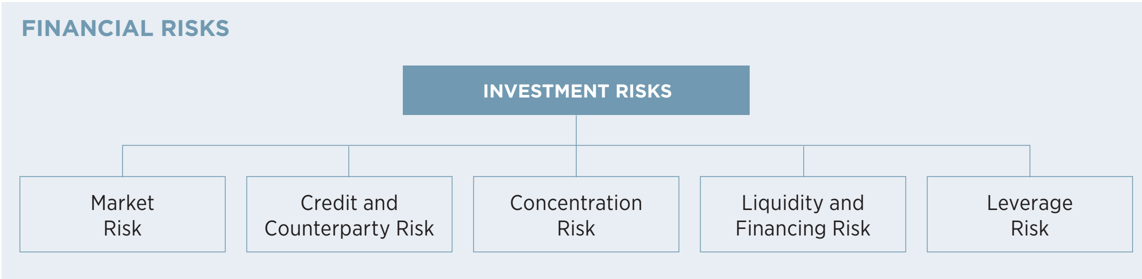
- Promote a risk-aware culture;
- Establish and implement a risk management framework that enables PSP Investments to identify, assess, manage, and monitor enterprise risks;
- Integrate enterprise risk management into strategic and financial objectives;
- Operationalize sound risk management processes.

All of PSP Investments' risk policies were reviewed and refined during fiscal year 2010, based on experience to date and PSP Investments' push for continuous improvement.

PSP Investments faces six principal enterprise risks inherent to its activities and environment that have been categorized as financial and non-financial risks.

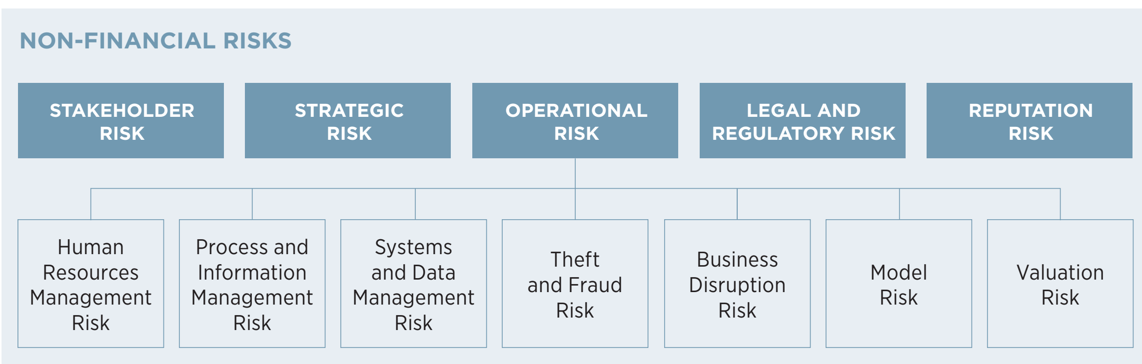
FINANCIAL RISKS

- Investment risk: the risk of loss inherent in achieving investment objectives, including market, credit and counterparty, concentration, liquidity and financing, and leverage risks. PSP Investments' mandate is to manage investment risks recognizing their contributions to pension risks. However, PSP Investments is not directly responsible for managing pension risks.



NON-FINANCIAL RISKS

- Stakeholder risk: the risk associated with PSP Investments' particular status as a crown corporation and any related legislation.
- Strategic risk: the risk of not achieving strategic goals or business objectives.
- Operational risk: the risk of a direct or indirect loss resulting from inadequate or failed internal processes, people or systems, or from external events.
- Legal and regulatory risk: the risk associated with the failure to comply with or failure to adapt to current or changing legislation, regulations or other mandatory industry practices.
- Reputation risk: the risk that an activity undertaken by PSP Investments or its representatives impairs its image in the community or lowers public opinion and stakeholder confidence in it, resulting in the inability to achieve its objectives.



Legend: Enterprise Risk

In fiscal year 2010, PSP Investments continued the implementation of its enterprise risk management framework, aligned with its three-year strategic plan. Key accomplishments for the fiscal year included the following:

- Realigned and enhanced the Risk Management Group capabilities by consolidating valuation, market and credit risk functions to improve focus on the specific risk profile of PSP Investments' asset classes;
- Refined risk limits and formalized the attribution of active risk across asset classes through a structured risk budget process;
- Improved capabilities in sensitivity analysis and stress testing to complement value-at-risk (VaR) measurement and provide a more comprehensive measure of investment risk;
- Enhanced monitoring and reporting of leverage activities, treasury activities and liquidity risk.

RISK MANAGEMENT GOVERNANCE

PSP Investments promotes a risk-aware culture involving all employees. Senior management and employees are not only active participants in risk identification, but also in risk evaluation, management, monitoring and reporting.

The Board of Directors contributes to risk oversight by:

- Establishing the investment objectives, investment policy and policy portfolio;
- Participating in the definition of PSP Investments' risk philosophy;
- Knowing the extent to which PSP Investments' management has established effective enterprise risk management within the organization;
- Reviewing the corporate risk profile provided by management; and
- Being apprised of the most significant risks and how PSP Investments' management is responding to them.

In order to oversee and manage risks related to its investments and operations, senior management has created various committees, including the Management Investment Committee, Management Operations Committee, Risk Steering Committee, the Valuation Committee, New Product Committee and the Information Technology Governance Committee.

INVESTMENT RISK MANAGEMENT

The Investment Risk Management Policy has been revised and is an integral component of PSP Investments' risk management program to support the management of risks incurred through the fund's investment processes. The Policy establishes an investment risk management framework, with a goal of ensuring that investment activities respect the risk philosophy of PSP Investments. The framework covers the key elements required to establish a comprehensive investment risk management process. These include:

- Risk measurement;
- Risk budgeting;
- Risk limits and controls;
- Risk limit escalation protocols; and
- Risk reporting.

OPERATIONAL RISK MANAGEMENT

Operational risk is one of the key enterprise risks that PSP Investments is exposed to. The Operational Risk Management Policy currently in place within PSP Investments defines the guiding principles and frames boundaries to prudently and proactively manage the risks inherent to PSP Investments' ongoing operations.

Operational risk management at PSP Investments is structured around seven types of risk:

- Human resources management;
- Process and information management;
- Systems and Data Management;
- Theft and fraud;
- Business disruption;
- Model risk; and
- Valuation risk.

INTERNAL AUDIT AND COMPLIANCE

INTERNAL AUDIT

Internal Audit is an independent objective assurance and consulting activity designed to add value and improve PSP Investments' operations. It helps to achieve PSP Investments' objectives by using a systematic disciplined approach to evaluate and improve the effectiveness of processes, systems, risk management, control and governance processes. In order to ensure the independence required for Internal Audit to play its role effectively, the group reports functionally to the Audit and Conflicts Committee of the Board of Directors, and administratively to the Executive Vice President, Chief Operating Officer and Chief Financial Officer.

INTERNAL CONTROLS

The internal control environment is derived from the Committee of Sponsoring Organizations (COSO) model. COSO defines internal control as a process, effected by an entity's board of directors, management and personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting;
- Compliance with applicable laws and regulations.

Assisted by externally contracted internal auditors, PSP Investments reviews annually its control environment as well as key controls in all departments as required under Section 28 of the Act.

The control functions are carried out at various levels and in various departments: investment and operations' managers, finance and control, risk management, internal audit and compliance. Each control is designed to ensure that PSP Investments' policies and procedures are respected and applied consistently. All policies are approved by the Board of Directors and are supported by procedures that provide a framework for their implementation.

In fiscal year 2010, the Governance Committee of the Board of Directors undertook to conduct a review of the policy-making process at PSP Investments to ensure that careful consideration is given when drafting and revising policies to finding the appropriate mix of principles and boundaries, considering the scale, scope and complexity of PSP Investments' activities and organizational structure.

COMPLIANCE

PSP Investments must act with integrity and maintain high ethical standards at all times. The objective of the Compliance Department, in conjunction with the Legal Department, is to ensure stringent compliance of PSP Investments with its policies and procedures as well as relevant laws and statutory requirements. Compliance with its internal investment policies and procedures, is mainly achieved through daily monitoring of transactions. Processes are also in place to monitor compliance with the Code of Conduct for Officers, Employees and Others (the "Code of Conduct").

The Code of Conduct serves as a framework that provides officers, employees and others subject to the Code of Conduct with a full understanding of the organization's corporate principles and values with the aim of assisting them in determining appropriate business practices and behaviour.

The Code of Conduct includes a whistle-blowing provision designed to encourage officers, employees and others to step forward and report any financial fraud or other fraudulent and inappropriate activities. Among other things, the Code of Conduct deals with overall honesty and integrity; personal and professional conduct; compliance with the Code of Conduct and the law; conflict of interest procedures; the reporting of personal investment transactions; gifts, hospitality and other benefits; external appointments or employment within any organization or association; political activities; and dealings with public officials.

The Audit and Conflicts Committee is responsible for monitoring the application of the Code of Conduct . Management reports quarterly on compliance matters, including compliance with the Code of Conduct, to the Audit and Conflicts Committee. The Code may be viewed on PSP Investments' website **www.investpsp.ca** under "Governance – Code of Conduct".

GOVERNANCE

Effective governance is essential to safeguard the capital entrusted to PSP Investments and to ensure that appropriate objectives are pursued and achieved, consistent with the fulfillment of the Corporation's legislated mandate. This section describes PSP Investments' governance model, including PSP Investments' mandate, the roles of the Board of Directors and Board committees and key policies that guide the organization's activities and behaviour.

LEGISLATED MANDATE

Effective April 1, 2000, the federal government created three new pension fund accounts—one for each of the Public Service, the Canadian Forces and the Royal Canadian Mounted Police (RCMP) pension plans. Employer and employee contributions in respect of service since April 1, 2000 for each plan, are credited to these pension fund accounts. Amounts equal to the net balances of these accounts (that is, contributions minus benefits payments for service since April 1, 2000, and plan administration expenses) are transferred to separate accounts at PSP Investments, to be invested in accordance with the approved investment policy and strategy.

On March 1, 2007, the federal government established the Reserve Force Pension Plan. Since that date, an amount equal to the net balance of the pension fund account created for this plan is transferred to PSP Investments pursuant to the terms of the establishing regulation and within the meaning of the *Public Sector Pension Investment Board Act* ("the Act").

The government manages and administers these pension plans. The President of the Treasury Board is responsible for the Public Service Plan, the Minister of National Defence for the Canadian Forces Plan and the Reserve Force Plan, and the Minister of Public Safety for the RCMP Plan.

PSP Investments' mandate is set forth in the Act. This mandate is twofold; it consists of managing funds transferred from the Public Service, the Canadian Forces, the RCMP and the Reserve Force pension plans (the "Plans") in the best interests of the contributors and beneficiaries, and investing the funds with a view to achieving a maximum rate of return without undue risk of loss, having regard to the funding, policies and requirements of the Plans and the ability of those Plans to meet their financial obligations.

ROLES AND RESPONSIBILITIES OF THE BOARD OF DIRECTORS AND BOARD COMMITTEES

BOARD OF DIRECTORS

In order to ensure that legislative and regulatory objectives are met, the Board of Directors has defined its role to include, among other responsibilities, the following:

- Appointment and termination of the President and CEO;
- Annual review and approval of proposed amendments to the written Statement of Investment Policies, Standards and Procedures (SIP&P);
- Approval of strategies for achieving investment performance objectives and benchmarks against which to measure performance;
- Adoption of appropriate policies for the proper conduct and management of PSP Investments, including a Code of Conduct for Officers and Employees and Others, and a Code of Conduct for Directors;
- Ensuring that effective investment and operations risk policies are in place;
- Approval of human resources and compensation policies;
- Establishment of appropriate performance evaluation processes for the Board of Directors, the President and CEO and other members of senior management; and
- Approval of quarterly and annual financial statements for each underlying Pension Plan Account and for PSP Investments as a whole.

The Terms of Reference describing the roles and responsibilities of the Board Chair and the Board of Directors and its committees may be viewed in their entirety on PSP Investments' website **www.investpsp.ca** under "Governance – Duties & Responsibilities". Every three years, a governance review is conducted to assess the extent to which PSP Investments' Terms of Reference are being fulfilled and, based on the examination, a governance report is submitted to the Governance Committee. The purpose of this report is to assist the Board of Directors in ensuring that each of the key fiduciaries has carried out its duties and responsibilities as set out in its Terms of Reference. A governance review was conducted at the end of fiscal year 2010. The report produced by an independent consultant concluded that the Terms of Reference are consistent with the requirements of the Act and form part of an internally consistent structure reflecting best practices for organizations with mandates and structures similar to those of PSP Investments.

The Report also confirmed that the Board of Directors and its committees have dealt with all material matters set out in its Terms of Reference.

BOARD COMMITTEES

The Board of Directors has established four standing committees to assist in the fulfillment of its obligations. A Special Committee was created in 2008 to assess the linkage of the Plans' pension liabilities. The Special Committee was wound up on February 9, 2010, and its former responsibilities transferred to the Governance Committee.

- Investment Committee
- Audit and Conflicts Committee
- Human Resources and Compensation Committee
- Governance Committee
- Special Committee (wound up on February 9, 2010)

INVESTMENT COMMITTEE

The Investment Committee is responsible for overseeing the investment management function of PSP Investments. In particular, the Investment Committee performs the duties that are assigned to it by the Board of Directors including, among others, the approval of all investment proposals and related borrowings, and the execution of the documentation related to such investments and borrowings, except if PSP Investments' Delegation of Authority provides otherwise. The Investment Committee is also responsible for recommending to the Board of Directors a written Statement of Investment Policies, Standards and Procedures (SIP&P) for each Plan, and for conducting an annual review of the SIP&P and, if necessary, recommending changes. Finally, another significant responsibility of the Investment Committee entails approval of the engagement of external investment managers empowered with discretionary authority to invest PSP Investments' assets.

The Investment Committee is comprised of all members of the Board of Directors and is chaired by Mr. Anthony R. Gage.

AUDIT AND CONFLICTS COMMITTEE

The Audit and Conflicts Committee's role is generally to review the adequacy and effectiveness of PSP Investments' system of internal controls. This includes internal controls over the accounting and financial reporting systems within PSP Investments, as well as internal information system controls and security. The Audit and Conflicts Committee is also in charge of monitoring the application of the Code of Conduct for Officers, Employees and Others. Many of the duties of the Audit and Conflicts Committee are laid out in the Act. In addition to those mentioned above, these duties include:

- Reviewing quarterly and annual financial statements of each underlying Pension Plan Account and of PSP Investments as a whole, recommending them to the Board for approval and discussing any letters to management regarding any significant concerns on the part of the joint auditors;
- Meeting with PSP Investments' joint auditors to discuss PSP Investments' annual financial statements and the auditors' report; and
- Adopting and maintaining an appropriate whistle-blowing mechanism for reporting financial fraud or other fraudulent and inappropriate activities.

On March 31, 2010, the Audit and Conflicts Committee was comprised of the following Directors[1]:

- William A. MacKinnon, Chair
- Jamie Baillie
- Cheryl Barker
- Lynn Haight

[1] Mr. Keith Martell was the Chair of the Audit and Conflicts Committee until January 14, 2010. Messrs. Anil Rastogi and William A. Saunderson were members of the Audit and Conflicts Committee up until April 3, 2009 and January 14, 2010, respectively.

HUMAN RESOURCES AND COMPENSATION COMMITTEE

The Board of Directors strongly believes in the importance of the human resources function to the success of PSP Investments. Accordingly, the Human Resources and Compensation Committee assists the Board of Directors in ensuring that the necessary policies and procedures are in place to efficiently and effectively manage PSP Investments' human resources and to offer all employees fair and competitive compensation aligned with performance. In this spirit, the Human Resources and Compensation Committee is responsible for:

- Making recommendations to the Board of Directors regarding PSP Investments' human resources, training and compensation policies, and periodically reviewing such policies and recommending changes as necessary;
- Reviewing annually, on an aggregate basis, the total compensation of all employees of PSP Investments;
- Reviewing annually, the performance evaluations of the President and CEO and other Officers of PSP Investments and making recommendations to the Board on the remuneration of these individuals;
- Ensuring the compliance of PSP Investments' human resources policies and practices with applicable legislation; and
- Reviewing PSP Investments' succession planning and reporting to the Board of Directors on such planning.

On March 31, 2010, the Human Resources and Compensation Committee was comprised of the following Directors:

- Michael P. Mueller, Chair
- Bob Baldwin
- Léon Courville
- Anthony R. Gage
- Jean Lefebvre

GOVERNANCE COMMITTEE

The Governance Committee's role is generally to assist the Board of Directors in developing and monitoring PSP Investments' approach to its own governance. The Board of Directors has designated the Governance Committee to monitor the application of the Code of Conduct for Directors. Among the more significant of the Governance Committee's duties are the following:

- Monitoring and assessing the relationship between the Board of Directors and Management, defining the limits to Management's responsibilities and ensuring that the Board of Directors functions independently of Management;
- Reviewing at least every two years, with the assistance and input of the President and CEO and the Board Chair of PSP Investments, the Terms of Reference for the Board of Directors and the committees of the Board of Directors, and recommending to the Board such amendments as may be necessary or advisable;
- Developing and recommending to the Board of Directors for its approval, the by-laws and governance-related policies; and
- Overseeing the implementation of procedures for assessing the effectiveness of the Board of Directors as a whole and for conducting a peer review.

On March 31, 2010, the Governance Committee was comprised of the following Directors[2]:

- Bob Baldwin, Chair
- Jamie Baillie
- Cheryl Barker
- Léon Courville

ACCOUNTABILITY AND REPORTING TO GOVERNMENT

PSP Investments' President and CEO is appointed by and reports to the Board of Directors. In turn, the Board of Directors reports to Parliament through the President of the Treasury Board, who is responsible for PSP Investments' legislation.

The President of the Treasury Board is also required to table PSP Investments' annual report in Parliament. PSP Investments is required to provide its annual report as well as quarterly financial statements to the President of the Treasury Board, the Minister of National Defence and the Minister of Public Safety.

The President and CEO and the Board Chair of PSP Investments are required to meet once a year with Advisory Committees appointed to oversee the Plans. Since 2009, PSP Investments is required to hold a public meeting on an annual basis. PSP Investments also communicates on an ongoing basis with the Chief Actuary of Canada and with Treasury Board officers.

Pursuant to the *Financial Administration Act* (FAA), Deloitte & Touche LLP and the Auditor General of Canada serve as joint auditors of PSP Investments and are responsible, amongst other duties, for conducting a Special Examination. PSP Investments is subject to a Special Examination held at least every 10 years, as provided for in the FAA. As recommended by the Board of Directors, PSP Investments' joint auditors will be conducting a Special Examination in fiscal year 2011 to determine if PSP Investments' financial and management controls, information systems and management practices were maintained in a manner that provides reasonable assurance that they met the requirements of paragraph 131(2) (a and c) of the FAA. The most recent Special Examination in respect of PSP Investments was conducted in fiscal year 2006. The results, which were presented in a Special Examination Report dated November 15, 2005, indicated that there were no significant deficiencies in PSP Investments' systems and practices.

DIRECTORS' SELECTION

The Governor in Council appoints all members of the Board of Directors on the recommendation of the President of the Treasury Board. Qualified candidates for directorship are selected and recommended to the President of the Treasury Board by an eight-member Nominating Committee established by the President of the Treasury Board. The Nominating Committee operates separately from the Board of Directors and the Treasury Board. PSP Investments' legislation disqualifies as potential Directors members of the Senate, the House of Commons and provincial legislatures, as well as employees of PSP Investments or the federal government and those entitled to benefits from the Plans. Directors hold office during good behaviour for a term not exceeding four years. On the expiry of the term of an incumbent Director, the incumbent continues in office until he or she is reappointed or a successor is appointed.

All Directors of PSP Investments must have an excellent understanding of the role of a director and possess a general knowledge of pensions and a broad knowledge of investment management and its related risks. The Board of Directors plays an active role in guiding PSP Investments. Therefore, a substantial time commitment is expected of Board members, particularly the Board Chair and the Chairs of Board committees, for meetings, travel and preparation for meetings.

[2] Mr. Anil Rastogi was a member of the Governance Committee up until April 3, 2009. Mr. William A. Saunderson was a member of the Governance Committee up until January 14, 2010.

The Act provides that PSP Investments' Board of Directors is comprised of 12 members including the Board Chair. On March 8, 2010, the President of the Treasury Board announced a reduction of 245 Governor in Council appointments across the Government of Canada. Further to this announcement, changes to the Act to reduce the composition of the Board of Directors from 12 to 11 members were also announced. In fiscal year 2010, two members were appointed and three Directors left PSP Investments' Board. On January 14, 2010 the Governor in Council appointed Ms. Lynn Haight and Mr. William A. MacKinnon as Directors of PSP Investments for terms of four years. The terms of Messrs. Keith Martell and William A. Saunderson expired on the same date. On April 3, 2009, Mr. Anil Rastogi resigned as a Director of PSP Investments. Finally, during the past fiscal year, the terms of Ms. Cheryl Barker, Messrs. Anthony R. Gage and Michael P. Mueller were extended for an additional four years. On March 31, 2010, 10 board positions were occupied and one vacant position was in the process of being filled.

The Canadian securities regulators adopted a definition of "independent director" applicable to publicly listed issuers. In the context, "independent director" has been defined as an individual who has no direct or indirect material relationship with the issuer and a "material relationship" has been defined as a relationship which could, in the view of the issuers board of directors, be reasonably expected to interfere with the exercise of an individual's independent judgement. Although PSP Investments is not subject to this regulation, based on the above definition, all Directors of PSP Investments are considered independent.

A short biography of each of the Directors as of March 31, 2010 can be found beginning on page 55.

ASSESSMENT OF BOARD PERFORMANCE

The regulations adopted under the Act require the Board of Directors to set out in the annual report the procedures in place for the assessment of its own performance. In accordance with those requirements, the Governance Committee implemented a formal evaluation process designed to encourage frank and confidential discussions between the Chair of the Board and individual Directors, as well as between the Chair of the Board and the management team of PSP Investments.

To facilitate the assessment process, procedures have been put in place to evaluate the performance of the Chair of the Board, the Chairs of Board committees, individual Board members and the Board as a whole. Every Director as well as the President and CEO and certain members of the management team participate in the evaluation process. The Chair of the Governance Committee presents the results of the evaluation to the Board of Directors. The ensuing Board discussion focuses on concerns and opportunities for improvement, what is working properly and what has improved since previous assessments.

CODE OF CONDUCT FOR DIRECTORS

The Code of Conduct for Directors is designed to provide a workable process for identifying, minimizing and resolving potential conflicts of interest. Derived from the Act and the *Conflict of Interest Act*, the Code of Conduct sets out in detail Directors' statutory and fiduciary duties relating to conflicts of interest and helps ensure that Directors have a full understanding and appreciation of PSP Investments' principles and values. Ultimately, the Code of Conduct for Directors aims to assist Directors in determining appropriate business practices and behaviour.

The Code of Conduct for Directors, among other things:

- Requires Directors to give written notice to the Board of Directors of the nature and extent of their interest in a transaction or proposed transaction;
- Prohibits Directors from voting on a resolution or participating in a discussion in any circumstances if they have a conflict of interest;
- Requires the disclosure of any other business activity in which they participate which directly or indirectly affects PSP Investments' activities or is in competition with PSP Investments' activities; and
- Requires the Directors to confirm annually that they have not traded securities on the restricted list, except as permitted under the Code of Conduct for Directors.

The Governance Committee is responsible for monitoring the application of the Code of Conduct for Directors. The Code of Conduct for Directors may be viewed in its entirety on PSP Investments' website **www.investpsp.ca** under "Governance – Code of Conduct for Directors".

DIRECTOR EDUCATION PROGRAM

The Act requires the Nominating Committee to have regard to the desirability of having on the Board of Directors a sufficient number of Directors with proven financial ability or relevant work experience such that PSP Investments will be able to effectively achieve its objectives. The legislation then calls for Directors with relevant expertise to use their knowledge or skills in exercising their duties.

To enhance Directors' financial knowledge and skills, PSP Investments created a Director Education Program. In fiscal year 2010, each Director was allocated an individual budget equal to 15% of the retainer and meeting fees he or she earned in fiscal year 2009, to be used primarily to strengthen their understanding of investment management. As well as providing individual courses, conferences and reading material, the Director Education Program stages group training sessions the day before each regular Board of Directors' meeting. During the sessions, distinguished speakers are invited to make presentations on a variety of topics that contribute to the individual and collective expertise of Board members.

DIRECTORS' COMPENSATION

The approach to director remuneration adopted by the Board of Directors reflects key requirements of the Act. The first requirement is that the Board should include a sufficient number of Directors with proven financial ability or relevant work experience such that PSP Investments will be able to effectively achieve its objectives. The second requirement is that Directors' compensation should be set "having regard to the remuneration received by persons having similar responsibilities and engaged in similar activities".

The Board reviews Directors' compensation once every two years and considers any changes that may be warranted based on a report and recommendations provided by the Governance Committee. The most recent review was conducted in fiscal year 2009 with the assistance of an independent compensation consultant.

The following remuneration for Directors was approved by the Board of Directors in fiscal year 2009, and the Board subsequently agreed there would be no increase in these amounts for fiscal years 2010 and 2011:

- Annual retainer for the Board Chair: $125,000;
- Annual retainer for each Director other than the Board Chair: $27,500;
- Attendance fee for each Board meeting: $1,500;
- Attendance fee for each committee meeting: $1,250;
- Annual retainer for each Chair of a committee of the Board of Directors: $8,750;
- Additional meeting fee for each Director who attends a meeting in person if the Director's primary residence is outside Québec or Ontario, or in any case where a Board of Directors or committee meeting is held in a location outside Québec and requires a Director to travel more than three hours away from his or her primary residence: $1,500.

Directors of PSP Investments are not entitled to additional compensation in the form of retirement benefits or short-term or long-term incentives.

The Board of Directors met eight times during fiscal year 2010 and its committees held 30 meetings. This translated into total remuneration for Directors of $736,032. The tables on the following two pages illustrate and break down the above-mentioned information.

ATTENDANCE OF DIRECTORS BOARD AND COMMITTEES – FISCAL YEAR 2010

	Board of Directors		Audit and Conflicts Committee		Governance Committee		Human Resources and Compensation Committee		Investment Committee	Special Committee[4]
	Regular	Special	Regular	Special	Regular	Special	Regular	Special	Regular	
Number of meetings Fiscal Year 2010	7	1	6	1	5	2	6	1	7	2
Jamie Baillie	7/7	1/1	6/6	1/1	5/5	2/2			7/7	
Bob Baldwin	7/7	1/1			5/5	2/2	6/6	1/1	7/7	1/2
Cheryl Barker	7/7	1/1	6/6	1/1	5/5	2/2			7/7	
Paul Cantor[1]	7/7	1/1							7/7	
Léon Courville	7/7	1/1			5/5	2/2	6/6	1/1	7/7	
Anthony R. Gage	7/7	1/1					6/6	1/1	7/7	2/2
Lynn Haight[2]	1/1	–	2/2	–					2/2	
Jean Lefebvre	6/7	1/1					5/6	1/1	6/7	2/2
William A. MacKinnon[3]	0/1	–	1/2	–					2/2	
Keith G. Martell[5]	5/6	1/1	4/4	1/1					4/5	
Michael P. Mueller	7/7	1/1					6/6	1/1	7/7	2/2
Anil K. Rastogi[5]	1/1	–	1/1	–	1/1				1/1	
William A. Saunderson[5]	4/6	0/1	4/4	0/1	4/4	0/1			4/5	

[1] Mr. Cantor is not a member of the Audit and Conflicts Committee, the Governance Committee, the Human Resources and Compensation Committee or the Special Committee, but as Board Chair he may attend all committee meetings.

[2] Ms. Haight was appointed Director and a member of the Investment Committee on January 14, 2010. She was appointed as a member of the Audit and Conflicts Committee on February 9, 2010.

[3] Mr. MacKinnon was appointed Director and a member of the Investment Committee on January 14, 2010. He was appointed as a member and Chair of the Audit and Conflicts Committee, respectively, on February 9 and 10, 2010.

[4] The Special Committee was wound up on February 9, 2010.

[5] Mr. Rastogi resigned on April 3, 2009. Messrs. Martell and Saunderson's terms as Directors of PSP Investments expired on January 14, 2010.

REMUNERATION OF DIRECTORS FISCAL YEAR 2010

	Remuneration [1]				
Name	Annual Retainer	Chair of a Committee/ Retainer	Boards/ Committees Meeting Fees	Travel Fees	Total
Jamie Baillie	$27,500	–	$36,500	$10,500	$74,500
Bob Baldwin	$27,500	$8,750	$37,750	–	$74,000
Cheryl Barker	$27,500	–	$36,500	$9,000	$73,000
Paul Cantor	$125,000 (Board Chair)	–	–	–	$125,000
Léon Courville	$27,500	–	$36,500	–	$64,000
Anthony R. Gage	$27,500	$8,750	$29,500	$9,000	$74,750
Lynn Haight	$5,882	–	$6,500	–	$12,382
Jean Lefebvre	$27,500	$7,535	$25,500	–	$60,535
William A. MacKinnon	$5,882	$1,215	$3,750	–	$10,847
Keith G. Martell [2]	$21,694	$6,903	$18,500	$6,000	$53,097
Michael P. Mueller	$27,500	$8,750	$29,500	–	$65,750
Anil K. Rastogi [2]	$227	–	$5,250	–	$5,477
William A. Saunderson [2]	$21,694	–	$21,000	–	$42,694

1 The Directors are also entitled to reimbursement of their reasonable travel and related expenses when applicable.

2 Mr. Rastogi resigned on April 3, 2009. Messrs. Martell and Saunderson's terms as Directors of PSP Investments have expired on January 14, 2010.

INVESTMENT GOVERNANCE OVERSIGHT

In order to ensure adequate governance oversight of its investments, PSP Investments has adopted a Responsible Investment Policy and Proxy Voting Guidelines. PSP Investments also participates in collaborative initiatives with other like-minded institutional investors.

RESPONSIBLE INVESTMENT

PSP Investments recognizes that a broad range of financial and non-financial considerations can be relevant in terms of making investment decisions. During fiscal year 2010, PSP Investments reviewed and amended its Responsible Investment Policy, which embodies PSP Investments' belief that responsible corporate behaviour with respect to environmental, social and governance factors can generally have a positive influence on long-term financial performance. In analyzing the risks inherent in any investment, PSP Investments looks to identify, monitor and mitigate environmental, social and governance issues that are, or could become, material to long-term financial performance.

With the assistance of a service provider and through collaborative initiatives with other like-minded institutional investors, PSP Investments is actively engaging issuers with a view to improving their environmental, social and governance practices.

PSP Investments' Responsible Investment Policy may be viewed on PSP Investments' website **www.investpsp.ca** under "Investments – Investment Policies – Responsible Investment Policy".

PROXY VOTING

The Proxy Voting Guidelines (the "Guidelines") are designed to ensure that securities beneficially owned by PSP Investments will be voted in accordance with its investment policy and objectives. The Guidelines stipulate that PSP Investments will give due consideration to corporate governance principles when assessing the merits of an issue and will exercise its voting rights with a view to maximizing the value of its shareholdings.

The Guidelines focus on areas of corporate governance with respect to which PSP Investments may be requested to vote from time to time and the principles on which it will rely in determining a response to such requests. Areas important in terms of their potential impact on performance include:

- Independence and effectiveness of a company's board of directors;
- Management and directors' compensation, including equity compensation plans;
- Takeover protection;
- Shareholder rights; and
- Responsible investing.

In fiscal year 2010, PSP Investments reviewed and amended the Guidelines to take into consideration market trends.

To ensure more active management of its proxy voting, PSP Investments is assisted by two service providers in voting the equities held in accounts managed internally as well as those in segregated accounts managed by external managers.

The Guidelines may be viewed on PSP Investments' website **www.investpsp.ca** under "Investments – Investment Policies – Proxy Voting Guidelines".

COLLABORATIVE INITIATIVES

In 2006, PSP Investments joined the Canadian Coalition for Good Governance. In 2007, Gordon J. Fyfe, PSP Investments' President and CEO, became a member of the Coalition's Board of Directors.

PSP Investments has been a signatory of the Carbon Disclosure Project since 2006. The Carbon Disclosure Project acts on behalf of 534 institutional investors representing $64 trillion in assets under management to encourage public companies to disclose how they are managing climate change risks and opportunities that may be affecting their businesses.

In fiscal year 2010, PSP Investments became a signatory of the CDP Water Disclosure Project, which will enable institutional investors to better understand the business risks and opportunities associated with water scarcity and other water-related risks by increasing the availability of high-quality information on this issue.

PSP Investments' Private Equity Group played an active role in the implementation of the Institutional Limited Partners Association's Private Equity Principles, a best-practice governance undertaking that will guide institutional investors' future investments in the private-equity sector.

COMPENSATION

PSP Investments' Board of Directors oversees all aspects of compensation for employees of PSP Investments and approves a total compensation package for PSP Investments' officers, including an annual base salary as well as short- and long-term incentives.

PSP Investments' Compensation Policy is designed to attract and retain talented employees, reward performance and reinforce business strategies and priorities. Employees are often solicited by other organizations that need to fill positions similar to those at PSP Investments. The Board of Directors recognizes the fundamental value added by a motivated and committed team and strongly believes that the recruitment and retention of performance-oriented employees is critical to achieving PSP Investments' objectives.

In order to attract and retain talented employees, the Board of Directors has established a Compensation Policy that aims to maintain total compensation at a fair and competitive level. Compensation plans are aligned with PSP Investments' strategic plan and integrated with business performance measurement. PSP Investments' Compensation Policy provides balanced performance-based compensation and is effectively designed to reward prudent risk taking. Total compensation is comprised of base salary, short-term and long-term incentives, benefits, pension and other remuneration.

In addition, the Employee Performance Management and Professional Development Planning process contributes to improving business performance and employee engagement.

In order to ensure that PSP Investments offers competitive compensation to its employees, managers and officers, their compensation is benchmarked with that of peers, a select group of Canadian organizations in the pension fund and investment management industry, the financial services industry and other similar industries appropriate for the positions being benchmarked. For fiscal year 2010, the main comparator group was comprised of: Alberta Investment Management Corporation, British Columbia Investment Management Corporation, *Caisse de dépôt et placement du Québec*, Canada Pension Plan Investment Board, Hospitals of Ontario Pension Plan, Ontario Municipal Employees Retirement System and Ontario Teachers' Pension Plan, amongst others. These organizations were selected based on three main criteria: the size of the pension plans, their business sector and their talent pool. Data from these peer organizations are gathered periodically and on an ad hoc basis using compensation surveys published by well-established, specialized compensation consulting firms.

To remain competitive, PSP Investments aims for the following:

1. Base salaries at the median of the comparator group;
2. Incentive compensation plans with potential payouts superior to the median of the comparator group for superior performance; and
3. Benefits that compare favourably to the comparator group.

At the executive level, compensation is comprised of base salaries (approximately 30%), incentive compensation plans at target (approximately 60%) and benefits (approximately 10%).

On an annual basis, the Board of Directors ensures that PSP Investments' executive compensation is consistent with the organization's Compensation Policy. In fiscal year 2010, the Board of Directors retained the services of an independent compensation consulting firm to recommend the appropriate annual base salary adjustments for fiscal year 2011 and the appropriate compensation levels, particularly with respect to incentive compensation. This firm provided no other services to the organization in fiscal year 2010.

In early April of 2009, the G20 leaders, including Canada, endorsed the G20 Working Group Report (the "G20 Report") which makes a number of recommendations for large financial institutions which are designed to enhance sound regulation and strengthen international regulatory standards for financial institutions and increase transparency in global financial markets. The G20 Report makes 25 recommendations, three of which relate to compensation (the "G20 Compensation Recommendations"). It is important to note that the G20 Report specifically addresses financial institutions and does not apply directly to pension funds. While there is no requirement for PSP Investments to comply with the G20 Compensation Recommendations, PSP Investments completed a thorough analysis of its compensation programs in order to assess their alignment with the G20 Compensation Recommendations which are based on the Financial Stability Forum Principles for Sound Compensation Practices (the "FSF Principles").

This self-assessment concluded that PSP Investments' compensation programs and practices were consistent with the G20 Compensation Recommendations and FSF Principles. In addition, the Human Resources and Compensation Committee of the Board of Directors mandated Deloitte & Touche LLP to independently review Management's self-assessment. The independent consultant confirmed PSP Investments' level of compliance and concurred as follows:

- PSP Investments' self-assessment concluded rightfully that its compensation programs and practices were aligned with the G20 Compensation Recommendations and FSF Principles.
- PSP Investments has established and implemented compensation programs and processes that are consistent with the organization's long-term goals and risk management practices.
- The Board of Directors and the Human Resources and Compensation Committee play an active role in the design and operation of compensation programs; and have appropriate mechanisms for review and monitoring, independently of the management.
- Overall, PSP Investments has established processes and compensation programs that are effectively designed to reduce the potential for rewarding excessive risk taking.

BASE SALARY

Base salary reviews take place annually and any changes are effective from the beginning of each fiscal year. Changes to the base salary may also occur during the year to reflect significant changes in responsibility, market conditions or exceptional circumstances.

Given the prevailing financial and economic context, base salaries for officers and senior managers were not increased in fiscal year 2010.

INCENTIVE PLANS

The incentive plans remained unchanged in fiscal year 2010.

In the course of fiscal year 2009, PSP Investments undertook a detailed review of incentive plans offered to both officers and employees to ensure that total compensation remained competitive with the comparator group and reflected PSP Investments' principles and objectives of attracting, retaining and motivating employees to achieve sustained high performance. This review was conducted with the support and advice of an independant compensation consulting firm.

The incentive plans are comprised of the following:

- A Short-Term Incentive Plan (STIP), to recognize performance results for both the current year and the most recent four years;
- A Long-Term Incentive Plan (LTIP), based on four-year, forward-looking cycles with possible payouts after the fourth year to recognize long-term results; and
- A Restricted Fund Unit Plan (RFU), designed to align the interests of the participants with those of PSP Investments' stakeholders and to help retain key employees.

SHORT-TERM INCENTIVE PLAN

DESCRIPTION OF THE PLAN

PSP Investments' Short-Term Incentive Plan (the "STIP") was established in February 2009, with effect from April 1, 2008. It replaced the Annual Incentive Plan, which was previously in effect.

The STIP is designed to: (i) reward participants for the achievement of superior and sustained individual contributions and for PSP Investments' overall performance; (ii) help attract and retain high-calibre employees; and (iii) align the interests of participants with PSP Investments' stakeholders. PSP Investments' permanent salaried employees and any other employees designated by the President and CEO are eligible to participate in the STIP.

The STIP is a cash-based plan that pays an incentive award to participants, taking into account the achievement of strategic objectives and the investment performance of the assets managed by PSP Investments. Under the STIP, the target incentive, based on a percentage of base salary, is measured on the achievement of individual strategic objectives as well as on investment performance, which may include any combination of (i) the total fund investment performance of PSP Investments; (ii) the investment performance of a particular asset class; or (iii) the investment performance of a portfolio.

At the beginning of each fiscal year, each participant in the STIP is advised of his or her target short-term incentive award. The performance measures chosen and the weighting given to each will depend on the participant's position level. For the first four years of participation in the STIP, participants will go through a transition period building up to a rolling four-year period for calculating the investment performance. The investment performance measure is calculated on the current year investment performance and on the most recent four-year period of participation in the STIP by an employee.

The Human Resources and Compensation Committee reviews the short-term incentive compensation payment process to be satisfied that the payments are calculated in accordance with the terms of the STIP. In addition, the Board of Directors approves the short-term incentive compensation payable to officers of PSP Investments.

FISCAL YEAR 2010 PERFORMANCE

In fiscal year 2010, the total fund investment performance of PSP Investments was above the incentive threshold and, therefore, payouts were earned for that component of the STIP for eligible participants with one year of participation. The total fund performance for periods other than one year, including the four-year period, was below threshold and generated no incentive payment for eligible participants.

The one-year investment performance of Infrastructure, Private Equity and Public Markets was well above threshold while it was below threshold for Real Estate. Therefore, payouts were earned for eligible participants in asset classes that exceeded incentive thresholds. For Private Equity, payouts reached the maximum level for the one and four-year investment performance periods. The one-year investment performance resulted in maximum payouts for Infrastructure and Public Markets. The four-year asset class performance was above threshold for Infrastructure and generated payouts for eligible participants. Eligible participants in Public Markets who generated a four-year performance above threshold also earned payouts. The four-year asset class performance for Real Estate was below threshold and generated no incentive payment.

The results of the strategic objectives component of the STIP indicate that objectives were achieved and, therefore, generated on an aggregate basis the right for eligible employees to receive an incentive award.

The total incentive amount earned under the STIP was $8.8 million in fiscal year 2010 (293 employees), $5.2 million in fiscal year 2009 (277 employees), and $6.1 million in fiscal year 2008 (205 employees).

In addition, the Board of Directors upon recommendation of the Human Resources and Compensation Committee, has approved a special incentive payment equivalent to the total fund component of the STIP at target for PSP employees with more than one year of participation in the plan. As a result, an amount of $2.3 million was paid to 234 employees. The decision of the Board is to recognize that PSP Investments' strong investment performance in fiscal year 2010 is the result of a sound investment strategy adopted over the past several years.

LONG-TERM INCENTIVE PLAN

DESCRIPTION OF THE PLAN

The PSP Investments' Long-Term Incentive Plan (the "LTIP") was established in February 2009, with effect from April 1, 2008. Similarly to the STIP, the LTIP is designed to: (i) reward participants for the achievement of superior and sustained investment performance by PSP Investments; (ii) attract and retain high-calibre employees; and (iii) align the interests of participants with those of PSP Investments' stakeholders.

The LTIP is a cash-based plan that pays a percentage of base salary to participants taking solely into account the achievement of investment performance on the assets managed by PSP Investments. It requires above threshold performance for a four-year period before a payout is earned. It is provided to PSP Investments' employees in eligible managerial positions as well as to other employees who are recommended by the President and CEO and approved by the Human Resources and Compensation Committee of the Board of Directors.

At the beginning of each fiscal year, each participant in the LTIP is advised of his or her target incentive amount. This target incentive amount is based on a forward-looking four-year investment performance, which may include any combination of: (i) the total fund investment performance of PSP Investments and (ii) the investment performance of a particular asset class. The performance measures chosen and the weighting given to each depend on the participant's position level.

The incentive amount payable is determined at the end of the four-year performance period based on the amount by which the total fund actual value added and the asset class actual value added exceeded the incentive thresholds. The incentive amount calculated for the participant is adjusted based on the total fund rate of return over the four-year performance period. This will either increase or decrease the incentive amount payable resulting from the performance of the total fund return over the four-year period.

Until March 31, 2008, long-term incentive compensation awards were granted under the Deferred Incentive Plan, which used a three-year payout cycle. In order to compensate for the gap in the incentive opportunity between the Deferred Incentive Plan's payout cycle and the four-year payout cycle of the LTIP, a shadow Deferred Incentive Plan has been maintained for fiscal year 2009. Awards earned under the Deferred Incentive Plan for fiscal year 2009 will be calculated at the end of fiscal year 2011 for payout in fiscal year 2012.

The Human Resources and Compensation Committee reviews the long-term incentive compensation grant process to be satisfied that the grants are calculated in accordance with the terms of the LTIP. In addition, the Board of Directors approves long-term incentive grants to officers of PSP Investments.

LONG-TERM INCENTIVE PAYMENTS

There were no payments based on the Long-Term Incentive Plan in fiscal year 2010, because the initial four-year cycle had not been completed. The first potential payments on the LTIP will occur in fiscal year 2012.

DEFERRED INCENTIVE PAYMENTS

The Deferred Incentive Plan amounts paid in fiscal year 2010 were amounts earned in fiscal year 2008, with a two-year deferral period. The Human Resources and Compensation Committee is satisfied that the payouts were calculated in accordance with the terms of the Deferred Incentive Plan.

The total incentive amount paid under the Deferred Incentive Plan was $2.0 million in fiscal year 2010, $3.0 million in fiscal year 2009, and $2.6 million in fiscal year 2008.

RESTRICTED FUND UNIT PLAN

PSP Investments' Restricted Fund Unit Plan (the "RFU") was established in February 2009, with effect as of April 1, 2009. Under the RFU, grants of restricted fund units can be made to the President and CEO and, upon recommendation of the President & CEO, to employees who report directly to this position. Discretionary grants may also be made to other participants based on performance-related considerations. The Human Resources and Compensation Committee of the Board of Directors reviews and approves the grants of restricted fund units. In addition, the Board of Director approves grants to officers of PSP Investments.

The grants made under the RFU will vest over a three-year period from the effective date of the grant. The annual amount paid is adjusted by the total fund investment performance for the period covered since the grant.

The total incentive amount paid under the RFU was $0.4 million in fiscal year 2010.

GROUP INSURANCE BENEFITS

The Group Insurance Plan introduced in the fall of 2007 provides the following group insurance benefits: health and dental care, long-term disability, critical illness, life insurance, accidental death and dismemberment, and an employee assistance program. The Group Insurance Plan is intended to ensure a proper balance between employee needs and competitiveness with our peer group.

OTHER REMUNERATION

PSP Investments' executives are provided with a perquisites allowance to cover some expenses frequently offered to executives, such as a car allowance, parking facilities and health and fitness club memberships. In addition, PSP Investments offers its executives a health-and-lifestyle assessment.

RETIREMENT PLANS

All PSP Investments' employees participate in the Public Sector Pension Investment Board Pension Plan (the "Employee Pension Plan") and all eligible employees participate in the Supplemental Employee Retirement Plan of the Public Sector Pension Investment Board (the "SERP").

The Employee Pension Plan provides partially indexed pension benefits, for each year of participation, which are equal to 2% of the employee's best average earnings, being the average of the best three consecutive calendar years of base salary earnings.

The benefits payable under the Employee Pension Plan are limited by the *Income Tax Act* (Canada). The SERP has been established for all employees, as an unfunded arrangement, to provide defined benefits in excess of the Employee Pension Plan, where such benefits are so limited.

Employees participating in the Employee Pension Plan and the SERP contribute 3.5% of their base salary, up to the maximum contribution allowable under the *Income Tax Act* (Canada).

RETIREMENT BENEFITS

Name	Number of Years of Credited Service [1]	Annual Benefit		Accrued Obligation at Start of Year (Final Regulations) [2, 4]	Compensatory Increase [5]	Non-Compensatory Increase [6]	Accrued Obligation at Year End [2, 7]
		At Year End [2]	At Age 65 [2, 3]				
Gordon J. Fyfe	6.50	$62,600	$188,600	$501,400	$53,800	$140,100	$695,300
Derek Murphy	6.08	$37,700	$113,600	$311,200	$36,500	$86,100	$433,800
Jim Pittman	5.17	$21,600	$98,800	$132,300	$17,900	$51,700	$201,900
Neil Cunningham	2.42	$12,000	$80,100	$66,500	$34,100	$33,800	$134,400
Bruno Guilmette	4.42	$22,600	$129,500	$121,600	$20,200	$54,800	$196,600

[1] Number of credited years of service used for both the Employee Pension Plan and the Supplemental Employee Retirement Plan.

[2] Sum of benefits accrued under the Employee Pension Plan and the Supplemental Employee Retirement Plan.

[3] For the purpose of calculating the annual benefits payable at age 65, the final average earnings are calculated as at March 31, 2010.

[4] Accrued obligation using a discount rate of 6.6%. The obligations are calculated as at March 31, 2009 using the assumptions and methods that were used for the accounting disclosures as at December 31, 2008.

[5] Includes service cost at the beginning of the year, the impact of pay different from that reflected in last year's calculation (difference in the accrued obligation between the expected and the actual salary) and impact of amendments to the pension plans if any.

[6] Includes change in assumptions, non-pay-related experience (which includes the interest cost for the year, employee contributions made in the year and benefit payment made in the year).

[7] Accrued obligation using a discount rate of 6.0%. The obligations are calculated as at March 31, 2010 using the assumptions and methods that were used for the accounting disclosures as at December 31, 2009.

SUMMARY COMPENSATION TABLE

Total compensation paid to PSP Investments' five highest-paid officers in fiscal year 2010 totalled $5,852,446, an increase of $794,661 over the $5,057,785 reported in the 2009 annual report. The increase is mainly due to the strong performances of the Private Equity and Infrastructure asset classes which triggered payments well above target under the STIP.

Compensation paid during the fiscal year 2010 to five highest-paid officers of PSP Investments includes the payment of amounts earned over the four-year period ended March 31, 2008 under the Deferred Incentive Plan and deferred for two years as a retention mechanism.

Name	Fiscal Year	Base Salary	Short-term Incentive Plan	Deferred Incentive Plan [1]	Restricted Fund Units	Benefits and Other Compensation	Pension and SERP Plans	Total Compensation
Gordon J. Fyfe	2010	$485,000	$552,900	$37,280	$0	$35,768	$53,800	$1,164,748
President and Chief Executive Officer	2009	$485,000	$189,122	$611,100	n/a	$35,876	$98,500	$1,419,598
	2008	$466,000	$153,780	$546,163	n/a	$32,062	$83,100	$1,281,105
Derek Murphy	2010	$314,000	$749,178	$400,851	$17,117	$25,619	$36,500	$1,543,265
First Vice President, Private Equity Investments	2009	$314,000	$117,762	$336,105	n/a	$25,668	$66,200	$859,735
	2008	$300,000	$389,773[2]	$257,093	n/a	$22,062	$58,100	$1,027,028
Jim Pittman	2010	$215,000	$505,609	$323,598	$30,285	$80,131	$17,900	$1,172,523
Vice President, Private Equity Investments	2009	$214,942	$71,509	$199,682	n/a	$16,104	$37,900	$540,137
	2008	$200,000	$131,478	$95,189	n/a	$16,271	$20,700	$463,638
Neil Cunningham	2010	$260,000	$158,600	$555,153	$9,449	$25,710	$34,100	$1,043,012
First Vice President, Real Estate Investments	2009	$260,000	$180,760	$364,673	n/a	$25,660	$49,200	$880,293
	2008	$240,365	$531,026	$314,612	n/a	$19,562	$11,200	$1,116,765
Bruno Guilmette	2010	$263,000	$505,151	$0	$14,337	$126,210	$20,200	$928,898
First Vice President, Infrastructure Investments	2009	$263,000	$310,941	$423,542	n/a	$24,748	$40,000	$1,062,231
	2008	$250,000	$240,000	n/a	n/a	$24,516	–	$514,516
Derek Watchorn [3]	2009	$237,188	–	$435,031	n/a	$616,403[4]	$10,071	$1,298,693
President and Chief Executive Officer of Revera Inc.	2008	$569,250	$390,648	$538,000	n/a	$25,295	$10,000	$1,533,193
	2007	$568,880	$426,938	$199,552	n/a	$34,261	$9,500	$1,239,131

Notes

[1] Amounts paid in fiscal year 2010 were earned in fiscal year 2008.

[2] The award was recalculated in fiscal year 2009 using a revised benchmark result for fiscal year 2008.

[3] Mr. Watchorn is not an employee of PSP Investments, but was employed by Revera Inc., a wholly-owned subsidiary of PSP Investments until May 30, 2009. His compensation is based on a contract with Revera Inc. Revera Inc.'s financial year ends on December 31.

[4] Amount includes an installment paid as of June 1, 2009 in accordance with Mr. Watchorn's severance agreement.

LONG-TERM INCENTIVE PLAN AWARDS GRANTED FOR FISCAL YEAR 2010

The following table shows the range of future potential payouts. Payments will be based on PSP Investments' total fund performance and asset class performance.

Name	Award Type	Fiscal 2010 Grant	Vesting Period	Estimated Future Payouts[1]		
				Threshold[2]	Target	Maximum
Gordon J. Fyfe	LTIP	$485,000	4 years	$0	$485,000	$2,425,000
	RFU	$0	–	n/a	–	–
Derek Murphy	LTIP	$282,600	4 years	$0	$282,600	$1,413,000
	RFU	$42,390	3 years	n/a	$42,390	$42,390
Jim Pittman	LTIP	$150,500	4 years	$0	$150,500	$752,500
	RFU	$75,000	3 years	n/a	$75,000	$75,000
Neil Cunningham	LTIP	$234,000	4 years	$0	$234,000	$1,170,000
	RFU	$23,400	3 years	n/a	$23,400	$23,400
Bruno Guilmette	LTIP	$236,700	4 years	$0	$236,700	$1,183,500
	RFU	$35,505	3 years	n/a	$35,505	$35,505

1 Actual payouts will be adjusted upwards or downwards by PSP Investments' compound rate of return over the performance vesting periods.

2 Threshold refers to the minimum amount payable for a certain level of performance, below which level no award is payable.

LONG-TERM INCENTIVE PLAN AWARDS ACCUMULATED VALUE

The total accumulated value[1] as at March 31, 2010 of all long-term incentive awards granted but not yet vested or paid to PSP Investments' five highest-paid officers is shown in the following table.

Name	Plan	Awards paying out at the end of fiscal year			Total
		2011	2012	2013	
Gordon J. Fyfe	DIP	$0	n/a	n/a	$0
	LTIP	n/a	$0	$947,236	$947,236
	RFU	$0	$0	–	$0
Derek Murphy	DIP	$46,502	n/a	n/a	$46,502
	LTIP	n/a	$301,207	$801,884	$1,103,091
	RFU	$17,117	$17,117	–	$34,322
Jim Pittman	DIP	$39,620	n/a	n/a	$39,620
	LTIP	n/a	$256,655	$506,915	$763,570
	RFU	$30,285	$30,205	–	$60,726
Neil Cunningham	DIP	$200,556	n/a	n/a	$200,556
	LTIP	n/a	$0	$228,509	$228,509
	RFU	$9,449	$9,449	–	$18,898
Bruno Guilmette	DIP	$377,809	n/a	n/a	$377,809
	LTIP	n/a	$247,935	$627,660	$875,595
	RFU	$14,337	$14,337	–	$28,674

1 LTIPs' accumulated values are estimated by using actual total fund and asset class performance for those years where performance is known and a multiplier of one (1.0x) for future years. DIPs' and RFUs' accumulated values reflect PSP Investments' total fund rate of return for fiscal year 2010 but no returns for future years.

POST-EMPLOYMENT POLICIES

All senior executive officers of PSP Investments have a contractual agreement.

The President and CEO's severance pay is equivalent to two times his annual base salary, plus two times the average annual amount earned under the short-term and long-term incentive plans for the three-year period prior to the termination.

For the First Vice Presidents, the severance pay is set at 12 months of base salary and target STIP award, plus one month of salary and target STIP award (one-twelfth of the full-year target STIP award) for every year of service, up to a maximum of 18 months. Insured benefits such as health, dental and life insurance are continued during the severance period.

The next table shows the potential payments that would be made upon termination (without cause) for the five highest-paid officers at PSP Investments.

Name	Years of service [1]	Severance [2]	Resignation	Retirement [3]
Gordon J. Fyfe	6.58 years	$2,746,910	$0	n/a
Derek Murphy	6.0 years	$894,900	$0	n/a
Jim Pittman [4]	5.17 years	n/a	n/a	n/a
Neil Cunningham	5.79 years	$699,833	$0	n/a
Bruno Guilmette	4.33 years	$666,267	$0	n/a

[1] Assumes a notional termination as at March 31, 2010.

[2] Excludes incentive compensation amounts payable for the current year, which are included in the Summary Compensation Table.

[3] None of the five-highest paid officers for fiscal year 2010 are eligible for retirement.

[4] There is no contractual agreement for Mr. Jim Pittman.

GLOSSARY

A

ACT
The *Public Sector Pension Investment Board Act* is the legislation that governs PSP Investments.

ACTIVE INVESTMENT MANAGEMENT
The application of manager skills in selecting investments, with the goal of earning higher returns than the general market.

ACTIVE RISK
The probability of investment losses from active investment management relative to a benchmark.

ANNUAL REPORT
A publication that includes the audited financial statements of an organization as well as management's discussion and analysis of its financial results and operations. PSP Investments' annual report must be issued within 90 days of its March 31 year-end and tabled by the President of the Treasury Board in the House of Commons and the Senate.

ANNUALIZED RATE OF RETURN
A rate of return expressed over one year, although the actual rates of return being annualized are for periods longer or shorter than one year.

ASSET-BACKED COMMERCIAL PAPER (ABCP)
Short-term corporate securities, typically with a maturity of less than one year, issued by a bank or other conduit, which are backed by assets such as real estate, auto loans or other commercial assets.

ASSET-BACKED TERM NOTES (ABTN)
Long-term notes created through the securitization of a pool of assets such as real estate, auto loans or other commercial assets.

ASSET MIX
The proportion of assets invested in cash, fixed income securities, equities and other asset classes. Asset mix should reflect an investor's investment goals and risk tolerance.

ASSET MIX POLICY
Policy setting the guidelines for the management of the asset mix needed to achieve an expected level of investment returns. Pension funds set their asset mix policy to ensure that investment returns plus plan member contributions are sufficient to pay all current and future pension benefits. In making our investment decisions, we take into consideration the financial obligations of the pension plans for which PSP Investments invests money.

B

BASIS POINT OR BPS
One-hundredth of a percentage point. The difference between 5.25% and 5.50% is 25 basis points.

BENCHMARK
A standard against which rates of return can be measured, such as stock and bond market indices developed by stock exchanges and investment dealers.

BRIC
BRIC or BRICs are terms used in economics to refer to the combination of Brazil, Russia, India, and China.

C

CAPITALIZATION RATE (CAP RATE)
The net operating income produced by a real estate asset divided by its market value. Capitalization rate is an indirect measure of how fast an investment will pay for itself and is typically used to compare real estate property values.

CASH EQUIVALENTS
Short-term, highly liquid securities (e.g. commercial paper, treasury bills, demand notes) with a term to maturity of less than one year from the date of issue. These investments are relatively easy to convert into cash.

CFA INSTITUTE
CFA Institute (CFA®) is an international, non-profit organization of more than 96,000 investment practitioners and educators in over 133 countries and territories. The investment performance standards of the CFA Institute detail methodology and guidelines that promote uniformity in reporting investment performance.

COLLATERALIZED DEBT OBLIGATIONS
A type of asset-backed security that is constructed from a portfolio of fixed income assets. Collateralized debt obligations are usually divided into several tranches with different risk levels and corresponding interest payments. Any losses are applied first to the more junior tranches (lowest risk rating), before moving up in seniority.

COST VALUE (OR BOOK VALUE)
The purchase price, or original cost, of an investment.

COUNTERPARTY RISK
The risk to each party of a contract that the counterparty will not live up to its contractual obligations.

CREDIT RISK
Risk of loss resulting from the failure of a borrower or counterparty to honour its financial or contractual obligations.

CUSTODIAN
An independent organization entrusted with holding investments on behalf of the owner. The custodian maintains the financial records for the investments and may perform other services for the owner as well.

GLOSSARY

D

DERIVATIVE FINANCIAL INSTRUMENTS (DERIVATIVES)
Financial contracts that derive their value from an underlying asset or index, such as an interest rate or foreign currency exchange rate. For example, a derivative contract based on the S&P 500 Index of large US stocks fluctuates in value with the index, but involves buying one contract rather than each stock in the index. Derivatives can be less expensive and easier to acquire than the underlying assets. They can be used to manage risk, reduce cost and enhance returns. Some common derivatives are forwards, futures, swaps and options.

DISCOUNT RATE
The interest rate used in determining the present value of future cash flows.

DIVERSIFICATION
A strategy to spread investment risk among different asset classes (stocks and bonds), among different types of assets (public and private equities, real estate, infrastructure), among securities (different stocks), among economic sectors (financial services and natural resources) and among different countries.

E

EQUITIES (OR STOCKS)
Financial instruments that represent an ownership interest in a corporation, as well as a claim to proportionate shares of that corporation's assets and earnings.

F

FAIR VALUE
An estimate of the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

FISCAL YEAR
A company's accounting or financial reporting year. PSP Investments' fiscal year commences April 1 and ends March 31.

FIXED INCOME SECURITIES
Securities, such as bonds, mortgages, debentures and preferred shares that generate a predictable stream of interest by paying a fixed rate of return until a specific date, maturity or redemption.

FOREIGN CURRENCY RISK
The risk that an investment's value will be affected by changes in exchange rates. International investments cause investors to face the risk of currency fluctuations.

FUNDING REQUIREMENTS
Total contributions (employers and employee) required to fund the financial obligations of the Plans.

G

GENERAL PARTNER
The managing partner in a Limited Partnership. The General Partner receives a management fee and a percentage of the Limited Partnership's profits, and acts as the intermediary between investors with capital and businesses seeking capital to grow.

I

INDEX
A broad-based measurement of a general market trend. Called an index because it is designed to reflect not only price changes, but value changes as well.

INDEX FUND
An investment fund that closely replicates the return of a market index.

INFLATION-LINKED
That has a behaviour highly correlated with inflation.

INFRASTRUCTURE
Long-term capital facilities such as highways, utilities, airports and pipelines offering essential services to the community. Investments in infrastructure assets are attractive due to the low volatility of returns and desirable revenue characteristics such as predictability and sensitivity to inflation.

INTEREST RATE RISK
The risk that an investment's value will change due to fluctuations in interest rates. Long-term fixed income securities, such as bonds and preferred stock, subject their owners to the greatest amount of interest rate risk. Short-term securities, such as Treasury bills, are influenced much less by interest rate movements.

INTERNAL RATE OF RETURN (IRR)
The discount rate at which the net present value of an investment equals zero.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)
IFRS is the collection of financial reporting standards developed by the International Accounting Standards Board (IASB), an independent, international standard-setting organization. The Canadian Accounting Standards Board (AcSB) is adopting IFRS for all Publicly Accountable Enterprises (PAEs) effective January 1, 2011. These changes are part of a worldwide shift to IFRS; they are intended to facilitate global capital flows and bring greater clarity and consistency to financial reporting in the global marketplace.

INVESTMENT MANAGEMENT FEE
An annual fee paid to an investment manager for its services. The fee can be based on the level of assets under management, or on the performance of the portfolio.

L

LETTER OF CREDIT
A document a corporation obtains from its financial institution that guarantees payment to a third party.

LEVERAGE
The use of various financial instruments or borrowed capital, such as loans, to increase the potential return of an investment.

LIMITED PARTNER
An investor in a Limited Partnership (i.e., private equity fund).

LIMITED PARTNERSHIP
The legal structure used by most venture and private equity funds. Created pursuant to a Limited Partnership Agreement entered into between a General Partner and one or more Limited Partners, a limited partnership is usually a fixed-life investment vehicle. The partnership is managed by the General Partner using policy laid down in the Limited Partnership Agreement. This agreement also covers terms, fees, structures and other items agreed on between the Limited Partners and the General Partner. The Limited Partners receive income, capital gains and tax benefits.

LIQUIDITY RISK
Liquidity risk is the risk of financial loss as a result of an institution's inability to meet day-to-day financial obligations as they come due, or the liquidation of an asset in adverse market conditions. The main sources of liquidity risk are treasury movements, renewal of corporate borrowings and contingency collateral calls.

M

MARKET RISK
Market risk is the risk of loss due to changes in the level, volatility and correlation of equity prices, the term structure of interest rates, as well as currency and commodity spot and forward prices.

MARK-TO-MARKET
A measure of the fair value of investments at a specified point in time. Mark-to-market adjustments aim to provide a realistic appraisal of a company's current financial situation.

MASTER NETTING AGREEMENT/ARRANGEMENT
An agreement/arrangement that allows an entity undertaking multiple financial instrument transactions with a single counterparty to make a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any contract.

MEZZANINE DEBT FINANCING
The use of subordinated debt together with equity to finance a company. Investors in subordinated instruments stand behind those with senior instruments such as bonds. To enhance investment returns, the subordinated instrument may have stock conversion features such as rights, warrants or options.

MSCI EAFE INDEX
A stock index created by Morgan Stanley Capital International (MSCI) to measure the returns of investments in Europe, Australia and the Far East. It contains stocks from 21 countries, including Japan, Australia, Hong Kong, New Zealand, Singapore, the UK and the Eurozone countries.

N

NET PRESENT VALUE (NPV)
The present value of an investment's future net cash flows less the initial investment.

NOTIONAL AMOUNTS
The principal used to calculate interest and other payments on derivative contracts.

O

OPTION
A derivative contract that grants the owner the right, but not the obligation, either to buy or sell a specified quantity of an asset at a fixed price on or before a specific date.

P

PASSIVE INVESTMENT MANAGEMENT
A strategy designed to replicate a market index return.

PENSION FUND ACCOUNT
Created effective April 1, 2000 by the federal government to receive the employer and employee net contributions in respect of the pension plans to provide for liabilities for service since April 1, 2000. There are four pension fund accounts, one for each of the Public Service Pension Plan, the Canadian Forces Pension Plan and the Royal Canadian Mounted Police (RCMP) Pension Plan. A pension fund account was also set up effective March 1, 2007, for the Reserve Force Pension Plan.

PENSION PLAN ACCOUNT (OR PLAN ACCOUNT)
Separate accounts established by PSP Investments for each of the pension fund accounts to receive from the government the pension fund account's proceeds of the net contributions as well as the allocation of its investments and the results of its operations. There are four pension plan accounts, one for each pension fund. The combined results of the four pension plan accounts are referred to as the "Consolidated Plan Account".

PENSION PLANS (OR PLANS)
The pension plans of the federal Public Service, the Canadian Forces, the Royal Canadian Mounted Police and the Reserve Force.

PLAN LIABILITIES
Plan liabilities represent the financial obligations of a pension plan relative to the benefits earned by the plan participants. The liabilities correspond to the value calculated by the pension actuary of all accrued benefits as of the date of valuation payable in the future.

GLOSSARY

POLICY PORTFOLIO
The asset mix, set by the Board of Directors, identifying how the funds managed should be allocated between different asset classes (example: cash, fixed income securities, equities, real estate, etc.).

PORTFOLIO
A group of investments, such as equities and bonds and possibly financial instruments such as derivatives, grouped for investment purposes.

PRIVATE EQUITY
Ownership interest in assets that do not trade on public exchanges or over the counter, or interests in a publicly-traded security with restrictions on liquidity.

PUBLIC MARKET SECURITIES
Investments in interest-bearing and equity securities traded on recognized public exchanges worldwide.

R

RETURN (OR RATE OF RETURN)
The percentage of change in asset value in a particular period, consisting of income (such as interest, dividends or rent), plus realized and unrealized capital gains or capital losses.

RISK
The probability of investment losses, either in absolute terms or versus a benchmark.

RISK-ADJUSTED RETURN
A measure of investment return adjusted to reflect the risk that was assumed to produce that return.

S

SECURITIES LENDING
Securities lending is the temporary loan of a security from one investor to another. Loaned securities are generally collateralized, reducing the lender's credit exposure to the borrower. Except for the right to vote proxies, the lender retains entitlement to all the benefits of owning the original securities, including the receipt of dividends and interest. Additionally, the lender receives a fee for the use of the securities and can reinvest the collateral. The lender, however, bears the market risk of the loaned securities. This is due to the borrower being obligated to ultimately return the original securities, not the original market value of the securities at the time the loan was made.

SHORT SELLING
The selling of a security that the seller does not own at the time of sale. The seller will borrow the security in order to complete the delivery. Short-sellers assume that they will be able to buy the security for less than the price at which they sold short.

S&P/TSX EQUITY INDEX
The most diversified Canadian market index, representing almost 90% of the capitalization of Canadian-based companies listed on the TSX, excluding income trusts. A committee of the Toronto Stock Exchange and Standard and Poor's selects companies for inclusion in the S&P/TSX Equity Index.

STANDARD AND POOR'S 500 COMPOSITE INDEX (S&P 500 TOTAL RETURN INDEX)
A US index consisting of 500 stocks chosen for market size, liquidity and industry group representation. It is a market-value-weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value. The Standard and Poor's company selects stocks for inclusion in the Index.

STATEMENT OF INVESTMENT POLICIES, STANDARDS AND PROCEDURES (SIP&P)
A written investment policy approved by PSP Investments' Board of Directors, and reviewed at least annually, relating to each Pension Plan. This is a requirement under paragraph 7(2)(a) of the Act. It addresses matters such as categories of investments; use of derivative products; asset diversification and expected investment returns; management of credit, market and other financial risks; liquidity of investments; lending of cash and securities; evaluation of investments that are not regularly traded on a public exchange; and the exercise of any voting rights that PSP Investments has through its investments.

STRUCTURED INVESTMENT VEHICLE
A structured investment vehicle (SIV) is a fund that borrows money by issuing short-term securities at low interest and then lends that money by buying long-term securities at higher interest, making a profit for investors from the difference.

SUBPRIME MORTGAGE
A type of mortgage loan that is normally made to borrowers with low credit quality; as a result, lending institutions often charge a higher rate of interest on subprime mortgages to compensate themselves for carrying more risk.

SWAPS
Financial derivatives in which two counterparties exchange one stream of cash flows for another stream. Swaps can be used to hedge risk or to speculate on market outcomes. For example, in an interest-rate swap one party could agree to pay a fixed interest rate and receive an adjustable rate from another party. There are many other types of swaps, including currency swaps, debt-equity swaps and credit-default swaps.

T

TIME-WEIGHTED RATE OF RETURN

A return calculation methodology that eliminates the impact of cash flows into (or out of) a portfolio. This methodology recognizes the fact that managers have no control over the size and timing of cash flows.

V

VALUE-AT-RISK (VaR)

A method used to measure market risk. VaR is the maximum loss not exceeded within a given probability (defined as the "confidence level"), over a given period of time.

VOLATILITY

Generally refers to variability (in frequency and magnitude) of returns around an average or reference point over a period of time.

MANAGEMENT TEAM

GORDON J. FYFE
President and Chief Executive Officer

JOHN VALENTINI
Executive Vice President, Chief Operating Officer and Chief Financial Officer

GUY ARCHAMBAULT
First Vice President, Human Resources

NEIL CUNNINGHAM
First Vice President, Real Estate Investments

DANIEL GARANT
First Vice President, Public Market Investments

BRUNO GUILMETTE
First Vice President, Infrastructure Investments

DEREK MURPHY
First Vice President, Private Equity

DIRECTORS'

BIOGRAPHIES

PAUL CANTOR

Chair, PSP Investments
Senior Advisor, Bennett Jones LLP

MEMBER:
Investment Committee

Board member since March 28, 2000

Mr. Cantor is Senior Advisor at Bennett Jones LLP. He is also Chair of the York University Board of Governors and sits on the Boards of ING Bank of Canada and of Intact Financial Corporation. Mr. Cantor previously served as Chair & CEO of National Trust Company; President & CEO of Confederation Life; President, Investment Bank, Canadian Imperial Bank of Commerce (CIBC); and Managing Partner of Russell Reynolds Associates Canada. As well, he has held Board appointments at CIBC, National Trust Company, Torstar, E-L Financial and Hees International Bancorp. Mr. Cantor was the founding Executive Director of the World Bank/Government of Canada-sponsored International Leadership Centre for Financial Sector Supervision at York University. He began his career at the Government of Canada's Department of Finance and subsequently worked at Polysar Limited, a federal crown corporation.

Mr. Cantor is a former Chair of the Canadian Bankers Association's Taxation Committee and acted as Chair of the ICD Commission on the Governance of Executive Compensation. He also served on the Federal Reserve Bank of New York's International Capital Markets Committee; on Revenue Canada Taxation's Advisory Committee; and on the Ontario Premier's Council on Economic Renewal.

Mr. Cantor holds a BA from the University of Alberta, an LLB from the University of Toronto and is a Fellow of the Institute of Canadian Bankers (Ryerson University).

JAMIE BAILLIE

President and Chief Executive Officer
Credit Union Atlantic

MEMBER:
Audit and Conflicts Committee /
Governance Committee /
Investment Committee /

Board member since March 5, 2007

Mr. Baillie was appointed President & CEO of Credit Union Atlantic in 2005. He is also a member of the Equifax Canada, Inc. Advisory Board. Previously, Mr. Baillie served for three years as Chief of Staff, Office of the Premier of Nova Scotia, and was a Partner with the executive search firm Robertson Surrette. For the past four years, Mr. Baillie has been named one of Atlantic Canada's Top 50 CEOs by *Atlantic Business* magazine. An active community volunteer, he is a member of the Boards of Dalhousie University and the Halifax International Airport Authority, and past-chair of the Board of Neptune Theatre. Mr. Baillie holds a B.Comm. from Dalhousie University, a Chartered Accountant (CA) designation, and is a graduate of the Canadian Securities Institute.

BOB BALDWIN

Consultant

MEMBER:
Governance Committee – Chair /
Human Resources and Compensation Committee / Investment Committee /
Special Committee*

Board member since March 28, 2000

Mr. Baldwin is an Ottawa-based consultant who specializes in pensions, ageing society and labour-market issues. Previously, he was Director of Social and Economic Policy at the Canadian Labour Congress (CLC) and was the CLC's pension specialist from 1977 to 2005. Mr. Baldwin is a member of the Committee on Professional Conduct of the Canadian Institute of Actuaries; he chairs the Board of Trustees of the Canada Wide Industrial Pension Plan; and advises the Trade Union Advisory Committee to the Organisation for Economic Co-Operation and Development (OECD) on pension issues. A Senior Associate with Informetrica Limited, Mr. Baldwin is also an Adjunct Research Professor at Carleton University and a Policy Associate of the Caledon Institute of Social Policy. He holds a Masters Degree in Political Science from the University of Western Ontario.

DIRECTORS'

BIOGRAPHIES

CHERYL BARKER *Corporate Director* MEMBER: Audit and Conflicts Committee / Governance Committee / Investment Committee Board member since December 18, 2006	Ms. Barker is a member of the Board of Directors and Chair of the Audit Committee of Canada Media Fund and also serves as a trustee and Chair of the Audit Committee of Lanesborough REIT. She was President of Manitoba Telecom Services Inc. (MTS) from 2004 until her retirement in February 2006. Ms. Barker's career at MTS spanned 19 years, during which she served in a variety of key positions, including President and COO of MTS Communications Inc.; Chair, President and CEO of Bell Intrigna Inc.; and CFO and Treasurer of MTS. A Chartered Accountant (CA), Ms. Barker holds a B.Sc. as well as a Certificate in Education from the University of Manitoba.

LÉON COURVILLE *Corporate Director* MEMBER: Governance Committee / Human Resources and Compensation Committee / Investment Committee Board member since March 5, 2007	Mr. Courville has devoted his entire career to the sciences of management and finance, serving first as a professor and researcher at universities in Canada and the United States before being appointed President of the National Bank of Canada. He is enjoying an active "retirement" as a corporate director and proprietor of the Domaine Les Brome vineyard, which he founded in 1999. Mr. Courville is a member of the Boards of Directors of Nav Canada, the *Institut de Tourisme et d'Hôtellerie du Québec* and the *Institut Économique de Montréal*. His research and publications have garnered awards and bursaries in Canada and abroad, including the Coopers & Lybrand Award for his work entitled *The Storm - Navigating the New Economy*. Mr. Courville holds a Ph.D. in Economics from Carnegie-Mellon University.

ANTHONY R. GAGE *Corporate Director* MEMBER: Human Resources and Compensation Committee / Investment Committee – Chair / Special Committee* Board member since June 27, 2006	Mr. Gage sits on the Board of Governors of the University of Victoria, is a Director of Sky Investment Counsel and Head of the Management Committee of JEA Pension System Solutions. He is a former Chair of the Board of Phillips, Hager & North Investment Management. His career at Phillips, Hager & North, where he served as President and CEO from 1994 to 1999, spanned more than 20 years. Previously, Mr. Gage was Assistant Vice-President and Director of Confed Investment Counseling, the pension fund management arm of Confederation Life. Mr. Gage holds a BA (Economics) from the University of Victoria and an MBA (Finance) from the University of British Columbia. He is a Chartered Financial Analyst (CFA) and an accredited Chartered Director (McMaster University).

LYNN HAIGHT *Corporate Director* MEMBER: Audit and Conflicts Committee / Investment Committee Board member since January 14, 2010	Ms. Haight retired as Chief Operating Officer and Chief Financial Officer of the Foresters insurance organization. She previously served as Vice President, US Fixed Annuities, and Chief Accountant of Manulife Financial. A corporate director and consultant, Ms. Haight is a Trustee and Chair of the Audit Committee of the Ontario Arts Council. She also sits on the Boards of the World Bank's Consortium of International Agricultural Research Centres, Green Shield Canada and Somerville College, Oxford University. She has served as Chair of Foresters Holdings Europe, Chair of the World Agroforestry Centre in Nairobi, Kenya, and Chair of the Sectoral Advisory Group for business services to the federal Minister of Trade. Ms. Haight holds an MA Honours from Oxford. She is a Fellow of the Canadian Institute of Chartered Accountants, a Fellow of the Canadian Association of Management Consultants and a Certified Corporate Director.

JEAN LEFEBVRE *Corporate Director* **MEMBER:** Human Resources and Compensation Committee / Investment Committee / Special Committee* - Chair Board member since August 25, 2003	Mr. Lefebvre is an independent asset-management consultant. From 1998 to 2001, he served as Senior Vice-President of TAL Global Asset Management. Previously, Mr. Lefebvre worked as a pension and asset-management consultant with William M. Mercer and Tomenson-Alexander. He began his career at the Dominion Life Insurance Company as actuarial assistant, and later held the position of Chief Actuary at AEterna Life and at Westmount Life, where he was also Chief Administrative Officer and a member of the Board of Directors. For many years, he also was a lecturer in actuarial science at the *Université de Montréal* . Mr. Lefebvre holds a BA and a B.Sc. from the *Université de Montréal*. He is a Fellow of the Society of Actuaries and of the Canadian Institute of Actuaries.

WILLIAM A. MACKINNON *Corporate Director* **MEMBER:** Audit and Conflicts Committee – Chair since February 9, 2010 / Investment Committee Board member since January 14, 2010	Mr. Mackinnon is a member of the Boards of Directors of Telus, Pioneer Petroleum and Novadaq Technologies. Very active in professional and community circles, he serves as Chair of the Board of Directors of the Toronto Board of Trade, Vice-Chair of the Board of the Institute of Chartered Accountants of Canada, Vice-Chair of The Toronto East General Hospital Board, and as a member of the Board of of the C.D. Howe Foundation and Co-Chair of its Tax Policy Committee. He is also a member of the Boards of the Toronto Community Foundation and Roy Thomson Hall and, in 2008, served as Chair of Campaign for the Toronto United Way. Mr. Mackinnon joined KPMG Canada in 1968, became a Partner in 1977 and was the firm's Chief Executive Officer from 1999 until his retirement at the end of 2008. He also served on the KPMG International Board of Directors. Mr. Mackinnon holds a B.Comm. from the University of Manitoba. He obtained his Chartered Accountant (CA) designation in 1971 and became a FCA in 1994.

MICHAEL P. MUELLER *Corporate Director* **MEMBER:** Human Resources and Compensation Committee – Chair / Investment Committee / Special Committee* Board member since December 18, 2006	Mr. Mueller is Chairman of the Board of the Scarborough Hospital, and a member of the Boards of AIM Therapeutics, Biovest Corp. I, Budco, Annidis Corp, and the Scarborough Hospital Foundation. He also serves as a strategic advisor to a number of Canadian, US and European companies. From 2003 to 2005, he was President and CEO of MDS Capital Corporation. Mr. Mueller previously held a series of senior executive positions at TD Bank, including Vice Chairman and Global Head of Investment and Corporate Banking. He is a former member of the Boards of Directors of TM BioScience, the Katimavik Foundation, MDS Capital and Canadian Medical Discoveries Funds I and II. Mr. Mueller holds a B.Sc. from the University of Western Ontario and an MBA from York University.

* The Special Committee was wound up on February 9, 2010.

FINANCIAL STATEMENTS AND NOTES TO THE FINANCIAL STATEMENTS

TABLE OF CONTENTS

APPENDIX

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

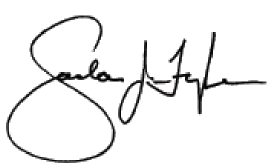
The consolidated financial statements of the Public Sector Pension Investment Board ("PSP Investments") as well as the financial statements of the Public Service, the Canadian Forces, the Royal Canadian Mounted Police and the Reserve Forces Pension Plan Accounts ("the financial statements") have been prepared by management and approved by the Board of Directors. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Management is responsible for the contents of the financial statements and the financial information contained in the annual report.

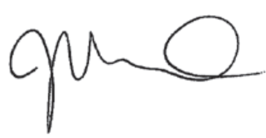
PSP Investments maintains records and systems of internal control and supporting procedures to provide reasonable assurance that PSP Investments' assets are safeguarded and controlled, and that transactions are in accordance with the applicable provisions of Part X of the *Financial Administration Act* and, as appropriate, the *Public Sector Pension Investment Board Act* ("the Act"), the accompanying regulations, the by-laws, and the Statement of Investment Policies, Standards and Procedures ("the SIP&P").

In this regard, investments of PSP Investments held during the year ended March 31, 2010 were in accordance with the Act and the SIP&P.

The Audit and Conflicts Committee assists the Board of Directors in discharging its responsibility to approve the annual financial statements. The Committee meets regularly with both management and the external auditors to discuss the scope and findings of audits and other work that the external auditors may be requested to perform from time to time, to review financial information, and to discuss the adequacy of internal controls. The Committee reviews the annual financial statements and recommends them to the Board of Directors for approval.

PSP Investments' external "joint" auditors, the Office of the Auditor General of Canada and Deloitte & Touche LLP ("the External Auditors"), have conducted an independent examination of the financial statements in accordance with Canadian generally accepted auditing standards, performing such tests and other procedures as they consider necessary to express an opinion in their Auditors' Report. The External Auditors have full and unrestricted access to management and the Audit and Conflicts Committee to discuss findings related to the integrity of PSP Investments' financial reporting and the adequacy of internal control systems.





Gordon J. Fyfe
President and
Chief Executive Officer
May 10, 2010

John Valentini
Executive Vice President,
Chief Operating Officer and Chief Financial Officer
May 10, 2010

INVESTMENT CERTIFICATE

The *Public Sector Pension Investment Board Act* ("the Act") requires that a certificate be signed by a director on behalf of the Board of Directors, stating that the investments of the Public Sector Pension Investment Board ("PSP Investments") held during the financial year were in accordance with the Act and PSP Investments' investment policies, standards and procedures. Accordingly, the Investment Certificate follows:

"The investments of PSP Investments held during the year ended March 31, 2010, were in accordance with the Act and PSP Investments' Statement of Investment Policies, Standards and Procedures".

Paul Cantor
Chairperson
May 10, 2010

PUBLIC SECTOR PENSION INVESTMENT BOARD

CONSOLIDATED

AUDITORS' REPORT

To the President of the Treasury Board

We have audited the Consolidated Balance Sheet of the Public Sector Pension Investment Board (PSP Investments) as at March 31, 2010, and the Consolidated Statements of Net Income (loss) from Operations and Comprehensive Income and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of PSP Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of PSP Investments as at March 31, 2010, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of PSP Investments and of its wholly-owned subsidiaries that have come to our notice during our audit of the consolidated financial statements have, in all significant respects, been in accordance with the applicable provisions of Part X of the *Financial Administration Act* and regulations, the *Public Sector Pension Investment Board Act* and regulations and the by-laws of PSP Investments and its wholly-owned subsidiaries.

Deloitte & Touche LLP[1]

[1] Chartered accountant auditor permit No. 18527

Montreal, Canada
May 10, 2010

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 10, 2010

CONSOLIDATED BALANCE SHEET

As at March 31

($ millions)	2010	2009
ASSETS		
Investments (Note 3 (a))	**$ 48,359**	$ 38,259
Investment-related assets (Note 3 (a))	**627**	741
Cash	**2**	1
Other assets	**47**	40
TOTAL ASSETS	**$ 49,035**	$ 39,041
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 2,709**	$ 5,203
Accounts payable and other liabilities	**56**	61
TOTAL LIABILITIES	**$ 2,765**	$ 5,264
NET ASSETS	**$ 46,270**	$ 33,777
Share capital (Note 5)	**$ –**	$ –
Public Service Pension Plan Account	**33,661**	24,496
Canadian Forces Pension Plan Account	**9,107**	6,750
Royal Canadian Mounted Police Pension Plan Account	**3,271**	2,416
Reserve Force Pension Plan Account	**231**	115
NET ASSETS	**$ 46,270**	$ 33,777

Commitments (Note 13)

The accompanying notes are an integral part of the consolidated financial statements.

On behalf of the Board of Directors:

Paul Cantor
Chair of the Board

William A. MacKinnon
Chair of the Audit and Conflicts Committee

PUBLIC SECTOR PENSION INVESTMENT BOARD

CONSOLIDATED STATEMENT OF NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME

For the year ended March 31

($ millions)	2010	2009
INVESTMENT INCOME (LOSS) (Note 7)	**$ 7,605**	$ (9,493)
OPERATING EXPENSES (Note 8)	**$ 92**	$ 86
NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME (Note 9)	**$ 7,513**	$ (9,579)

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2010	2009
NET ASSETS, BEGINNING OF YEAR	**$ 33,777**	$ 38,925
Fund transfers (Note 6)	**4,980**	4,431
Net income (loss) from operations and comprehensive income	**7,513**	(9,579)
Increase (decrease) in net assets for the year	**12,493**	(5,148)
NET ASSETS, END OF YEAR	**$ 46,270**	$ 33,777

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) is a crown corporation established under the *Public Sector Pension Investment Board Act* ("the Act") with a mandate to invest the net contributions of the Public Service, Canadian Forces, Royal Canadian Mounted Police and Reserve Force pension plans in financial markets.

The Public Service, Canadian Forces and Royal Canadian Mounted Police Pension Funds were established by amendments to the *Public Service Superannuation Act*, the *Canadian Forces Superannuation Act* and the *Royal Canadian Mounted Police Superannuation Act* ("the *Superannuation Acts*"), to receive contributions and make benefit payments in respect of member service after April 1, 2000. The Reserve Force Pension Fund was established by an amendment to the *Canadian Forces Superannuation Act* to receive contributions and make benefit payments in respect of member service after March 1, 2007. The net contributions are transferred, by each Pension Fund, to their respective PSP Investments Plan Account for investment.

PSP Investments is responsible for managing amounts that are transferred to it in the best interests of the beneficiaries and contributors under the *Superannuation Acts*. The amounts are to be invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plans established under the *Superannuation Acts*.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These consolidated financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it from the Public Service, Canadian Forces, Royal Canadian Mounted Police and Reserve Force Pension Funds ("the Pension Funds"). Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of all the Pension Funds. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and the requirements of the Act. PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value are included in investment income (loss) as net unrealized gains (losses).

Comparative figures have been reclassified to conform to the current year's presentation.

PLAN ACCOUNTS

PSP Investments maintains records of each Pension Fund's net contributions, as well as the allocation of its investments and the results of its operations to each of the plan accounts. Separate financial statements for each Plan account have been prepared.

VALUATION OF INVESTMENTS

Investments, investment-related assets and investment-related liabilities are recorded as of the trade date (the date upon which the substantial risks and rewards are transferred) and are stated at fair value. Fair value is an estimate of the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Market prices or rates are used to determine fair value where an active market exists (such as a recognized securities exchange), as it is the best evidence of the fair value of an investment. If quoted market prices or rates are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the end of the reporting period that are derived from observable market data.

Valuation techniques are generally applied to investments in the Private Equity, Real Estate and Infrastructure asset classes (collectively "Private Market Investments"), over-the-counter (OTC) derivatives as well as asset-backed term notes (ABTNs). The values derived from applying these techniques are impacted by the choice of valuation model and the underlying assumptions made concerning factors such as the amounts and timing of future cash flows, discount rates, volatility and credit risk. In certain cases, such assumptions are not supported by market observable data.

The valuation methods of each asset class are described in Notes 3 (a) and (b).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF CAPITAL DEBT FINANCING

PSP Investments' short-term capital debt financing is recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' long-term capital debt financing is based on prices that are obtained from third-party pricing sources. It is measured using an interest rate curve with a spread consistent with PSP Investments' credit quality.

TRANSACTION COSTS

Transaction costs are incremental costs directly attributable to the acquisition, due diligence, issue, or disposal of a financial asset or financial liability. Transaction costs are expensed as incurred and recorded as a component of investment income (loss).

INVESTMENT MANAGEMENT FEES

Investment management fees are costs directly attributable to the external management of assets on behalf of PSP Investments. Investment management fees incurred for Private Market Investments are paid, as determined by the fund manager, either by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment (Note 3 (a) (ii)). These amounts are recorded against investment income (loss). Investment management fees are also incurred for certain public equity investments and these amounts are paid, either directly by PSP Investments or offset against distributions received from pooled fund investments. In both cases, they are recorded against investment income (loss) (Note 7).

INCOME RECOGNITION

Investment income (loss) is made up of interest income, dividends, realized gains (losses) on the disposal of investments and unrealized gains (losses) which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Interest income is recognized as earned. Dividends are recognized on the ex-dividend date and are reflected as dividend income. Dividends paid on securities sold short are reflected as dividend expense. Additionally, other income includes the related distributions from pooled funds, limited partnerships as well as from direct and co-investments, all from Private Market Investments.

TRANSLATION OF FOREIGN CURRENCIES

Investment transactions in foreign currencies are recorded at exchange rates prevailing on the transaction date. Investments denominated in foreign currencies and held at the end of the year are translated at exchange rates in effect at the year-end date. The resulting realized and unrealized gains (losses) on foreign exchange are included in investment income (loss).

FUND TRANSFERS

Amounts received from each Pension Fund are recorded in their respective plan account.

INCOME TAXES

PSP Investments and the majority of its subsidiaries are exempt from Part I tax under paragraph 149(1)*(d)* of the *Income Tax Act* (Canada).

USE OF ESTIMATES

In preparing these consolidated financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of Private Market Investments, ABTNs, derivatives, related income and expenses and note disclosures. Although estimates and assumptions reflect management's best judgement, actual results may differ from these estimates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

2. CHANGES IN ACCOUNTING POLICIES

AMENDMENT TO ACCOUNTING STANDARD

In June 2009, the Canadian Institute of Chartered Accountants (CICA) amended Section 3862 "Financial Instruments – Disclosures" of the CICA Handbook. This amendment is effective for annual financial statements relating to fiscal years ending after September 30, 2009.

The amendment enhances disclosures about fair value measurements of financial instruments as well as the liquidity risk of derivative financial liabilities.

The principal disclosures introduced by this amendment require financial instruments measured at fair value to be categorized into one of three fair value hierarchy levels. Such categorization is based on the significance of the inputs used in measuring such value as well as disclosure of movements between levels of the fair value hierarchy.

Additional disclosures for liquidity risk call for a maturity analysis for derivative financial liabilities based on the way in which an entity manages its liquidity risk.

PSP Investments adopted the provisions of such amendments for its March 31, 2010 consolidated financial statements. Required disclosures are made in Note 3 (c) and Note 4 (c).

FUTURE CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises will converge with International Financial Reporting Standards (IFRS) effective January 1, 2011. In response to this change, PSP Investments has put in place a transition plan that would allow it to prepare and present its March 31, 2012 consolidated financial statements under IFRS.

In analyzing the various impacts of its transition to IFRS, PSP Investments concluded that the requirement to consolidate its controlled investments ranked as one of the most significant of such impacts.

In April 2010, the AcSB issued Section 4600 "Pension Plans" of the CICA Handbook requiring pension plans in Canada to follow this standard rather than convert to IFRS in the same fashion as other publicly accountable enterprises. Under Section 4600, pension plans would continue to account for and report their investments at fair value as was previously done under Section 4100 "Pension Plans" of the CICA Handbook. The provisions of Section 4600 apply to annual financial statements relating to fiscal years beginning on or after January 1, 2011.

Concurrent with the issuance of Section 4600, the AcSB issued an exposure draft that proposed a scope expansion to include entities, such as PSP Investments, that are separate from pension plans and whose sole purpose is to hold and invest assets received from one or more pension plans, but does not itself have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments. The AcSB has indicated that it anticipates reaching a decision concerning the exposure draft in June 2010.

Management is currently monitoring the outcome of this exposure draft and evaluating its impact on PSP Investments' consolidated financial statements as well as the IFRS transition plan.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS

(A) INVESTMENT PORTFOLIO

The investment portfolio, before allocating the effect of derivative contracts and investment-related assets and liabilities to the asset classes to which they relate, as at March 31, is as follows:

($ millions)	2010		2009	
Asset Class	**Fair Value**	**Cost**	Fair Value	Cost
World Equity				
Canadian Equity	**$ 10,353**	**$ 9,115**	$ 6,327	$ 7,671
Foreign Equity:				
US Large Cap Equity	**2,136**	**2,060**	716	985
EAFE Large Cap Equity	**2,066**	**2,374**	1,161	1,847
Small Cap Developed World Equity	**1,955**	**1,816**	730	990
Emerging Markets Equity	**2,522**	**2,255**	1,461	1,838
Private Equity	**5,251**	**5,615**	4,257	4,985
Nominal Fixed Income				
Cash, Cash Equivalents and Other [1]	**4,630**	**4,764**	3,069	3,326
World Government Bonds	**1,096**	**1,170**	759	675
Canadian Fixed Income	**7,097**	**6,909**	7,145	7,185
Real Return Assets				
World Inflation-Linked Bonds	**337**	**353**	196	198
Real Estate	**6,141**	**6,180**	7,105	6,425
Infrastructure	**2,361**	**2,423**	2,711	2,335
Absolute Return	**2,414**	**2,243**	2,622	2,732
INVESTMENTS	**$ 48,359**	**$ 47,277**	$ 38,259	$ 41,192
Investment-Related Assets				
Amounts receivable from pending trades	**$ 149**	**$ 149**	$ 256	$ 256
Derivative-related receivables	**478**	**6**	485	65
Total Investment-Related Assets	**$ 627**	**$ 155**	$ 741	$ 321
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (458)**	**$ (458)**	$ (506)	$ (506)
Securities sold short	**(114)**	**(131)**	(354)	(442)
Derivative-related payables	**(415)**	**(3)**	(1,710)	(98)
Capital debt financing:				
Short-term	**(649)**	**(649)**	(1,579)	(1,579)
Long-term	**(1,073)**	**(1,024)**	(1,054)	(1,024)
Total Investment-Related Liabilities	**$ (2,709)**	**$ (2,265)**	$ (5,203)	$ (3,649)
NET INVESTMENTS	**$ 46,277**	**$ 45,167**	$ 33,797	$ 37,864

[1] Includes floating rate notes with maturities greater than one year with a fair value of $1,397 million (2009 – $18 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Canadian Equity and Foreign Equity

Canadian Equity and Foreign Equity include direct and indirect investments in common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds, and securities convertible into common shares of publicly listed issuers.

Valuation Techniques

Direct investments in Canadian and Foreign Equities are measured at fair value using quoted market prices, namely, the bid price. In the case of investments in pooled funds, fair value is measured by using unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(ii) Private Equity, Real Estate and Infrastructure

The Private Equity asset class is comprised of direct investments in companies and fund investments. They include investments in private companies, mezzanine debt and distressed debt. The Private Equity asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Private Equity asset class contracted by direct investments controlled by PSP Investments is nil (2009 – nil).

The Real Estate asset class is comprised of direct investments in companies, in properties, third-party debts and fund investments in the real estate sector. Real Estate investments are classified into two portfolios (an equity portfolio and a debt portfolio). The equity portfolio is comprised of direct investments in properties and companies in the office, retail, industrial, hospitality and residential sectors, as well as private funds and publicly traded securities invested in real estate assets. The debt portfolio is comprised of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, mezzanine loans and other structured investments (collectively "Real Estate Debt") where significant portions of the value are attributed to the underlying real estate assets. The Real Estate asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Real Estate asset class contracted by direct investments controlled by PSP Investments is approximately $2,150 million (2009 – approximately $2,100 million).

The Infrastructure asset class is comprised of direct investments in companies and fund investments. They include investments in companies engaged in the management, ownership or operation of assets in power, regulated businesses, transportation, telecom or social infrastructure. The Infrastructure asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Infrastructure asset class contracted by direct investments controlled by PSP Investments is approximately $100 million (2009 – approximately $150 million).

Investment management fees, as disclosed in Note 1, are incurred for Private Market Investments and generally vary between 0.1% and 2.1% of the total invested and/or committed amount. Investment management fees of $152 million for the year ended March 31, 2010 (2009 – $160 million) were recorded against investment income (loss).

Valuation Techniques

The fair value of Private Market Investments held directly by PSP Investments is determined at least annually, using acceptable industry valuation methods. For each investment, the relevant methodology is applied consistently over time.

For direct Private Markets Investments as well as investments in Real Estate Debt, management uses the services of third-party appraisers to determine the fair value. In selecting appraisers, management ensures their independence and that valuation methods used are consistent with professional appraisal standards. Such standards include the *International Private Equity and Venture Capital Valuation Guidelines*, the *Canadian Uniform Standards of Professional Appraisal Practice* and the *Uniform Standards of Professional Appraisal Practice* in the United States of America. In validating the work performed by appraisers, management ensures that the assumptions used correspond to financial information and forecasts of the underlying investment.

For direct investments in Private Equity and Infrastructure, valuation methods used include discounted cash flows analysis, earnings multiples, prices of recent comparable transactions and publicly traded comparables. Assumptions used in such valuations include discount rates and projected cash flows, which are not fully supported by prices from market observable transactions.

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(ii) Private Equity, Real Estate and Infrastructure (continued)

Valuation Techniques (continued)

For direct investments in Real Estate, valuation methods used include discounted cash flows as well as recent comparable transactions. Assumptions used in such valuations include capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

The fair value of Real Estate Debt is determined using either a yield-based or collateral-based valuation technique. The yield-based valuation technique involves discounting expected future cash flows that incorporate assumptions with respect to interest rates offered for similar loans to borrowers with similar credit ratings. The collateral-based valuation technique involves assessing the recoverable value of the collateral in question, net of disposal fees.

In the case of Private Equity, Real Estate and Infrastructure fund investments, the fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

(iii) Nominal Fixed Income and World Inflation-Linked Bonds

Nominal Fixed Income includes Cash, Cash Equivalents and Other, Canadian Fixed Income and World Government Bonds. Cash Equivalents include short-term instruments having a maximum term to maturity of one year. Floating rate notes are included in Cash, Cash Equivalents and Other, provided the final maturity date does not exceed three years and the coupons reset more than once per year. Bonds reported as Nominal Fixed Income include Canadian government bonds, Canadian provincial and territorial bonds, Canadian municipal bonds and corporate bonds, as well as international sovereign bonds. World Inflation-Linked Bonds reported as Real Return Assets are fixed income securities that earn inflation adjusted returns.

PSP Investments holds ABTNs reported as Canadian Fixed Income in the investment portfolio. The ABTNs were received in exchange for third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007 and were subsequently restructured in January 2009. The ABTNs had an original face value of $1,962 million. During the year ended March 31, 2010, PSP Investments received $67 million of principal repayments on the ABTNs.

PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs. As at March 31, 2010, the margin funding facilities had not been drawn upon. As part of the exchange of the non-bank ABCP for the ABTNs, it was agreed to include in the agreement a moratorium which prevents collateral calls for a period of 18 months ending July 21, 2010.

Management's best estimate of the fair value of PSP Investments' ABTNs as at March 31, 2010 is equal to $1,185 million (2009 – $1,039 million). The ABTNs' fair value has been reduced by the impact of the funding facilities amounting to $65 million on March 31, 2010 (2009 – $94 million). PSP Investments recorded an increase of $213 million in the fair value of the ABTNs during the year ended March 31, 2010 (decrease of $483 million during the year ended March 31, 2009).

Valuation Techniques

Cash Equivalents are recorded at cost plus accrued interest, which approximate fair value.

Fair values of bonds and floating rate notes are based on prices obtained from third-party pricing sources. They are determined using either an appropriate interest rate curve with a spread associated with the credit quality of the issuer or other generally accepted pricing methodologies.

ABTNs are measured at fair value using comparable notes with similar credit quality and terms as a proxy, while taking into consideration the impact of the funding facilities. The valuation model used includes certain assumptions that are not fully supported by market observable data. Such assumptions include interest rate spreads, assumed credit rating (ranging from BB to AAA–), expected returns, an average maturity of seven years as well as liquidity estimates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iv) Absolute Return

In addition to the different asset classes outlined in the Statement of Investment Policies, Standards and Procedures (SIP&P), PSP Investments employs a number of absolute return strategies through units of externally managed pooled funds.

Valuation Techniques

The fair value of investments in pooled funds is measured by using the unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(v) Amounts Receivable and Payable from Pending Trades

Amounts receivable from pending trades consist of proceeds on sales of investments, excluding derivative financial instruments, which have been traded but remain unsettled at the end of the reporting period.

Amounts payable from pending trades consist of the cost of purchases of investments, excluding derivative financial instruments, which have been traded but remain unsettled at the end of the reporting period.

Valuation Techniques

The fair value of amounts receivable and payable from pending trades reflects the value at which their underlying original sale or purchase transactions were undertaken.

(vi) Securities Sold Short

Securities sold short reflect PSP Investments' commitment to purchasing securities pursuant to short selling transactions. In such transactions, PSP Investments sells securities it does not own with a commitment to purchasing similar securities on the market to cover its position.

Valuation Techniques

Using ask prices as inputs, the fair value of securities sold short is measured using the same method as the similar long positions presented under Nominal Fixed Income, World Inflation-Linked Bonds, Canadian Equity and Foreign Equity.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts, the value of which is derived from changes in underlying assets, interest or exchange rates. PSP Investments uses derivative financial instruments to increase returns or to replicate investments synthetically. Derivatives are also used to reduce the risk associated with existing investments.

PSP Investments uses the following types of derivative financial instruments as described below:

(i) Swaps

Swaps are transactions whereby two counterparties exchange cash flow streams with each other based on predetermined conditions that include a notional amount and a term. Swaps are used to increase returns or to adjust exposures of certain assets without directly purchasing or selling the underlying assets.

(ii) Futures

Futures are standardized contracts to take or make delivery of an asset (buy or sell) at a specific time in the future for a specific price that has been agreed upon today. Futures are used to adjust exposures to specified assets without directly purchasing or selling the underlying assets.

(iii) Forwards

Forwards are contracts involving the sale by one party and the purchase by another party of a predefined amount of an underlying instrument, at a predefined price and a predefined date in the future. Forwards are used for yield enhancement purposes or to manage exposures to currencies and interest rates.

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(iv) Options

Options are the right, but not the obligation, to buy or sell a given amount of an underlying security, index, or commodity, at an agreed-upon price stipulated in advance, either at a determined date or at any time before the predefined maturity date.

(v) Warrants and Rights

Warrants are options on an underlying asset which is in the form of a transferable security and which can be listed on an exchange.

Rights are securities giving shareholders entitlement to purchase new shares issued by a corporation at a predetermined price (normally less than the current market price) in proportion to the number of shares already owned. Rights are issued only for a short period of time, after which they expire.

(vi) Collateralized Debt Obligations

Collateralized debt obligations are a type of asset-backed security that is constructed from a portfolio of credit-related assets. Collateralized debt obligations are usually divided into several tranches with different credit risk levels and corresponding interest payments. Any losses are applied first to the more junior tranches (lowest risk rating) before moving up in seniority.

Valuation Techniques

All listed derivative financial instruments are recorded at fair value using quoted market prices with the bid price for long positions and the ask price for short positions. Except for collateralized debt obligations, OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. For many pricing models there is no material subjectivity because the methodologies employed do not necessitate significant judgment and the pricing inputs are observed from actively quoted markets. Additionally, the pricing models used are widely accepted and used by other market participants.

The fair value of collateralized debt obligations are determined based on valuation techniques that use significant assumptions that are not all directly market observable. Such assumptions include default correlation data and recovery rate which are estimated by management. The instruments are then valued by discounting the expected cash flows using an appropriate discount factor.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Notional values of derivative financial instruments are not recorded as assets or liabilities as they represent the face amount of the contract. Notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions disclosed below, with the exception of credit derivatives[1]. Rather, they serve as the basis upon which the cash flows and the fair value of the contracts are determined.

The following table summarizes the derivatives portfolio as at March 31:

($ millions)		2010				2009	
		Notional Value	Fair Value			Notional Value	Fair Value
INVESTMENTS			Assets	Liabilities	Net		
Equity and Commodity Derivatives							
Futures		$ 113	$ –	$ –	$ –	$ 628	$ –
Total Return Swaps		3,524	116	(1)	115	2,909	106
Variance Swaps		–	–	–	–	107	6
Warrants		1	1	–	1	1	1
Options:	Listed-written	5	–	–	–	–	–
Currency Derivatives							
Forwards		10,183	310	(28)	282	20,620	(171)
Options:	OTC-purchased	654	4	–	4	619	7
	OTC-written	171	–	(1)	(1)	156	(2)
Interest Rate Derivatives							
Bond forwards		206	–	(2)	(2)	349	–
Futures		522	–	–	–	–	–
Interest Rate Swaps		3,904	24	(38)	(14)	3,933	(4)
Total Return Swaps		2,811	19	(14)	5	3,525	55
Swaptions		–	–	–	–	2,506	–
Options:	Listed-purchased	425	–	–	–	–	–
	Listed-written	1,165	–	–	–	2,494	–
	OTC-written	–	–	–	–	1,500	–
Credit Derivatives[1]:							
	Purchased	28	1	–	1	64	52
	Sold	744	3	(331)	(328)	1,632	(1,275)
Total		$ 24,456	$ 478	$ (415)	$ 63	$ 41,043	$ (1,225)

[1] Credit derivatives include collateralized debt obligations and a credit default swap. PSP Investments, through sold credit derivatives, indirectly guarantees the underlying reference obligations. The maximum potential exposure is the notional amount of the sold credit derivatives as shown in the table above.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives, as at March 31, is as follows:

($ millions)	**2010**	2009
Less than 3 months	**$ 9,200**	$ 24,392
3 to 12 months	**11,267**	11,874
Over 1 year	**3,989**	4,777
Total	**$ 24,456**	$ 41,043

(C) FAIR VALUE MEASUREMENT

Financial instruments are classified according to the following hierarchy based on the significant inputs used in measuring their fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities.

Level 2: Valuation is based on quoted market prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active. Level 2 also includes model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is based on model-based techniques for which significant assumptions are not observable in the market. They reflect management's assessment of the assumptions that market participants would use in pricing the financial instruments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of financial instruments, as at March 31, 2010, based on the methods described above:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 17,625	$ 1,407	$ –	$ –	$ 19,032
Private Equity	–	–	5,251	–	5,251
Nominal Fixed Income	135	11,403	1,285	–	12,823
Real Return Assets					
World Inflation-Linked Bonds	–	337	–	–	337
Real Estate	–	–	6,141	–	6,141
Infrastructure	–	–	2,361	–	2,361
Absolute Return	–	1,239	1,175	–	2,414
INVESTMENTS	$ 17,760	$ 14,386	$ 16,213	$ –	$ 48,359
Investment-Related Assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 149	$ 149
Derivative-related receivables	–	473	5	–	478
Total Investment-Related Assets	$ –	$ 473	$ 5	$ 149	$ 627
Investment-Related Liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (458)	$ (458)
Securities sold short	(114)	–	–	–	(114)
Derivative-related payables	–	(89)	(326)	–	(415)
Capital debt financing:					
Short-term	–	(649)	–	–	(649)
Long-term	–	(1,073)	–	–	(1,073)
Total Investment-Related Liabilities	$ (114)	$ (1,811)	$ (326)	$ (458)	$ (2,709)
NET INVESTMENTS	$ 17,646	$ 13,048	$ 15,892	$ (309)	$ 46,277

[1] No fair value hierarchy classification is required for these items.

The classification of financial instruments in the levels of the hierarchy is established at the time of the initial valuation of the instrument and reviewed on each subsequent reporting period-end.

There have been no significant transfers between Level 1 and Level 2 during the current fiscal year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

The following table shows a reconciliation of all movements in the fair value of financial instruments categorized within Level 3 for the year ended March 31:

($ millions)	2010 World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Opening Balance	$ 4,257	$ 1,127	$ 9,817	$ 682	$ (1,212)	$ 14,671
Purchases	1,525	–	1,270	269	1	3,065
Sales/Settlements	(954)	(67)	(1,442)	(8)	–	(2,471)
Total gains (losses)[1]	423	225	(1,143)	232	890	627
Transfers into or out of Level 3	–	–	–	–	–	–
Closing Balance	$ 5,251	$ 1,285	$ 8,502	$ 1,175	$ (321)	$ 15,892

Total gains (losses), for the year ended March 31, included in investment income (loss) are presented as follows:

($ millions)	2010 World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Total realized gains (losses)	$ 43	$ 16	$ 28	$ –	$ (1)	$ 86
Total unrealized gains (losses)	$ 380	$ 209	$ (1,171)	$ 232	$ 891	$ 541
Total gains (losses)[1]	$ 423	$ 225	$ (1,143)	$ 232	$ 890	$ 627

[1] Included in Note 7 (a).

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (a) and (b). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 3% increase/decrease in the fair value of financial instruments categorized as Level 3. This excludes Private Market fund investments as well as Real Estate Debt, where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of Private Market fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (a). With respect to Real Estate Debt, the fair value is obtained from third-party appraisers as described in Note 3 (a).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(D) INVESTMENT ASSET MIX

The SIP&P sets out the long-term target weights of the assets that shall be invested for the four Plan Accounts. Investments are classified by asset mix category as set out in the SIP&P based on the economic intent of the investment strategies of the underlying assets.

The net investments, as at March 31, are as follows:

($ millions)	2010			2009		
	Fair Value		Policy Portfolio Long-Term Target	Fair Value		Policy Portfolio Long-Term Target
World Equity						
Canadian Equity	$ 13,547	29.2%	30.0%	$ 8,815	26.1%	30.0%
Foreign Equity:						
US Large Cap Equity	2,111	4.6	5.0	926	2.7	5.0
EAFE Large Cap Equity	2,043	4.4	5.0	1,043	3.1	5.0
Small Cap Developed World Equity	1,977	4.3	5.0	781	2.3	5.0
Emerging Markets Equity	2,987	6.5	7.0	2,122	6.3	7.0
Private Equity	5,426	11.7	10.0	4,191	12.4	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	1,892	4.1	2.0	73	0.2	2.0
World Government Bonds	2,128	4.6	5.0	2,105	6.2	5.0
Canadian Fixed Income	4,830	10.4	8.0	4,253	12.6	8.0
Real Return Assets						
World Inflation-Linked Bonds	2,145	4.6	5.0	2,389	7.1	5.0
Real Estate	5,118	11.1	10.0	4,653	13.8	10.0
Infrastructure	2,073	4.5	8.0	2,446	7.2	8.0
NET INVESTMENTS	$ 46,277	100.0%	100.0%	$ 33,797	100.0%	100.0%

[1] Includes amounts related to absolute return and real estate debt strategies.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(E) SECURITIES LENDING & BORROWING PROGRAMS

PSP Investments participates in securities lending and borrowing programs whereby it lends and borrows securities in order to enhance portfolio returns.

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. In the absence of an event of default, the same securities or equivalent securities must be returned to the counterparty at the end of the contract. PSP Investments does not repledge any collateral held.

The following table illustrates the fair values of PSP Investments' securities and collateral associated with the lending and borrowing programs as at March 31:

($ millions)	2010	2009
Securities Lending		
Securities lent	**$ 4,005**	$ 2,701
Collateral contractually receivable [1]	**4,179**	2,827
Securities Borrowing		
Securities borrowed	**113**	355
Collateral contractually payable [2]	**119**	363

[1] The minimum fair value of collateral required is equal to 102% of the fair value of the securities lent.

[2] The minimum fair value of collateral required is equal to 100% of the fair value of the securities borrowed.

4. INVESTMENT RISK MANAGEMENT

Risk Management is a central part of PSP Investments' strategic management. It is a continuous process whereby PSP Investments methodically addresses the risks related to its various investment activities with the goal of achieving a maximum rate of return without undue risk of loss and a sustained benefit within each activity and across the total portfolio.

A risk governance structure that includes required reporting on risk to all levels in the organization also ensures that appropriate objectives are pursued and achieved in line with the fulfillment of PSP Investments' legislated mandate. The Board of Directors and its committees oversee various issues related to risk and receive assurance from senior management and an independent internal auditor reporting directly to the Audit and Conflicts Committee.

The use of financial instruments exposes PSP Investments to credit and liquidity risks as well as market risks including foreign exchange and interest rate risks. These risks are managed in accordance with the Investment Risk Management Handbook, which is an integral part of PSP Investments' risk control system. The Investment Risk Management Handbook contains an Investment Risk Management Policy which supplements the SIP&P (Policy Portfolio). The Policy Portfolio determines a diversification strategy to mitigate risk whereby PSP Investments invests in a diversified portfolio of investments based on established criteria. Additionally, the objective of these policies is to provide a framework for the management of credit, liquidity and market risks. Derivative financial instruments, traded either on exchanges or OTC, are one of the vehicles used to mitigate the impact of market risk.

(A) MARKET RISK

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, volatility in share and commodity prices, interest rate, foreign exchange or other factors affecting similar securities traded in the market.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Market risk is measured using the method known as Value-at-Risk (VaR). VaR is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. PSP Investments has chosen a yearly 95% confidence level to measure and report VaR. PSP Investments uses a Historical VaR model incorporating three years of monthly market returns which are scaled to a twelve-month holding period. Risk Management is responsible for implementing and maintaining a VaR measurement methodology for all asset classes and all financial risk factors.

Historical VaR is statistically valid under normal market conditions and does not specifically consider losses from severe market events. The Historical VaR model also assumes that the future will behave in a similar pattern to the past. If future market conditions differ significantly from those of the past, potential losses may differ from those originally estimated. The VaR is an estimate of a single value in a distribution of potential losses that can be experienced. As a result, it is not an estimate of the maximum potential loss.

The goal of actively managing the portfolio is to outperform the policy portfolio benchmarks while maintaining the active risk under 400 basis points (bps). Relative VaR, as a result, is the maximum amount of loss of total investments, with 95% confidence level, relative to the policy portfolio benchmark over a twelve-month period.

The following table shows the total Relative VaR and the diversification effect as at March 31 based on the economic intent of the investment strategies of the underlying assets. The diversification effect captures the effect of holding different types of assets which may react differently in various types of situations and thus having the effect of reducing overall Relative VaR.

Active Risk Taken

(Relative VaR – $ millions)	2010	2009
World Equity	$ 688	$ 788
Real Return Assets	868	1,065
Absolute Return	411	1,160
Total Relative VaR (Undiversified)	1,967	3,013
Diversification Effect	(984)	(1,660)
Total Relative VaR	**$ 983**	$ 1,353

Risk Management monitors the absolute risk of the Policy Portfolio on a quarterly basis to ensure no undue loss may be experienced by PSP Investments.

Generally, changes in VaR between reporting periods are due to changes in the level of exposure, volatilities and/or correlations among asset classes. Although VaR is a widely accepted risk measure, it must be complemented by other risk measures. PSP Investments therefore uses stress testing and scenario analysis to examine the impact on financial results of abnormally large movements in risk factors. Stress testing and scenario analysis are used to test a portfolio's sensitivity to various risk factors and key model assumptions. These methods also use historically stressed periods to evaluate how a current portfolio would fare under such circumstances. Stress testing is also deployed to assess new product behaviour. Stress testing and scenario analysis are utilized as a complement to the Historical VaR measure in order to provide greater insight on the size of potential losses that may be experienced. PSP Investments uses the expected shortfall and tail analysis measures to determine this. Expected shortfall is defined as the conditional expectation beyond the VaR level. It is measured by averaging all data points showing a loss greater than VaR measured at a given confidence level. By increasing the confidence level of the VaR measure from 95% to 99%, PSP Investments is able to assess the size of the potential loss that would be exceeded one year out of 100 (instead of one year out of 20). Therefore, there is a greater probability for larger losses, at the 99% confidence level, in extreme market conditions. Risk Management presents a stress testing and scenario analysis report to senior management on a quarterly basis.

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(i) Interest Rate Risk

Interest rate risk refers to the risk that fluctuations in interest rates will directly affect the fair value of PSP Investments' net asset values. The most significant exposure to interest rate risk is related to the investment in bonds, ABTNs and Real Estate Debt.

The terms to maturity of the investments, before allocating the effect of derivative contracts and investment-related assets and liabilities, as at March 31, are as follows:

	Terms to Maturity					
($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	2010 Total	2009 Total
Government of Canada bonds	$ 185	$ 1,630	$ 343	$ 375	$ 2,533	$ 3,055
Provincial and Territorial bonds	182	577	308	531	1,598	1,480
Municipal bonds	4	22	50	8	84	84
Corporate bonds	257	608	450	382	1,697	1,487
ABTNs	–	45	–	1,140	1,185	1,039
Total Canadian Fixed Income	$ 628	$ 2,882	$ 1,151	$ 2,436	$ 7,097	$ 7,145
Total World Government Bonds	$ 8	$ 474	$ 329	$ 285	$ 1,096	$ 759
Total World Inflation-Linked Bonds	$ –	$ 81	$ 78	$ 178	$ 337	$ 196
Real Estate Debt [1]	$ 275	$ 175	$ –	$ 33	$ 483	$ 752
Grand Total	$ 911	$ 3,612	$ 1,558	$ 2,932	$ 9,013	$ 8,852

[1] Real Estate Debt is a component of the Real Estate asset class disclosed in Note 3 (a).

The terms to maturity of PSP Investments' capital debt financing are disclosed in Note 10.

Absolute return strategies, as described in Note 3, and derivative contracts are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 4 (a).

Additionally, the exposure to interest rate risk for short-term instruments and amounts receivable from pending trades would not be significant due to their short-term nature.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts, positions in foreign currencies. PSP Investments' policy is to hedge 50% of its foreign currency investments excluding Emerging Markets Equity.

The underlying net foreign currency exposures, after allocating the effect of derivative contracts and investment-related assets and liabilities for both monetary and non-monetary items, as at March 31, are as follows:

	2010		2009	
Currency (in millions of Canadian $)	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 6,276**	**51.2%**	$ 4,624	52.9%
Euro	**1,815**	**14.8**	2,066	23.6
British Pound	**778**	**6.4**	519	5.9
Brazilian Real	**669**	**5.5**	65	0.7
Hong Kong Dollar	**506**	**4.1**	300	3.4
Japanese Yen	**429**	**3.5**	389	4.5
Korean Won	**351**	**2.9**	166	1.9
New Taiwan Dollar	**200**	**1.6**	174	2.0
South African Rand	**157**	**1.3**	93	1.1
Australian Dollar	**151**	**1.2**	165	1.9
Indian Rupee	**150**	**1.2**	85	1.0
Turkish Lira	**109**	**0.9**	60	0.7
Others	**658**	**5.4**	40	0.4
Total	**$ 12,249**	**100.0%**	$ 8,746	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies of $4,981 million ($4,081 million US, €580 million, £1 million and 312 million South African Rands (ZAR)) which are not included in the foreign currency exposure table.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

PSP Investments is exposed to credit risk, that is, the risk that the issuer of a debt security or a counterparty to a derivative contract is unable to meet its financial obligations.

Credit risk encompasses the risk of a deterioration of creditworthiness and the respective concentration risk. Credit risk monitoring entails an evaluation of the credit quality of each issuer to which PSP Investments is exposed. To perform this evaluation, PSP Investments relies on four recognized credit rating agencies. A minimum of two credit ratings are used to classify each security; securities rated by only one agency are classified as "not rated". If the agencies disagree as to a security's credit quality, PSP Investments uses the lowest of the available ratings.

To monitor the evolution of credit risk, PSP Investments periodically produces a concentration report by credit rating of all credit-sensitive financial securities with the exception of securities held in pooled funds or for Private Market Investments.

PSP Investments' concentration of credit risk by credit rating, as at March 31, is as follows:

	2010	2009
Investment grade (AAA to BBB–)	**89.9%**	88.7%
Below investment grade (BB+ and below)	**–**	–
Not rated:		
Rated by a single credit rating agency	**8.5**	8.5
Not rated by credit rating agencies	**1.6**	2.8
Total	**100.0%**	100.0%

The breakdown of credit concentration risk for PSP Investments does not include investments in distressed debt included in pooled funds in the amount of approximately $2 billion as at March 31, 2010 (2009 – $2 billion). Such investments typically include debt securities of issuers close to default, and the investment in such securities are quasi-equity in nature.

As at March 31, 2010, PSP Investments also has a net notional exposure of $614 million to collateralized debt obligations, of which approximately 64% of the dollar exposure is rated "Investment grade", as well as funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs (Note 3 (a) (iii)).

As at March 31, 2010, PSP Investments' maximum exposure to credit risk, excluding collateral held and the investments in distressed debt and collateralized debt obligations described above, amounts to approximately $13 billion (2009 – approximately $11 billion).

(i) Counterparty Risk

Counterparty risk represents the credit risk from current and potential exposure related to transactions involving derivative contracts. In order to minimize derivative contract counterparty risk, PSP Investments deals only with counterparties with a minimum credit rating of "A–" as at the trade date, as provided by a recognized credit rating agency. PSP Investments monitors the credit ratings of counterparties on a daily basis and has the ability to terminate all trades with counterparties who have their credit rating downgraded below "A–" subsequent to the trade date. PSP Investments also uses credit mitigation techniques such as master-netting arrangements and collateral transfers through the use of Credit Support Annexes (CSA).

PSP Investments' policy also requires the use of the International Swaps and Derivative Association (ISDA) Master Agreement with all counterparties to derivative contracts. The ISDA Master Agreement provides the contractual framework within which dealing activities across a full range of OTC products are conducted and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or other pre-determined events occur.

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

Additionally, the CSA to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the event of the failure of the counterparty and requires PSP Investments to contribute further collateral when requested. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold.

PSP Investments deposited or pledged securities with a fair value of $209 million as collateral with various financial institutions as at March 31, 2010 (2009 – $1,036 million) while securities with a fair value of $179 million (2009 – $106 million) were received from other counterparties as collateral. PSP Investments does not repledge any collateral held. All collateral deposited, pledged and received were held with counterparties who had a minimum credit rating of "A–" as at March 31, 2010.

Risk Management is responsible for counterparty risk monitoring and mitigation as well as maintaining a comprehensive, disciplined, and enterprise-wide process for tracking and managing counterparty risk. As such, Risk Management measures counterparty risk on an ongoing basis, evaluates and tracks the creditworthiness of current counterparties and mitigates counterparty risk through collateral management.

(C) LIQUIDITY RISK

Liquidity risk corresponds to PSP Investments' ability to meet its financial obligations when they come due with sufficient and readily available cash resources. PSP Investments' cash position is monitored on a daily basis. In general, investments in cash, cash equivalents, floating rate notes, debt and public equities are expected to be highly liquid as they will be invested in securities that are actively traded. Risk Management utilizes appropriate measures and controls to monitor liquidity risk in order to ensure that there is sufficient liquidity to meet financial obligations as they come due. A liquidity report taking into consideration future forecasted cash flows is prepared and presented to senior management on a weekly basis. This ensures that sufficient cash reserves are available to meet forecasted cash outflows. Additionally, sufficient sources of liquidity are maintained for deployment in case of market disruption.

PSP Investments has the ability to raise additional capital through the use of its capital debt program. This program allows PSP Investments to issue short-term promissory notes and medium-term notes. Note 10 provides additional information on the usage of the capital debt program.

The terms to maturity of the notional amount of derivatives, including related payable amounts, are disclosed in Note 3 (b).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial assets and liabilities, aggregated according to their maturities as at March 31, 2010.

Liabilities are presented in the earliest period in which the counterparty can request payment.

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities				
Amounts payable from pending trades	$ (458)	$ –	$ –	$ (458)
Securities sold short	(114)	–	–	(114)
Capital debt financing	(624)	(25)	(1,073)	(1,722)
Accounts payable and other liabilities	(40)	–	(16)	(56)
Total	$ (1,236)	$ (25)	$ (1,089)	$ (2,350)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial assets and liabilities				
Derivative-related assets	$ 176	$ 280	$ 22	$ 478
Derivative-related liabilities	(33)	(19)	(363)	(415)
Total	$ 143	$ 261	$ (341)	$ 63

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

5. SHARE CAPITAL

Share capital consists of 10 shares having a par value of $10 that are issued to the Minister, the President of the Treasury Board, to be held on behalf of Her Majesty in right of Canada.

6. FUND TRANSFERS

PSP Investments received fund transfers of $4,980 million for the year ended March 31, 2010 (2009 – $4,431 million) from the Pension Funds. The transfers received are comprised of the net employer and employee contributions to their respective pension plans in respect of member service after April 1, 2000 for the Public Service, Canadian Forces and Royal Canadian Mounted Police Pension Funds. The transfers received from the Reserve Force Pension Fund are comprised of the net employer and employee contributions in respect of member service after March 1, 2007.

The breakdown of the fund transfers, for the year ended March 31, is as follows:

($ millions)	2010	2009
Public Service Pension Fund	**$ 3,707**	$ 3,179
Canadian Forces Pension Fund	**866**	853
Royal Canadian Mounted Police Pension Fund	**323**	314
Reserve Force Pension Fund	**84**	85
Total	**$ 4,980**	$ 4,431

7. INVESTMENT INCOME (LOSS)

(A) INVESTMENT INCOME (LOSS)

Investment income (loss), for the year ended March 31, is as follows:

($ millions)	2010	2009
Interest income	**$ 409**	$ 468
Dividend income	**408**	435
Other income	**204**	239
Security lending income (net) [1]	**10**	7
Dividend expense	**(22)**	(26)
Interest expense (Note 10)	**(53)**	(67)
Transaction costs	**(21)**	(37)
External investment management fees [2]	**(33)**	(53)
	902	966
Net realized gains (losses) [3]	**1,526**	(6,202)
Net unrealized gains (losses)	**5,177**	(4,257)
Investment Income (Loss)	**$ 7,605**	$ (9,493)

[1] Includes fees on securities borrowed.

[2] These are amounts incurred for public market investments that are paid directly by PSP Investments (Note 1). This excludes amounts incurred for Private Market Investments, disclosed in Note 3 (a) (ii), and certain public market pooled fund investments in the amount of $11 million for the year ended March 31, 2010 (2009 – $6 million) that are not paid directly by PSP Investments.

[3] Includes foreign currency gains (losses) of $621 million for the year ended March 31, 2010 (2009 – $(606) million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

7. INVESTMENT INCOME (LOSS) (continued)

(B) INVESTMENT INCOME (LOSS) BY ASSET MIX

Investment income (loss) by asset mix based on the economic intent of the investment strategies of the underlying assets as outlined in the SIP&P, for the year ended March 31, after allocating net realized and unrealized gains (losses) on investments to the asset classes to which they relate, is as follows:

($ millions)	2010	2009
World Equity		
Canadian Equity	**$ 3,690**	$ (3,598)
Foreign Equity:		
US Large Cap Equity	**247**	(449)
EAFE Large Cap Equity	**251**	(593)
Small Cap Developed World Equity	**282**	(492)
Emerging Markets Equity	**1,013**	(985)
Private Equity	**1,211**	(1,591)
Nominal Fixed Income		
Cash & Cash Equivalents	**45**	35
World Government Bonds	**(345)**	478
Canadian Fixed Income	**195**	195
Real Return Assets		
World Inflation-Linked Bonds	**(253)**	164
Real Estate	**28**	(782)
Infrastructure	**158**	112
Absolute Return [1]	**1,083**	(1,987)
Investment Income (Loss)	**$ 7,605**	$ (9,493)

[1] Includes amounts related to real estate debt strategies.

8. OPERATING EXPENSES

Operating expenses consist of the following for the year ended March 31:

($ thousands)	2010	2009
Salaries and benefits	**$ 53,434**	$ 48,287
Professional and consulting fees	**9,289**	9,993
Office supplies and equipment	**11,215**	8,780
Other operating expenses	**4,201**	7,986
Depreciation of fixed assets	**7,093**	4,657
Occupancy costs	**4,323**	3,614
Custodial fees	**1,556**	1,253
Remuneration earned by Directors	**794**	911
Travel and related expenses for Directors	**316**	383
Communication expenses	**175**	93
Total	**$ 92,396**	$ 85,957

Professional and consulting fees paid or accrued to the external auditors include audit fees of $470,000 (2009 – $469,000), audit-related fees of $145,000 (2009 – $144,000) and non-audit fees of $258,000 (2009 – $137,000). Audit fees of $470,000 (2009 – $571,000) and non-audit fees of $157,000 (2009 – $268,000) were paid and accrued to the externally contracted internal auditors of PSP Investments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

9. ALLOCATION OF NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME

The net income (loss) from operations and comprehensive income of PSP Investments is allocated to each plan account as follows:

(A) INVESTMENT INCOME (LOSS)

The investment income (loss) is allocated proportionately based upon the asset value held by each plan account.

(B) EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the plans for which it provides investment services. Under section 4(3) of the Act, the President of the Treasury Board shall determine to which plan account these costs will be charged, in consultation with the Minister of National Defence and the Minister of Public Safety. An allocation policy has been developed which allocates the direct costs of investment activities, such as external investment management fees and custodial fees, to each plan account, based upon the asset value of each plan account at the time the expense was incurred.

All other operating expenses, excluding the direct cost of investment activities listed above, for the year ended March 31, have been allocated in proportion to the annual amount of net assets in each Plan Account as follows:

	2010	2009
Public Service Pension Plan Account	**72.5%**	72.6%
Canadian Forces Pension Plan Account	**20.0**	20.1
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.3**	0.1
Total	**100.0%**	100.0%

Expenses are paid by PSP Investments by way of advances from the Public Service Pension Plan Account, which are reimbursed by the other plan accounts on a quarterly basis.

10. CAPITAL DEBT FINANCING

As of March 31, 2010, PSP Capital Inc. has $649 million (2009 – $1,579 million) of short-term promissory notes outstanding with maturity dates between 14 and 120 days of issuance. These notes are included in Note 3 (a) as a short-term investment-related liability. As at March 31, 2010, PSP Capital Inc. has $1 billion (2009 – $1 billion) of medium-term notes issued and outstanding. These medium-term notes bear interest of 4.57% per annum and have a maturity date of December 9, 2013. These medium-term notes are included in Note 3 (a) as a long-term investment-related liability. As at March 31, 2010, the fair value of these medium-term notes is $1,073 million (2009 – $1,054 million). The maximum authorized by the Board of Directors for both the short-term promissory notes and medium-term notes is $2 billion. The capital raised, primarily used to finance investments in the Real Estate and Infrastructure asset classes, is unconditionally and irrevocably guaranteed by PSP Investments and is in accordance with the approved PSP Investments' corporate policy for leverage.

Interest expense, for the year ended March 31, is as follows:

($ thousands)	**2010**	2009
Short-term promissory notes	**$ 7,424**	$ 56,591
Medium-term notes	**45,700**	10,017
Total	**$ 53,124**	$ 66,608

The operating expenses incurred by PSP Capital Inc. were allocated to each Plan account as described in Note 9 (b).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2010

11. CAPITAL MANAGEMENT

As an investment company, PSP Investments objectives in managing its capital are:

- To invest fund transfers, outlined in Note 6, in the best interests of the beneficiaries and contributors under the *Superannuation Acts*. The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plans established under the *Superannuation Acts*. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.
- To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc., and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 10 provides information on the capital debt financing and Note 4 (c) provides information on PSP Investments' liquidity. Additionally, as at March 31, 2010, PSP Investments has an operating line of credit of $10 million (2009 – $10 million). As at March 31, 2010, no amounts have been withdrawn (2009 – nil).

The capital structure of PSP Investments consists of fund transfers and capital debt financing. PSP Investments has no externally imposed restrictions on capital.

12. GUARANTEES AND INDEMNITY

PSP Investments provides indemnification to its Directors, its Officers and to certain PSP Investments representatives who are asked to serve on boards of directors (or like bodies) or investment advisory boards (or like bodies) of entities in which PSP Investments or its wholly-owned subsidiaries have made an investment or have a financial interest. As a result, but subject to the Act, PSP Investments may be required to indemnify these representatives for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties, unless the liability of such a representative relates to a failure to act honestly and in good faith. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

As part of investment transactions, PSP Investments and its subsidiaries guaranteed letter of credit facilities totalling $10 million as at March 31, 2010 (2009 – $15 million). The beneficiaries of these letter of credit facilities have the ability to draw against these facilities to the extent that the contractual obligations, as defined in the related agreements, are not met.

As at March 31, 2010, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, PSP Investments would assume the obligation up to $403 million (2009 – $403 million) plus interest and other related costs.

PSP Investments also unconditionally and irrevocably guarantees all credit facilities, short-term promissory notes and medium-term notes issued by PSP Capital Inc.

13. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, the outstanding commitments are as follows:

($ millions)	**2010**	2009
Private Equity	**$ 3,155**	$ 4,629
Real Estate	**1,394**	1,795
Infrastructure	**428**	576
Public markets	**327**	578
Total	**$ 5,304**	$ 7,578

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PUBLIC SECTOR PENSION INVESTMENT BOARD

2010 ANNUAL REPORT — APPENDIX

FINANCIAL STATEMENTS AND NOTES TO THE FINANCIAL STATEMENTS

PUBLIC SERVICE PENSION PLAN ACCOUNT

CANADIAN FORCES PENSION PLAN ACCOUNT

ROYAL CANADIAN MOUNTED POLICE PENSION PLAN ACCOUNT

RESERVE FORCE PENSION PLAN ACCOUNT

2010

PSP INVESTMENTS

FINANCIAL STATEMENTS AND NOTES TO THE FINANCIAL STATEMENTS

TABLE OF CONTENTS

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of the Public Sector Pension Investment Board ("PSP Investments") as well as the financial statements of the Public Service, the Canadian Forces, the Royal Canadian Mounted Police and the Reserve Forces Pension Plan Accounts ("the financial statements") have been prepared by management and approved by the Board of Directors. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Management is responsible for the contents of the financial statements and the financial information contained in the annual report.

PSP Investments maintains records and systems of internal control and supporting procedures to provide reasonable assurance that PSP Investments' assets are safeguarded and controlled, and that transactions are in accordance with the applicable provisions of Part X of the *Financial Administration Act* and, as appropriate, the *Public Sector Pension Investment Board Act* ("the Act"), the accompanying regulations, the by-laws, and the Statement of Investment Policies, Standards and Procedures ("the SIP&P").

In this regard, investments of PSP Investments held during the year ended March 31, 2010 were in accordance with the Act and the SIP&P.

The Audit and Conflicts Committee assists the Board of Directors in discharging its responsibility to approve the annual financial statements. The Committee meets regularly with both management and the external auditors to discuss the scope and findings of audits and other work that the external auditors may be requested to perform from time to time, to review financial information, and to discuss the adequacy of internal controls. The Committee reviews the annual financial statements and recommends them to the Board of Directors for approval.

PSP Investments' external "joint" auditors, the Office of the Auditor General of Canada and Deloitte & Touche LLP ("the External Auditors"), have conducted an independent examination of the financial statements in accordance with Canadian generally accepted auditing standards, performing such tests and other procedures as they consider necessary to express an opinion in their Auditors' Report. The External Auditors have full and unrestricted access to management and the Audit and Conflicts Committee to discuss findings related to the integrity of PSP Investments' financial reporting and the adequacy of internal control systems.

Gordon J. Fyfe
President and
Chief Executive Officer
May 10, 2010

John Valentini
Executive Vice President,
Chief Operating Officer and Chief Financial Officer
May 10, 2010

INVESTMENT CERTIFICATE

The *Public Sector Pension Investment Board Act* ("the Act") requires that a certificate be signed by a director on behalf of the Board of Directors, stating that the investments of the Public Sector Pension Investment Board ("PSP Investments") held during the financial year were in accordance with the Act and PSP Investments' investment policies, standards and procedures. Accordingly, the Investment Certificate follows:

"The investments of PSP Investments held during the year ended March 31, 2010, were in accordance with the Act and PSP Investments' Statement of Investment Policies, Standards and Procedures".

Paul Cantor
Chairperson
May 10, 2010

PUBLIC SERVICE PENSION PLAN ACCOUNT

AUDITORS' REPORT

To the President of the Treasury Board

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Public Service Pension Plan Account (the Public Service Pension Plan Account) as at March 31, 2010, and the Statements of Net Income (Loss) from Operations and Comprehensive Income and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's (PSP Investments) management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Public Service Pension Plan Account as at March 31, 2010, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the Public Service Pension Plan Account that have come to our notice during our audit of the financial statements have, in all significant respects, been in accordance with the applicable provisions of Part X of the *Financial Administration Act* and regulations, the *Public Sector Pension Investment Board Act* and regulations and the by-laws of PSP Investments and its wholly-owned subsidiaries.

Deloitte & Touche LLP[1]

[1] Chartered accountant auditor permit No. 18527

Montreal, Canada
May 10, 2010

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 10, 2010

PUBLIC SERVICE PENSION PLAN ACCOUNT

BALANCE SHEET

As at March 31

($ millions)	2010	2009
ASSETS		
Investments (Note 3 (a))	**$ 35,174**	$ 27,741
Investment-related assets (Note 3 (a))	**455**	537
Other assets	**32**	26
Due from the Canadian Forces Pension Plan Account	**6**	6
Due from the Royal Canadian Mounted Police Pension Plan Account	**2**	2
TOTAL ASSETS	**$ 35,669**	$ 28,312
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 1,970**	$ 3,773
Accounts payable and other liabilities	**38**	43
TOTAL LIABILITIES	**$ 2,008**	$ 3,816
NET ASSETS	**$ 33,661**	$ 24,496
Accumulated net income from operations and comprehensive income	**$ 5,642**	$ 184
Accumulated fund transfers	**28,019**	24,312
NET ASSETS	**$ 33,661**	$ 24,496

Commitments (Note 11)

The accompanying notes are an integral part of the financial statements.

On behalf of the board of Directors:

Paul Cantor
Chair of the Board

William A. MacKinnon
Chair of the Audit and Conflicts Committee

PUBLIC SERVICE PENSION PLAN ACCOUNT

STATEMENT OF NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME

For the year ended March 31

($ millions)	2010	2009
INVESTMENT INCOME (LOSS) (Note 6)	**$ 5,525**	$ (6,884)
OPERATING EXPENSES (Note 7)	**$ 67**	$ 63
NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ 5,458**	$ (6,947)

The accompanying notes are an integral part of the financial statements.

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2010	2009
NET ASSETS, BEGINNING OF YEAR	**$ 24,496**	$ 28,264
Fund transfers (Note 5)	**3,707**	3,179
Net income (loss) from operations and comprehensive income	**5,458**	(6,947)
Increase (decrease) in net assets for the year	**9,165**	(3,768)
NET ASSETS, END OF YEAR	**$ 33,661**	$ 24,496

The accompanying notes are an integral part of the financial statements.

PUBLIC SERVICE PENSION PLAN ACCOUNT

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) is a crown corporation established under the *Public Sector Pension Investment Board Act* ("the Act") with a mandate to invest the net contributions of the Public Service, Canadian Forces, Royal Canadian Mounted Police and Reserve Force pension plans in financial markets.

The Public Service Pension Fund was established by amendments to the *Public Service Superannuation Act*, to receive contributions and make benefit payments in respect of member service after April 1, 2000. The net contributions are transferred, by the Public Service Pension Fund, to PSP Investments – Public Service Pension Plan Account for investment. PSP Investments maintains records of the pension fund's net contributions, as well as the allocation of its investments and the results of its operations in the plan account.

PSP Investments is responsible for managing amounts that are transferred to it in the best interests of the beneficiaries and contributors under the *Public Service Superannuation Act*. The amounts are to be invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the *Public Service Superannuation Act*.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it from the Public Service Pension Fund in respect of member service after April 1, 2000. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of the Public Service Pension Fund. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and the requirements of the Act. PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value are included in investment income (loss) as net unrealized gains (losses).

Comparative figures have been reclassified to conform to the current year's presentation.

VALUATION OF INVESTMENTS

Investments, investment-related assets and investment-related liabilities are recorded as of the trade date (the date upon which the substantial risks and rewards are transferred) and are stated at fair value. Fair value is an estimate of the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Market prices or rates are used to determine fair value where an active market exists (such as a recognized securities exchange), as it is the best evidence of the fair value of an investment. If quoted market prices or rates are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the end of the reporting period that are derived from observable market data.

Valuation techniques are generally applied to investments in the Private Equity, Real Estate and Infrastructure asset classes (collectively "Private Market Investments"), over-the-counter (OTC) derivatives as well as asset-backed term notes (ABTNs). The values derived from applying these techniques are impacted by the choice of valuation model and the underlying assumptions made concerning factors such as the amounts and timing of future cash flows, discount rates, volatility and credit risk. In certain cases, such assumptions are not supported by market observable data.

The valuation methods of each asset class are described in Notes 3 (a) and (b).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF CAPITAL DEBT FINANCING

PSP Investments' short-term capital debt financing is recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' long-term capital debt financing is based on prices that are obtained from third-party pricing sources. It is measured using an interest rate curve with a spread consistent with PSP Investments' credit quality.

TRANSACTION COSTS

Transaction costs are incremental costs directly attributable to the acquisition, due diligence, issue, or disposal of a financial asset or financial liability. Transaction costs are expensed as incurred and recorded as a component of investment income (loss).

INVESTMENT MANAGEMENT FEES

Investment management fees are costs directly attributable to the external management of assets on behalf of PSP Investments. Investment management fees incurred for Private Market Investments are paid, as determined by the fund manager, either by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment (Note 3 (a) (ii)). These amounts are recorded against investment income (loss). Investment management fees are also incurred for certain public equity investments and these amounts are paid, either directly by PSP Investments or offset against distributions received from pooled fund investments. In both cases, they are recorded against investment income (loss) (Note 6).

INCOME RECOGNITION

The investment income (loss) has been allocated proportionately based on the asset value held by the Public Service Pension Plan Account ("the Plan").

Investment income (loss) is made up of interest income, dividends, realized gains (losses) on the disposal of investments and unrealized gains (losses) which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Interest income is recognized as earned. Dividends are recognized on the ex-dividend date and are reflected as dividend income. Dividends paid on securities sold short are reflected as dividend expense. Additionally, other income includes the related distributions from pooled funds, limited partnerships as well as from direct and co-investments, all from Private Market Investments.

TRANSLATION OF FOREIGN CURRENCIES

Investment transactions in foreign currencies are recorded at exchange rates prevailing on the transaction date. Investments denominated in foreign currencies and held at the end of the year are translated at exchange rates in effect at the year-end date. The resulting realized and unrealized gains (losses) on foreign exchange are included in investment income (loss).

FUND TRANSFERS

Amounts received from each Pension Fund are recorded in their respective plan account.

INCOME TAXES

PSP Investments and the majority of its subsidiaries are exempt from Part I tax under paragraph 149(1)*(d)* of the *Income Tax Act* (Canada).

USE OF ESTIMATES

In preparing these financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of Private Market Investments, ABTNs, derivatives, related income and expenses and note disclosures. Although estimates and assumptions reflect management's best judgement, actual results may differ from these estimates.

2. CHANGES IN ACCOUNTING POLICIES

AMENDMENT TO ACCOUNTING STANDARD

In June 2009, the Canadian Institute of Chartered Accountants (CICA) amended Section 3862 "Financial Instruments – Disclosures" of the CICA Handbook. This amendment is effective for annual financial statements relating to fiscal years ending after September 30, 2009.

The amendment enhances disclosures about fair value measurements of financial instruments as well as the liquidity risk of derivative financial liabilities.

The principal disclosures introduced by this amendment require financial instruments measured at fair value to be categorized into one of three fair value hierarchy levels. Such categorization is based on the significance of the inputs used in measuring such value as well as disclosure of movements between levels of the fair value hierarchy.

Additional disclosures for liquidity risk call for a maturity analysis for derivative financial liabilities based on the way in which an entity manages its liquidity risk.

PSP Investments adopted the provisions of such amendments for its March 31, 2010 financial statements. Required disclosures are made in Note 3 (c) and Note 4 (c).

FUTURE CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises will converge with International Financial Reporting Standards (IFRS) effective January 1, 2011. In response to this change, PSP Investments has put in place a transition plan that would allow it to prepare and present its March 31, 2012 financial statements under IFRS.

In analyzing the various impacts of its transition to IFRS, PSP Investments concluded that the requirement to consolidate its controlled investments ranked as one of the most significant of such impacts.

In April 2010, the AcSB issued Section 4600 "Pension Plans" of the CICA Handbook requiring pension plans in Canada to follow this standard rather than convert to IFRS in the same fashion as other publicly accountable enterprises. Under Section 4600, pension plans would continue to account for and report their investments at fair value as was previously done under Section 4100 "Pension Plans" of the CICA Handbook. The provisions of Section 4600 apply to annual financial statements relating to fiscal years beginning on or after January 1, 2011.

Concurrent with the issuance of Section 4600, the AcSB issued an exposure draft that proposed a scope expansion to include entities, such as PSP Investments, that are separate from pension plans and whose sole purpose is to hold and invest assets received from one or more pension plans, but does not itself have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments. The AcSB has indicated that it anticipates reaching a decision concerning the exposure draft in June 2010.

Management is currently monitoring the outcome of this exposure draft and evaluating its impact on PSP Investments' financial statements as well as the IFRS transition plan.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS

(A) INVESTMENT PORTFOLIO

The investment portfolio, before allocating the effect of derivative contracts and investment-related assets and liabilities to the asset classes to which they relate, as at March 31, is as follows:

($ millions)	2010		2009	
Asset Class	**Fair Value**	**Cost**	Fair Value	Cost
World Equity				
Canadian Equity	$ 7,530	$ 6,635	$ 4,587	$ 5,566
Foreign Equity:				
US Large Cap Equity	1,554	1,499	519	715
EAFE Large Cap Equity	1,503	1,727	842	1,340
Small Cap Developed World Equity	1,422	1,322	530	718
Emerging Markets Equity	1,834	1,640	1,059	1,333
Private Equity	3,819	4,082	3,086	3,614
Nominal Fixed Income				
Cash, Cash Equivalents and Other [1]	3,368	3,465	2,226	2,412
World Government Bonds	797	850	550	489
Canadian Fixed Income	5,162	5,026	5,181	5,211
Real Return Assets				
World Inflation-Linked Bonds	245	257	142	144
Real Estate	4,467	4,494	5,152	4,656
Infrastructure	1,717	1,763	1,966	1,693
Absolute Return	1,756	1,630	1,901	1,982
INVESTMENTS	$ 35,174	$ 34,390	$ 27,741	$ 29,873
Investment-Related Assets				
Amounts receivable from pending trades	$ 108	$ 108	$ 186	$ 186
Derivative-related receivables	347	4	351	47
Total Investment-Related Assets	$ 455	$ 112	$ 537	$ 233
Investment-Related Liabilities				
Amounts payable from pending trades	$ (333)	$ (333)	$ (367)	$ (367)
Securities sold short	(82)	(95)	(257)	(321)
Derivative-related payables	(302)	(3)	(1,240)	(71)
Capital debt financing:				
Short-term	(472)	(472)	(1,145)	(1,145)
Long-term	(781)	(744)	(764)	(742)
Total Investment-Related Liabilities	$ (1,970)	$ (1,647)	$ (3,773)	$ (2,646)
NET INVESTMENTS	$ 33,659	$ 32,855	$ 24,505	$ 27,460

[1] Includes floating rate notes with maturities greater than one year with a fair value of $1,016 million for the Plan (2009 – $13 million).

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Canadian Equity and Foreign Equity

Canadian Equity and Foreign Equity include direct and indirect investments in common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds, and securities convertible into common shares of publicly listed issuers.

Valuation Techniques

Direct investments in Canadian and Foreign Equities are measured at fair value using quoted market prices, namely, the bid price. In the case of investments in pooled funds, fair value is measured by using unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(ii) Private Equity, Real Estate and Infrastructure

The Private Equity asset class is comprised of direct investments in companies and fund investments. They include investments in private companies, mezzanine debt and distressed debt. The Private Equity asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Private Equity asset class contracted by direct investments controlled by PSP Investments for the Plan is nil (2009 – nil).

The Real Estate asset class is comprised of direct investments in companies, in properties, third-party debts and fund investments in the real estate sector. Real Estate investments are classified into two portfolios (an equity portfolio and a debt portfolio). The equity portfolio is comprised of direct investments in properties and companies in the office, retail, industrial, hospitality and residential sectors, as well as private funds and publicly traded securities invested in real estate assets. The debt portfolio is comprised of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, mezzanine loans and other structured investments (collectively "Real Estate Debt") where significant portions of the value are attributed to the underlying real estate assets. The Real Estate asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Real Estate asset class contracted by direct investments controlled by PSP Investments for the Plan is approximately $1,550 million (2009 – approximately $1,540 million).

The Infrastructure asset class is comprised of direct investments in companies and fund investments. They include investments in companies engaged in the management, ownership or operation of assets in power, regulated businesses, transportation, telecom or social infrastructure. The Infrastructure asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Infrastructure asset class contracted by direct investments controlled by PSP Investments for the Plan is approximately $70 million (2009 – approximately $100 million).

Investment management fees, as disclosed in Note 1, are incurred for Private Market Investments and generally vary between 0.1% and 2.1% of the total invested and/or committed amount. Investment management fees of $111 million for the year ended March 31, 2010 (2009 – $116 million) were recorded against investment income (loss).

Valuation Techniques

The fair value of Private Market Investments held directly by PSP Investments is determined at least annually, using acceptable industry valuation methods. For each investment, the relevant methodology is applied consistently over time.

For direct Private Markets Investments as well as investments in Real Estate Debt, management uses the services of third-party appraisers to determine the fair value. In selecting appraisers, management ensures their independence and that valuation methods used are consistent with professional appraisal standards. Such standards include the *International Private Equity and Venture Capital Valuation Guidelines*, the *Canadian Uniform Standards of Professional Appraisal Practice* and the *Uniform Standards of Professional Appraisal Practice* in the United States of America. In validating the work performed by appraisers, management ensures that the assumptions used correspond to financial information and forecasts of the underlying investment.

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(ii) Private Equity, Real Estate and Infrastructure (continued)

Valuation Techniques (continued)

For direct investments in Private Equity and Infrastructure, valuation methods used include discounted cash flows analysis, earnings multiples, prices of recent comparable transactions and publicly traded comparables. Assumptions used in such valuations include discount rates and projected cash flows, which are not fully supported by prices from market observable transactions.

For direct investments in Real Estate, valuation methods used include discounted cash flows as well as recent comparable transactions. Assumptions used in such valuations include capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

The fair value of Real Estate Debt is determined using either a yield-based or collateral-based valuation technique. The yield-based valuation technique involves discounting expected future cash flows that incorporate assumptions with respect to interest rates offered for similar loans to borrowers with similar credit ratings. The collateral-based valuation technique involves assessing the recoverable value of the collateral in question, net of disposal fees.

In the case of Private Equity, Real Estate and Infrastructure fund investments, the fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

(iii) Nominal Fixed Income and World Inflation-Linked Bonds

Nominal Fixed Income includes Cash, Cash Equivalents and Other, Canadian Fixed Income and World Government Bonds. Cash Equivalents include short-term instruments having a maximum term to maturity of one year. Floating rate notes are included in Cash, Cash Equivalents and Other, provided the final maturity date does not exceed three years and the coupons reset more than once per year. Bonds reported as Nominal Fixed Income include Canadian government bonds, Canadian provincial and territorial bonds, Canadian municipal bonds and corporate bonds, as well as international sovereign bonds. World Inflation-Linked Bonds reported as Real Return Assets are fixed income securities that earn inflation adjusted returns.

PSP Investments holds ABTNs reported as Canadian Fixed Income in the investment portfolio. The ABTNs were received in exchange for third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007 and were subsequently restructured in January 2009. The ABTNs had an original face value of $1,962 million, of which $1,422 million has been allocated to the Plan. During the year ended March 31, 2010, PSP Investments received $67 million of principal repayments on the ABTNs. During the year ended March 31, 2010, principal repayments on the ABTNs of $49 million has been allocated to the Plan.

PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $705 million was allocated to the Plan. As at March 31, 2010, the margin funding facilities had not been drawn upon. As part of the exchange of the non-bank ABCP for the ABTNs, it was agreed to include in the agreement a moratorium which prevents collateral calls for a period of 18 months ending July 21, 2010.

Management's best estimate of the fair value of PSP Investments' ABTNs allocated to the Plan as at March 31, 2010 is equal to $862 million (2009 – $755 million). The fair value of the ABTNs allocated to the Plan has been reduced by the impact of the funding facilities amounting to $47 million on March 31, 2010 (2009 – $68 million). PSP Investments recorded an increase of $156 million in the fair value of the ABTNs allocated to the Plan during the year ended March 31, 2010 (decrease of $350 million during the year ended March 31, 2009).

Valuation Techniques

Cash Equivalents are recorded at cost plus accrued interest, which approximate fair value.

Fair values of bonds and floating rate notes are based on prices obtained from third-party pricing sources. They are determined using either an appropriate interest rate curve with a spread associated with the credit quality of the issuer or other generally accepted pricing methodologies.

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Nominal Fixed Income and World Inflation-Linked Bonds (continued)

Valuation Techniques (continued)

ABTNs are measured at fair value using comparable notes with similar credit quality and terms as a proxy, while taking into consideration the impact of the funding facilities. The valuation model used includes certain assumptions that are not fully supported by market observable data. Such assumptions include interest rate spreads, assumed credit rating (ranging from BB to AAA–), expected returns, an average maturity of seven years as well as liquidity estimates.

(iv) Absolute Return

In addition to the different asset classes outlined in the Statement of Investment Policies, Standards and Procedures (SIP&P), PSP Investments employs a number of absolute return strategies through units of externally managed pooled funds.

Valuation Techniques

The fair value of investments in pooled funds is measured by using the unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(v) Amounts Receivable and Payable from Pending Trades

Amounts receivable from pending trades consist of proceeds on sales of investments, excluding derivative financial instruments, which have been traded but remain unsettled at the end of the reporting period.

Amounts payable from pending trades consist of the cost of purchases of investments, excluding derivative financial instruments, which have been traded but remain unsettled at the end of the reporting period.

Valuation Techniques

The fair value of amounts receivable and payable from pending trades reflects the value at which their underlying original sale or purchase transactions were undertaken.

(vi) Securities Sold Short

Securities sold short reflect PSP Investments' commitment to purchasing securities pursuant to short selling transactions. In such transactions, PSP Investments sells securities it does not own with a commitment to purchasing similar securities on the market to cover its position.

Valuation Techniques

Using ask prices as inputs, the fair value of securities sold short is measured using the same method as the similar long positions presented under Nominal Fixed Income, World Inflation-Linked Bonds, Canadian Equity and Foreign Equity.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts, the value of which is derived from changes in underlying assets, interest or exchange rates. PSP Investments uses derivative financial instruments to increase returns or to replicate investments synthetically. Derivatives are also used to reduce the risk associated with existing investments.

PSP Investments uses the following types of derivative financial instruments as described below:

(i) Swaps

Swaps are transactions whereby two counterparties exchange cash flow streams with each other based on predetermined conditions that include a notional amount and a term. Swaps are used to increase returns or to adjust exposures of certain assets without directly purchasing or selling the underlying assets.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(ii) Futures

Futures are standardized contracts to take or make delivery of an asset (buy or sell) at a specific time in the future for a specific price that has been agreed upon today. Futures are used to adjust exposures to specified assets without directly purchasing or selling the underlying assets.

(iii) Forwards

Forwards are contracts involving the sale by one party and the purchase by another party of a predefined amount of an underlying instrument, at a predefined price and a predefined date in the future. Forwards are used for yield enhancement purposes or to manage exposures to currencies and interest rates.

(iv) Options

Options are the right, but not the obligation, to buy or sell a given amount of an underlying security, index, or commodity, at an agreed-upon price stipulated in advance, either at a determined date or at any time before the predefined maturity date.

(v) Warrants and Rights

Warrants are options on an underlying asset which is in the form of a transferable security and which can be listed on an exchange.

Rights are securities giving shareholders entitlement to purchase new shares issued by a corporation at a predetermined price (normally less than the current market price) in proportion to the number of shares already owned. Rights are issued only for a short period of time, after which they expire.

(vi) Collateralized Debt Obligations

Collateralized debt obligations are a type of asset-backed security that is constructed from a portfolio of credit-related assets. Collateralized debt obligations are usually divided into several tranches with different credit risk levels and corresponding interest payments. Any losses are applied first to the more junior tranches (lowest risk rating) before moving up in seniority.

Valuation Techniques

All listed derivative financial instruments are recorded at fair value using quoted market prices with the bid price for long positions and the ask price for short positions. Except for collateralized debt obligations, OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. For many pricing models there is no material subjectivity because the methodologies employed do not necessitate significant judgment and the pricing inputs are observed from actively quoted markets. Additionally, the pricing models used are widely accepted and used by other market participants.

The fair value of collateralized debt obligations are determined based on valuation techniques that use significant assumptions that are not all directly market observable. Such assumptions include default correlation data and recovery rate which are estimated by management. The instruments are then valued by discounting the expected cash flows using an appropriate discount factor.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Notional values of derivative financial instruments are not recorded as assets or liabilities as they represent the face amount of the contract. Notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions disclosed below, with the exception of credit derivatives [1]. Rather, they serve as the basis upon which the cash flows and the fair value of the contracts are determined.

The following table summarizes the derivatives portfolio as at March 31:

($ millions)	**2010**				2009	
INVESTMENTS	**Notional Value**	**Fair Value Assets**	**Fair Value Liabilities**	**Fair Value Net**	Notional Value	Fair Value
Equity and Commodity Derivatives						
Futures	$ 82	$ –	$ –	$ –	$ 455	$ –
Total Return Swaps	2,563	84	(1)	83	2,109	77
Variance Swaps	–	–	–	–	78	5
Warrants and Rights	1	1	–	1	1	1
Options: Listed-written	4	–	–	–	–	–
Currency Derivatives						
Forwards	7,407	225	(20)	205	14,951	(126)
Options: OTC-purchased	476	3	–	3	449	5
OTC-written	124	–	(1)	(1)	113	(1)
Interest Rate Derivatives						
Bond Forwards	149	–	(1)	(1)	253	–
Futures	379	–	–	–	–	–
Interest Rate Swaps	2,840	17	(28)	(11)	2,852	(3)
Total Return Swaps	2,045	14	(10)	4	2,556	40
Swaptions	–	–	–	–	1,817	–
Options: Listed-purchased	309	–	–	–	–	–
Listed-written	847	–	–	–	1,807	–
OTC-written	–	–	–	–	1,088	–
Credit Derivatives [1]:						
Purchased	20	1	–	1	46	38
Sold	541	2	(241)	(239)	1,183	(925)
Total	**$ 17,787**	**$ 347**	**$ (302)**	**$ 45**	$ 29,758	$ (889)

[1] Credit derivatives include collateralized debt obligations and a credit default swap. PSP Investments, through sold credit derivatives, indirectly guarantees the underlying reference obligations. The maximum potential exposure is the notional amount of the sold credit derivatives as shown in the table above.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives, as at March 31, is as follows:

($ millions)	**2010**	2009
Less than 3 months	**$ 6,691**	$ 17,686
3 to 12 months	**8,195**	8,608
Over 1 year	**2,901**	3,464
Total	**$ 17,787**	$ 29,758

(C) FAIR VALUE MEASUREMENT

Financial instruments are classified according to the following hierarchy based on the significant inputs used in measuring their fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities.

Level 2: Valuation is based on quoted market prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active. Level 2 also includes model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is based on model-based techniques for which significant assumptions are not observable in the market. They reflect management's assessment of the assumptions that market participants would use in pricing the financial instruments.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of financial instruments, as at March 31, 2010 based on the methods described above:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 12,820	$ 1,023	$ –	$ –	$ 13,843
Private Equity	–	–	3,819	–	3,819
Nominal Fixed Income	98	8,294	935	–	9,327
Real Return Assets					
World Inflation-Linked Bonds	–	245	–	–	245
Real Estate	–	–	4,467	–	4,467
Infrastructure	–	–	1,717	–	1,717
Absolute Return	–	901	855	–	1,756
INVESTMENTS	$ 12,918	$ 10,463	$ 11,793	$ –	$ 35,174
Investment-Related Assets					
Amounts receivable from pending trades [1]	$ –	$ –	$ –	$ 108	$ 108
Derivative-related receivables	–	343	4	–	347
Total Investment-Related Assets	$ –	$ 343	$ 4	$ 108	$ 455
Investment-Related Liabilities					
Amounts payable from pending trades [1]	$ –	$ –	$ –	$ (333)	$ (333)
Securities sold short	(82)	–	–	–	(82)
Derivative-related payables	–	(65)	(237)	–	(302)
Capital debt financing:					
Short-term	–	(472)	–	–	(472)
Long-term	–	(781)	–	–	(781)
Total Investment-Related Liabilities	$ (82)	$ (1,318)	$ (237)	$ (333)	$ (1,970)
NET INVESTMENTS	$ 12,836	$ 9,488	$ 11,560	$ (225)	$ 33,659

[1] No fair value hierarchy classification is required for these items.

The classification of financial instruments in the levels of the hierarchy is established at the time of the initial valuation of the instrument and reviewed on each subsequent reporting period-end.

There have been no significant transfers between Level 1 and Level 2 during the current fiscal year.

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

The following table shows a reconciliation of all movements in the fair value of financial instruments categorized within Level 3 for the year ended March 31:

	2010					
($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Opening Balance	$ 3,086	$ 817	$ 7,118	$ 495	$ (878)	$ 10,638
Purchases	1,139	–	939	203	1	2,282
Sales/Settlements	(716)	(49)	(1,071)	(6)	–	(1,842)
Total gains (losses) [1]	310	167	(802)	163	644	482
Transfers into or out of Level 3	–	–	–	–	–	–
Closing Balance	$ 3,819	$ 935	$ 6,184	$ 855	$ (233)	$ 11,560

Total gains (losses), for the year ended March 31, included in investment income (loss) are presented as follows:

	2010					
($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Total realized gains (losses)	$ 33	$ 11	$ 21	$ –	$ (1)	$ 64
Total unrealized gains (losses)	$ 277	$ 156	$ (823)	$ 163	$ 645	$ 418
Total gains (losses) [1]	$ 310	$ 167	$ (802)	$ 163	$ 644	$ 482

[1] Included in Note 6 (a).

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (a) and (b). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 3% increase/decrease in the fair value of financial instruments categorized as Level 3. This excludes Private Market fund investments as well as Real Estate Debt, where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of Private Market fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (a). With respect to Real Estate Debt, the fair value is obtained from third-party appraisers as described in Note 3 (a).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(D) INVESTMENT ASSET MIX

The SIP&P sets out the long-term target weights of the assets that shall be invested for the four Plan Accounts. Investments are classified by asset mix category as set out in the SIP&P based on the economic intent of the investment strategies of the underlying assets.

The net investments, as at March 31, are as follows:

	2010			2009		
($ millions)		**Fair Value**	**Policy Portfolio Long-Term Target**		Fair Value	Policy Portfolio Long-Term Target
World Equity						
Canadian Equity	**$ 9,853**	**29.2%**	**30.0%**	$ 6,391	26.1%	30.0%
Foreign Equity:						
US Large Cap Equity	**1,536**	**4.6**	**5.0**	672	2.7	5.0
EAFE Large Cap Equity	**1,486**	**4.4**	**5.0**	756	3.1	5.0
Small Cap Developed World Equity	**1,438**	**4.3**	**5.0**	566	2.3	5.0
Emerging Markets Equity	**2,173**	**6.5**	**7.0**	1,539	6.3	7.0
Private Equity	**3,946**	**11.7**	**10.0**	3,039	12.4	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	**1,376**	**4.1**	**2.0**	53	0.2	2.0
World Government Bonds	**1,548**	**4.6**	**5.0**	1,526	6.2	5.0
Canadian Fixed Income	**3,513**	**10.4**	**8.0**	3,084	12.6	8.0
Real Return Assets						
World Inflation-Linked Bonds	**1,560**	**4.6**	**5.0**	1,732	7.1	5.0
Real Estate	**3,722**	**11.1**	**10.0**	3,374	13.8	10.0
Infrastructure	**1,508**	**4.5**	**8.0**	1,773	7.2	8.0
NET INVESTMENTS	**$ 33,659**	**100.0%**	**100.0%**	$ 24,505	100.0%	100.0%

[1] Includes amounts related to absolute return and real estate debt strategies.

3. INVESTMENTS (continued)

(E) SECURITIES LENDING & BORROWING PROGRAMS

PSP Investments participates in securities lending and borrowing programs whereby it lends and borrows securities in order to enhance portfolio returns.

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. In the absence of an event of default, the same securities or equivalent securities must be returned to the counterparty at the end of the contract. PSP Investments does not repledge any collateral held.

The following table illustrates the fair values of the Plan's allocated securities and collateral associated with the lending and borrowing programs as at March 31:

($ millions)	2010	2009
Securities Lending		
Securities lent	**$ 2,913**	$ 1,958
Collateral contractually receivable [1]	**3,039**	2,050
Securities Borrowing		
Securities borrowed	**82**	257
Collateral contractually payable [2]	**87**	263

[1] The minimum fair value of collateral required is equal to 102% of the fair value of the securities lent.

[2] The minimum fair value of collateral required is equal to 100% of the fair value of the securities borrowed.

4. INVESTMENT RISK MANAGEMENT

Risk Management is a central part of PSP Investments' strategic management. It is a continuous process whereby PSP Investments methodically addresses the risks related to its various investment activities with the goal of achieving a maximum rate of return without undue risk of loss and a sustained benefit within each activity and across the total portfolio.

A risk governance structure that includes required reporting on risk to all levels in the organization also ensures that appropriate objectives are pursued and achieved in line with the fulfillment of PSP Investments' legislated mandate. The Board of Directors and its committees oversee various issues related to risk and receive assurance from senior management and an independent internal auditor reporting directly to the Audit and Conflicts Committee.

The use of financial instruments exposes PSP Investments to credit and liquidity risks as well as market risks including foreign exchange and interest rate risks. These risks are managed in accordance with the Investment Risk Management Handbook, which is an integral part of PSP Investments' risk control system. The Investment Risk Management Handbook contains an Investment Risk Management Policy which supplements the SIP&P (Policy Portfolio). The Policy Portfolio determines a diversification strategy to mitigate risk whereby PSP Investments invests in a diversified portfolio of investments based on established criteria. Additionally, the objective of these policies is to provide a framework for the management of credit, liquidity and market risks. Derivative financial instruments, traded either on exchanges or OTC, are one of the vehicles used to mitigate the impact of market risk.

(A) MARKET RISK

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, volatility in share and commodity prices, interest rate, foreign exchange or other factors affecting similar securities traded in the market.

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Market risk is measured using the method known as Value-at-Risk (VaR). VaR is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. PSP Investments has chosen a yearly 95% confidence level to measure and report VaR. PSP Investments uses a Historical VaR model incorporating three years of monthly market returns which are scaled to a twelve-month holding period. Risk Management is responsible for implementing and maintaining a VaR measurement methodology for all asset classes and all financial risk factors.

Historical VaR is statistically valid under normal market conditions and does not specifically consider losses from severe market events. The Historical VaR model also assumes that the future will behave in a similar pattern to the past. If future market conditions differ significantly from those of the past, potential losses may differ from those originally estimated. The VaR is an estimate of a single value in a distribution of potential losses that can be experienced. As a result, it is not an estimate of the maximum potential loss.

The goal of actively managing the portfolio is to outperform the policy portfolio benchmarks while maintaining the active risk under 400 basis points (bps). Relative VaR, as a result, is the maximum amount of loss of total investments, with 95% confidence level, relative to the policy portfolio benchmark over a twelve-month period.

The following table shows the total Relative VaR allocated to the Plan and the diversification effect as at March 31 based on the economic intent of the investment strategies of the underlying assets. The diversification effect captures the effect of holding different types of assets which may react differently in various types of situations and thus having the effect of reducing overall Relative VaR.

Active Risk Taken

(Relative VaR – $ millions)	2010	2009
World Equity	$ 500	$ 571
Real Return Assets	631	772
Absolute Return	299	841
Total Relative VaR (Undiversified)	1,430	2,184
Diversification Effect	(716)	(1,203)
Total Relative VaR	$ 714	$ 981

Risk Management monitors the absolute risk of the Policy Portfolio on a quarterly basis to ensure no undue loss may be experienced by PSP Investments.

Generally, changes in VaR between reporting periods are due to changes in the level of exposure, volatilities and/or correlations among asset classes. Although VaR is a widely accepted risk measure, it must be complemented by other risk measures. PSP Investments therefore uses stress testing and scenario analysis to examine the impact on financial results of abnormally large movements in risk factors. Stress testing and scenario analysis are used to test a portfolio's sensitivity to various risk factors and key model assumptions. These methods also use historically stressed periods to evaluate how a current portfolio would fare under such circumstances. Stress testing is also deployed to assess new product behaviour. Stress testing and scenario analysis are utilized as a complement to the Historical VaR measure in order to provide greater insight on the size of potential losses that may be experienced. PSP Investments uses the expected shortfall and tail analysis measures to determine this. Expected shortfall is defined as the conditional expectation beyond the VaR level. It is measured by averaging all data points showing a loss greater than VaR measured at a given confidence level. By increasing the confidence level of the VaR measure from 95% to 99%, PSP Investments is able to assess the size of the potential loss that would be exceeded one year out of 100 (instead of one year out of 20). Therefore, there is a greater probability for larger losses, at the 99% confidence level, in extreme market conditions. Risk Management presents a stress testing and scenario analysis report to senior management on a quarterly basis.

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(i) Interest Rate Risk

Interest rate risk refers to the risk that fluctuations in interest rates will directly affect the fair value of the Plan's net asset values. The most significant exposure to interest rate risk is related to the investment in bonds, ABTNs and Real Estate Debt.

The terms to maturity of the investments, before allocating the effect of derivative contracts and investment-related assets and liabilities, as at March 31, are as follows:

	Terms to Maturity					
($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	2010 Total	2009 Total
Government of Canada bonds	$ 135	$ 1,186	$ 249	$ 273	$ 1,843	$ 2,215
Provincial and Territorial bonds	132	420	224	386	1,162	1,073
Municipal bonds	3	16	36	6	61	61
Corporate bonds	187	442	327	278	1,234	1,077
ABTNs	–	33	–	829	862	755
Total Canadian Fixed Income	$ 457	$ 2,097	$ 836	$ 1,772	$ 5,162	$ 5,181
Total World Government Bonds	$ 5	$ 345	$ 239	$ 208	$ 797	$ 550
Total World Inflation-Linked Bonds	$ –	$ 59	$ 57	$ 129	$ 245	$ 142
Real Estate Debt [1]	$ 200	$ 127	$ –	$ 25	$ 352	$ 545
Grand Total	$ 662	$ 2,628	$ 1,132	$ 2,134	$ 6,556	$ 6,418

[1] Real Estate Debt is a component of the Real Estate asset class disclosed in Note 3 (a).

The terms to maturity of PSP Investments' capital debt financing are disclosed in Note 8.

Absolute return strategies, as described in Note 3, and derivative contracts are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 4 (a).

Additionally, the exposure to interest rate risk for short-term instruments and amounts receivable from pending trades would not be significant due to their short-term nature.

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts, positions in foreign currencies. PSP Investments' policy is to hedge 50% of its foreign currency investments excluding Emerging Markets Equity.

The underlying net foreign currency exposures for the Plan, after allocating the effect of derivative contracts and investment-related assets and liabilities for both monetary and non-monetary items, as at March 31, are as follows:

	2010		2009	
Currency (in millions of Canadian $)	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 4,565**	**51.2%**	$ 3,353	52.9%
Euro	**1,321**	**14.8**	1,498	23.6
British Pound	**566**	**6.4**	376	5.9
Brazilian Real	**487**	**5.5**	47	0.7
Hong Kong Dollar	**368**	**4.1**	217	3.4
Japanese Yen	**312**	**3.5**	282	4.5
Korean Won	**255**	**2.9**	120	1.9
New Taiwan Dollar	**145**	**1.6**	126	2.0
South African Rand	**114**	**1.3**	67	1.1
Australian Dollar	**110**	**1.2**	120	1.9
Indian Rupee	**109**	**1.2**	62	1.0
Turkish Lira	**79**	**0.9**	44	0.7
Others	**478**	**5.4**	29	0.4
Total	**$ 8,909**	**100.0%**	$ 6,341	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies of $3,623 million ($2,968 million US, €422 million, £1 million and 227 million South African Rands (ZAR)) for the Plan which are not included in the foreign currency exposure table.

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

PSP Investments is exposed to credit risk, that is, the risk that the issuer of a debt security or a counterparty to a derivative contract is unable to meet its financial obligations.

Credit risk encompasses the risk of a deterioration of creditworthiness and the respective concentration risk. Credit risk monitoring entails an evaluation of the credit quality of each issuer to which PSP Investments is exposed. To perform this evaluation, PSP Investments relies on four recognized credit rating agencies. A minimum of two credit ratings are used to classify each security; securities rated by only one agency are classified as "not rated". If the agencies disagree as to a security's credit quality, PSP Investments uses the lowest of the available ratings.

To monitor the evolution of credit risk, PSP Investments periodically produces a concentration report by credit rating of all credit-sensitive financial securities with the exception of securities held in pooled funds or for Private Market Investments.

PSP Investments' concentration of credit risk by credit rating for the Plan, as at March 31, is as follows:

	2010	2009
Investment grade (AAA to BBB–)	**89.9%**	88.7%
Below investment grade (BB+ and below)	**–**	–
Not rated:		
Rated by a single credit rating agency	**8.5**	8.5
Not rated by credit rating agencies	**1.6**	2.8
Total	**100.0%**	100.0%

The breakdown of credit concentration risk for the Plan does not include investments in distressed debt included in pooled funds in the amount of approximately $1.5 billion as at March 31, 2010 (2009 – $1.5 billion). Such investments typically include debt securities of issuers close to default, and the investment in such securities are quasi-equity in nature.

As at March 31, 2010, the Plan also has a net notional exposure of $447 million to collateralized debt obligations, of which approximately 64% of the dollar exposure is rated "Investment grade", as well as funding facilities of a maximum amount of $705 million to support potential margin calls on the ABTNs (Note 3 (a) (iii)).

As at March 31, 2010, the Plan's maximum exposure to credit risk, excluding collateral held and the investments in distressed debt and collateralized debt obligations described above, amounts to approximately $9.4 billion (2009 – approximately $8 billion).

(i) Counterparty Risk

Counterparty risk represents the credit risk from current and potential exposure related to transactions involving derivative contracts. In order to minimize derivative contract counterparty risk, PSP Investments deals only with counterparties with a minimum credit rating of "A–" as at the trade date, as provided by a recognized credit rating agency. PSP Investments monitors the credit ratings of counterparties on a daily basis and has the ability to terminate all trades with counterparties who have their credit rating downgraded below "A–" subsequent to the trade date. PSP Investments also uses credit mitigation techniques such as master-netting arrangements and collateral transfers through the use of Credit Support Annexes (CSA).

PSP Investments' policy also requires the use of the International Swaps and Derivative Association (ISDA) Master Agreement with all counterparties to derivative contracts. The ISDA Master Agreement provides the contractual framework within which dealing activities across a full range of OTC products are conducted and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or other pre-determined events occur.

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

Additionally, the CSA to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the event of the failure of the counterparty and requires PSP Investments to contribute further collateral when requested. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold.

On behalf of the Plan, PSP Investments deposited or pledged securities with a fair value of $152 million as collateral with various financial institutions as at March 31, 2010 (2009 – $751 million) while securities with a fair value of $130 million (2009 – $77 million) were received from other counterparties as collateral. PSP Investments does not repledge any collateral held. All collateral deposited, pledged and received were held with counterparties who had a minimum credit rating of "A–" as at March 31, 2010.

Risk Management is responsible for counterparty risk monitoring and mitigation as well as maintaining a comprehensive, disciplined, and enterprise-wide process for tracking and managing counterparty risk. As such, Risk Management measures counterparty risk on an ongoing basis, evaluates and tracks the creditworthiness of current counterparties and mitigates counterparty risk through collateral management.

(C) LIQUIDITY RISK

Liquidity risk corresponds to PSP Investments' ability to meet its financial obligations when they come due with sufficient and readily available cash resources. PSP Investments' cash position is monitored on a daily basis. In general, investments in cash, cash equivalents, floating rate notes, debt and public equities are expected to be highly liquid as they will be invested in securities that are actively traded. Risk Management utilizes appropriate measures and controls to monitor liquidity risk in order to ensure that there is sufficient liquidity to meet financial obligations as they come due. A liquidity report taking into consideration future forecasted cash flows is prepared and presented to senior management on a weekly basis. This ensures that sufficient cash reserves are available to meet forecasted cash outflows. Additionally, sufficient sources of liquidity are maintained for deployment in case of market disruption.

PSP Investments has the ability to raise additional capital through the use of its capital debt program. This program allows PSP Investments to issue short-term promissory notes and medium-term notes. Note 8 provides additional information on the usage of the capital debt program.

The terms to maturity of the notional amount of derivatives, including related payable amounts, are disclosed in Note 3 (b).

4. INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial assets and liabilities, aggregated according to their maturities as at March 31, 2010.

Liabilities are presented in the earliest period in which the counterparty can request payment.

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities				
Amounts payable from pending trades	$ (333)	$ –	$ –	$ (333)
Securities sold short	(82)	–	–	(82)
Capital debt financing	(454)	(18)	(781)	(1,253)
Accounts payable and other liabilities	(30)	–	(8)	(38)
Total	$ (899)	$ (18)	$ (789)	$ (1,706)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial assets and liabilities				
Derivative-related assets	$ 128	$ 203	$ 16	$ 347
Derivative-related liabilities	(24)	(14)	(264)	(302)
Total	$ 104	$ 189	$ (248)	$ 45

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

5. FUND TRANSFERS

PSP Investments received fund transfers of $3,707 million for the year ended March 31, 2010 (2009 – $3,179 million) from the Public Service Pension Fund. The transfers received are comprised of the net employer and employee contributions to the Public Service pension plan in respect of member service after April 1, 2000.

6. INVESTMENT INCOME (LOSS)

(A) INVESTMENT INCOME (LOSS)

Investment income (loss), for the year ended March 31, is as follows:

($ millions)	2010	2009
Interest income	$ 297	$ 339
Dividend income	296	316
Other income	148	173
Security lending income (net) [1]	7	5
Dividend expense	(16)	(19)
Interest expense (Note 8)	(39)	(48)
Transaction costs	(15)	(26)
External investment management fees [2]	(24)	(38)
	654	702
Net realized gains (losses) [3]	1,110	(4,499)
Net unrealized gains (losses)	3,761	(3,087)
Investment Income (Loss)	$ 5,525	$ (6,884)

[1] Includes fees on securities borrowed.

[2] These are amounts incurred for public market investments that are paid directly by PSP Investments (Note 1). This excludes amounts incurred for Private Market Investments, disclosed in Note 3 (a) (ii), and certain public market pooled fund investments in the amount of $8 million for the year ended March 31, 2010 (2009 – $4 million) that are not paid directly by PSP Investments.

[3] Includes foreign currency gains (losses) of $451 million for the year ended March 31, 2010 (2009 – $(439) million).

(B) INVESTMENT INCOME (LOSS) BY ASSET MIX

Investment income (loss) by asset mix based on the economic intent of the investment strategies of the underlying assets as outlined in the SIP&P, for the year ended March 31, after allocating net realized and unrealized gains (losses) on investments to the asset classes to which they relate, is as follows:

($ millions)	2010	2009
World Equity		
Canadian Equity	$ 2,680	$ (2,610)
Foreign Equity:		
US Large Cap Equity	179	(326)
EAFE Large Cap Equity	183	(430)
Small Cap Developed World Equity	205	(357)
Emerging Markets Equity	736	(715)
Private Equity	880	(1,153)
Nominal Fixed Income		
Cash & Cash Equivalents	33	25
World Government Bonds	(250)	347
Canadian Fixed Income	142	142
Real Return Assets		
World Inflation-Linked Bonds	(184)	119
Real Estate	20	(566)
Infrastructure	115	81
Absolute Return [1]	786	(1,441)
Investment Income (Loss)	$ 5,525	$ (6,884)

[1] Includes amounts related to real estate debt strategies.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

7. EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the plans for which it provides investment services. Under section 4(3) of the Act, the President of the Treasury Board shall determine to which plan account these costs will be charged, in consultation with the Minister of National Defence and the Minister of Public Safety. An allocation policy has been developed which allocates the direct costs of investment activities, such as external investment management fees and custodial fees, to each plan account, based upon the asset value of each plan account at the time the expense was incurred.

All other operating expenses, excluding the direct cost of investment activities listed above, for the year ended March 31, have been allocated in proportion to the annual amount of net assets in each Plan Account as follows:

	2010	2009
Public Service Pension Plan Account	**72.5%**	72.6%
Canadian Forces Pension Plan Account	**20.0**	20.1
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.3**	0.1
Total	**100.0%**	100.0%

Expenses are paid by PSP Investments by way of advances from the Public Service Pension Plan Account, which are reimbursed by the other plan accounts on a quarterly basis.

(B) OPERATING EXPENSES

Operating expenses allocated to this Plan account, for the year ended March 31, consist of the following:

($ thousands)	**2010**	2009
Salaries and benefits	**$ 38,745**	$ 35,055
Professional and consulting fees	**6,735**	7,255
Office supplies and equipment	**8,135**	6,374
Other operating expenses	**3,046**	5,797
Depreciation of fixed assets	**5,143**	3,381
Occupancy costs	**3,135**	2,624
Custodial fees	**1,129**	910
Remuneration earned by Directors	**575**	661
Travel and related expenses for Directors	**127**	278
Communication expenses	**229**	68
Total	**$ 66,999**	$ 62,403

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

8. CAPITAL DEBT FINANCING

As of March 31, 2010, PSP Capital Inc. has $649 million (2009 – $1,579 million) of short-term promissory notes outstanding with maturity dates between 14 and 120 days of issuance, of which $472 million (2009 – $1,145 million) has been allocated to the Public Service Pension Plan Account and included in Note 3 (a) as a short-term investment-related liability. As at March 31, 2010, PSP Capital Inc. has $1 billion (2009 – $1 billion) of medium-term notes issued and outstanding, of which $725 million (2009 – $725 million) has been allocated to the Public Service Pension Plan Account. These medium-term notes bear interest of 4.57% per annum and have a maturity date of December 9, 2013. These medium-term notes are included in Note 3 (a) as a long-term investment-related liability. As at March 31, 2010, the fair value of these medium-term notes is $1,073 million (2009 – $1,054 million), of which $781 million (2009 – $764 million) has been allocated to the Public Service Pension Plan Account. The maximum authorized by the Board of Directors for both the short-term promissory notes and medium-term notes is $2 billion. The capital raised, primarily used to finance investments in the Real Estate and Infrastructure asset classes, is unconditionally and irrevocably guaranteed by PSP Investments and is in accordance with the approved PSP Investments' corporate policy for leverage.

The operating expenses incurred by PSP Capital Inc. were allocated to each Plan account as described in Note 7 (a).

Interest expense, for the year ended March 31, is as follows:

($ thousands)	**2010**	2009
Short-term promissory notes	**$ 5,393**	$ 41,051
Medium-term notes	**33,214**	7,263
Total	**$ 38,607**	$ 48,314

9. CAPITAL MANAGEMENT

As an investment company, PSP Investments objectives in managing its capital are:

- To invest fund transfers, outlined in Note 5, in the best interests of the beneficiaries and contributors under the *Superannuation Acts*. The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plans established under the *Superannuation Acts*. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.
- To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc., and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 8 provides information on the capital debt financing and Note 4 (c) provides information on PSP Investments' liquidity. Additionally, as at March 31, 2010, PSP Investments has an operating line of credit of $10 million (2009 – $10 million). As at March 31, 2010, no amounts have been withdrawn (2009 – nil).

The capital structure of PSP Investments consists of fund transfers and capital debt financing. PSP Investments has no externally imposed restrictions on capital.

10. GUARANTEES AND INDEMNITY

PSP Investments provides indemnification to its Directors, its Officers and to certain PSP Investments representatives who are asked to serve on boards of directors (or like bodies) or investment advisory boards (or like bodies) of entities in which PSP Investments or its wholly-owned subsidiaries have made an investment or have a financial interest. As a result, but subject to the Act, PSP Investments may be required to indemnify these representatives for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties, unless the liability of such a representative relates to a failure to act honestly and in good faith. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

As part of investment transactions, PSP Investments and its subsidiaries guaranteed letter of credit facilities. The beneficiaries of these letter of credit facilities have the ability to draw against these facilities to the extent that the contractual obligations, as defined in the related agreements, are not met. As at March 31, 2010, the maximum exposure of the Plan was $7 million (2009 – $11 million).

As at March 31, 2010, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan would assume the obligation up to $292 million (2009 – $292 million) plus interest and other related costs.

PSP Investments also unconditionally and irrevocably guarantees all credit facilities, short-term promissory notes and medium-term notes issued by PSP Capital Inc.

11. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, the portion of PSP Investments' commitments that would be assumed by the Plan is as follows:

($ millions)	**2010**	2009
Private Equity	**$ 2,295**	$ 3,356
Real Estate	**1,014**	1,301
Infrastructure	**311**	418
Public markets	**238**	419
Total	**$ 3,858**	$ 5,494

CANADIAN FORCES PENSION PLAN ACCOUNT

AUDITORS' REPORT

To the Minister of National Defence

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Canadian Forces Pension Plan Account (the Canadian Forces Pension Plan Account) as at March 31, 2010, and the Statements of Net Income (Loss) from Operations and Comprehensive Income and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's (PSP Investments) management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Canadian Forces Pension Plan Account as at March 31, 2010, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the Canadian Forces Pension Plan Account that have come to our notice during our audit of the financial statements have, in all significant respects, been in accordance with the applicable provisions of Part X of the *Financial Administration Act* and regulations, the *Public Sector Pension Investment Board Act* and regulations and the by-laws of PSP Investments and its wholly-owned subsidiaries.

Deloitte & Touche LLP[1]

[1] Chartered accountant auditor permit No. 18527

Montreal, Canada
May 10, 2010

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 10, 2010

CANADIAN FORCES PENSION PLAN ACCOUNT

BALANCE SHEET

As at March 31

($ millions)	2010	2009
ASSETS		
Investments (Note 3 (a))	**$ 9,523**	$ 7,650
Investment-related assets (Note 3 (a))	**123**	148
Other assets	**9**	7
TOTAL ASSETS	**$ 9,655**	$ 7,805
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 533**	$ 1,040
Accounts payable and other liabilities	**9**	9
Due to the Public Service Pension Plan Account	**6**	6
TOTAL LIABILITIES	**$ 548**	$ 1,055
NET ASSETS	**$ 9,107**	$ 6,750
Accumulated net income from operations and comprehensive income	**$ 1,587**	$ 96
Accumulated fund transfers	**7,520**	6,654
NET ASSETS	**$ 9,107**	$ 6,750

Commitments (Note 11)

The accompanying notes are an integral part of the financial statements.

On behalf of the board of Directors:

Paul Cantor
Chair of the Board

William A. MacKinnon
Chair of the Audit and Conflicts Committee

CANADIAN FORCES PENSION PLAN ACCOUNT

STATEMENT OF NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME

For the year ended March 31

($ millions)	2010	2009
INVESTMENT INCOME (LOSS) (Note 6)	**$ 1,509**	$ (1,905)
OPERATING EXPENSES (Note 7)	**$ 18**	$ 17
NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ 1,491**	$ (1,922)

The accompanying notes are an integral part of the financial statements.

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2010	2009
NET ASSETS, BEGINNING OF YEAR	**$ 6,750**	$ 7,819
Fund transfers (Note 5)	**866**	853
Net income (loss) from operations and comprehensive income	**1,491**	(1,922)
Increase (decrease) in net assets for the year	**2,357**	(1,069)
NET ASSETS, END OF YEAR	**$ 9,107**	$ 6,750

The accompanying notes are an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) is a crown corporation established under the *Public Sector Pension Investment Board Act* ("the Act") with a mandate to invest the net contributions of the Public Service, Canadian Forces, Royal Canadian Mounted Police and Reserve Force pension plans in financial markets.

The Canadian Forces Pension Fund was established by amendments to the *Canadian Forces Superannuation Act*, to receive contributions and make benefit payments in respect of member service after April 1, 2000. The net contributions are transferred, by the Canadian Forces Pension Fund, to PSP Investments – Canadian Forces Pension Plan Account for investment. PSP Investments maintains records of the pension fund's net contributions, as well as the allocation of its investments and the results of its operations in the plan account.

PSP Investments is responsible for managing amounts that are transferred to it in the best interests of the beneficiaries and contributors under the *Canadian Forces Superannuation Act*. The amounts are to be invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the Canadian Forces *Superannuation Act*.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it from the Canadian Forces Pension Fund in respect of member service after April 1, 2000. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of the Canadian Forces Pension Fund. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and the requirements of the Act. PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value are included in investment income (loss) as net unrealized gains (losses).

Comparative figures have been reclassified to conform to the current year's presentation.

VALUATION OF INVESTMENTS

Investments, investment-related assets and investment-related liabilities are recorded as of the trade date (the date upon which the substantial risks and rewards are transferred) and are stated at fair value. Fair value is an estimate of the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Market prices or rates are used to determine fair value where an active market exists (such as a recognized securities exchange), as it is the best evidence of the fair value of an investment. If quoted market prices or rates are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the end of the reporting period that are derived from observable market data.

Valuation techniques are generally applied to investments in the Private Equity, Real Estate and Infrastructure asset classes (collectively "Private Market Investments"), over-the-counter (OTC) derivatives as well as asset-backed term notes (ABTNs). The values derived from applying these techniques are impacted by the choice of valuation model and the underlying assumptions made concerning factors such as the amounts and timing of future cash flows, discount rates, volatility and credit risk. In certain cases, such assumptions are not supported by market observable data.

The valuation methods of each asset class are described in Notes 3 (a) and (b).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF CAPITAL DEBT FINANCING

PSP Investments' short-term capital debt financing is recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' long-term capital debt financing is based on prices that are obtained from third-party pricing sources. It is measured using an interest rate curve with a spread consistent with PSP Investments' credit quality.

TRANSACTION COSTS

Transaction costs are incremental costs directly attributable to the acquisition, due diligence, issue, or disposal of a financial asset or financial liability. Transaction costs are expensed as incurred and recorded as a component of investment income (loss).

INVESTMENT MANAGEMENT FEES

Investment management fees are costs directly attributable to the external management of assets on behalf of PSP Investments. Investment management fees incurred for Private Market Investments are paid, as determined by the fund manager, either by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment (Note 3 (a) (ii)). These amounts are recorded against investment income (loss). Investment management fees are also incurred for certain public equity investments and these amounts are paid, either directly by PSP Investments or offset against distributions received from pooled fund investments. In both cases, they are recorded against investment income (loss) (Note 6).

INCOME RECOGNITION

The investment income (loss) has been allocated proportionately based on the asset value held by the Canadian Forces Pension Plan Account ("the Plan").

Investment income (loss) is made up of interest income, dividends, realized gains (losses) on the disposal of investments and unrealized gains (losses) which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Interest income is recognized as earned. Dividends are recognized on the ex-dividend date and are reflected as dividend income. Dividends paid on securities sold short are reflected as dividend expense. Additionally, other income includes the related distributions from pooled funds, limited partnerships as well as from direct and co-investments, all from Private Market Investments.

TRANSLATION OF FOREIGN CURRENCIES

Investment transactions in foreign currencies are recorded at exchange rates prevailing on the transaction date. Investments denominated in foreign currencies and held at the end of the year are translated at exchange rates in effect at the year-end date. The resulting realized and unrealized gains (losses) on foreign exchange are included in investment income (loss).

FUND TRANSFERS

Amounts received from each Pension Fund are recorded in their respective plan account.

INCOME TAXES

PSP Investments and the majority of its subsidiaries are exempt from Part I tax under paragraph 149(1)(*d*) of the *Income Tax Act* (Canada).

USE OF ESTIMATES

In preparing these financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of Private Market Investments, ABTNs, derivatives, related income and expenses and note disclosures. Although estimates and assumptions reflect management's best judgement, actual results may differ from these estimates.

2. CHANGES IN ACCOUNTING POLICIES (continued)

AMENDMENT TO ACCOUNTING STANDARD

In June 2009, the Canadian Institute of Chartered Accountants (CICA) amended Section 3862 "Financial Instruments – Disclosures" of the CICA Handbook. This amendment is effective for annual financial statements relating to fiscal years ending after September 30, 2009.

The amendment enhances disclosures about fair value measurements of financial instruments as well as the liquidity risk of derivative financial liabilities.

The principal disclosures introduced by this amendment require financial instruments measured at fair value to be categorized into one of three fair value hierarchy levels. Such categorization is based on the significance of the inputs used in measuring such value as well as disclosure of movements between levels of the fair value hierarchy.

Additional disclosures for liquidity risk call for a maturity analysis for derivative financial liabilities based on the way in which an entity manages its liquidity risk.

PSP Investments adopted the provisions of such amendments for its March 31, 2010 financial statements. Required disclosures are made in Note 3 (c) and Note 4 (c).

FUTURE CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises will converge with International Financial Reporting Standards (IFRS) effective January 1, 2011. In response to this change, PSP Investments has put in place a transition plan that would allow it to prepare and present its March 31, 2012 financial statements under IFRS.

In analyzing the various impacts of its transition to IFRS, PSP Investments concluded that the requirement to consolidate its controlled investments ranked as one of the most significant of such impacts.

In April 2010, the AcSB issued Section 4600 "Pension Plans" of the CICA Handbook requiring pension plans in Canada to follow this standard rather than convert to IFRS in the same fashion as other publicly accountable enterprises. Under Section 4600, pension plans would continue to account for and report their investments at fair value as was previously done under Section 4100 "Pension Plans" of the CICA Handbook. The provisions of Section 4600 apply to annual financial statements relating to fiscal years beginning on or after January 1, 2011.

Concurrent with the issuance of Section 4600, the AcSB issued an exposure draft that proposed a scope expansion to include entities, such as PSP Investments, that are separate from pension plans and whose sole purpose is to hold and invest assets received from one or more pension plans, but does not itself have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments. The AcSB has indicated that it anticipates reaching a decision concerning the exposure draft in June 2010.

Management is currently monitoring the outcome of this exposure draft and evaluating its impact on PSP Investments' financial statements as well as the IFRS transition plan.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS

(A) INVESTMENT PORTFOLIO

The investment portfolio, before allocating the effect of derivative contracts and investment-related assets and liabilities to the asset classes to which they relate, as at March 31, is as follows:

($ millions)	2010		2009	
Asset Class	**Fair Value**	**Cost**	Fair Value	Cost
World Equity				
Canadian Equity	**$ 2,039**	**$ 1,794**	$ 1,265	$ 1,534
Foreign Equity:				
US Large Cap Equity	**420**	**406**	143	197
EAFE Large Cap Equity	**407**	**468**	232	369
Small Cap Developed World Equity	**385**	**358**	146	199
Emerging Markets Equity	**497**	**444**	292	368
Private Equity	**1,034**	**1,108**	852	996
Nominal Fixed Income				
Cash, Cash Equivalents and Other [1]	**912**	**938**	613	665
World Government Bonds	**216**	**230**	152	134
Canadian Fixed Income	**1,398**	**1,360**	1,429	1,436
Real Return Assets				
World Inflation-Linked Bonds	**66**	**69**	39	39
Real Estate	**1,209**	**1,214**	1,421	1,284
Infrastructure	**465**	**477**	542	467
Absolute Return	**475**	**448**	524	549
INVESTMENTS	**$ 9,523**	**$ 9,314**	$ 7,650	$ 8,237
Investment-Related Assets				
Amounts receivable from pending trades	**$ 29**	**$ 29**	$ 51	$ 51
Derivative-related receivables	**94**	**2**	97	13
Total Investment-Related Assets	**$ 123**	**$ 31**	$ 148	$ 64
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (90)**	**$ (90)**	$ (101)	$ (101)
Securities sold short	**(22)**	**(26)**	(71)	(89)
Derivative-related payables	**(82)**	**–**	(342)	(19)
Capital debt financing:				
Short-term	**(128)**	**(128)**	(316)	(316)
Long-term	**(211)**	**(202)**	(210)	(205)
Total Investment-Related Liabilities	**$ (533)**	**$ (446)**	$ (1,040)	$ (730)
NET INVESTMENTS	**$ 9,113**	**$ 8,899**	$ 6,758	$ 7,571

[1] Includes floating rate notes with maturities greater than one year with a fair value of $275 million for the Plan (2009 – $4 million).

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Canadian Equity and Foreign Equity

Canadian Equity and Foreign Equity include direct and indirect investments in common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds, and securities convertible into common shares of publicly listed issuers.

Valuation Techniques

Direct investments in Canadian and Foreign Equities are measured at fair value using quoted market prices, namely, the bid price. In the case of investments in pooled funds, fair value is measured by using unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(ii) Private Equity, Real Estate and Infrastructure

The Private Equity asset class is comprised of direct investments in companies and fund investments. They include investments in private companies, mezzanine debt and distressed debt. The Private Equity asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Private Equity asset class contracted by direct investments controlled by PSP Investments for the Plan is nil (2009 – nil).

The Real Estate asset class is comprised of direct investments in companies, in properties, third-party debts and fund investments in the real estate sector. Real Estate investments are classified into two portfolios (an equity portfolio and a debt portfolio). The equity portfolio is comprised of direct investments in properties and companies in the office, retail, industrial, hospitality and residential sectors, as well as private funds and publicly traded securities invested in real estate assets. The debt portfolio is comprised of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, mezzanine loans and other structured investments (collectively "Real Estate Debt") where significant portions of the value are attributed to the underlying real estate assets. The Real Estate asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Real Estate asset class contracted by direct investments controlled by PSP Investments for the Plan is approximately $450 million (2009 – approximately $410 million).

The Infrastructure asset class is comprised of direct investments in companies and fund investments. They include investments in companies engaged in the management, ownership or operation of assets in power, regulated businesses, transportation, telecom or social infrastructure. The Infrastructure asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Infrastructure asset class contracted by direct investments controlled by PSP Investments for the Plan is approximately $20 million (2009 – approximately $40 million).

Investment management fees, as disclosed in Note 1, are incurred for Private Market Investments and generally vary between 0.1% and 2.1% of the total invested and/or committed amount. Investment management fees of $30 million for the year ended March 31, 2010 (2009 – $32 million) were recorded against investment income (loss).

Valuation Techniques

The fair value of Private Market Investments held directly by PSP Investments is determined at least annually, using acceptable industry valuation methods. For each investment, the relevant methodology is applied consistently over time.

For direct Private Markets Investments as well as investments in Real Estate Debt, management uses the services of third-party appraisers to determine the fair value. In selecting appraisers, management ensures their independence and that valuation methods used are consistent with professional appraisal standards. Such standards include the *International Private Equity and Venture Capital Valuation Guidelines*, the *Canadian Uniform Standards of Professional Appraisal Practice* and the *Uniform Standards of Professional Appraisal Practice* in the United States of America. In validating the work performed by appraisers, management ensures that the assumptions used correspond to financial information and forecasts of the underlying investment.

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(ii) Private Equity, Real Estate and Infrastructure (continued)

Valuation Techniques (continued)

For direct investments in Private Equity and Infrastructure, valuation methods used include discounted cash flows analysis, earnings multiples, prices of recent comparable transactions and publicly traded comparables. Assumptions used in such valuations include discount rates and projected cash flows, which are not fully supported by prices from market observable transactions.

For direct investments in Real Estate, valuation methods used include discounted cash flows as well as recent comparable transactions. Assumptions used in such valuations include capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

The fair value of Real Estate Debt is determined using either a yield-based or collateral-based valuation technique. The yield-based valuation technique involves discounting expected future cash flows that incorporate assumptions with respect to interest rates offered for similar loans to borrowers with similar credit ratings. The collateral-based valuation technique involves assessing the recoverable value of the collateral in question, net of disposal fees.

In the case of Private Equity, Real Estate and Infrastructure fund investments, the fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

(iii) Nominal Fixed Income and World Inflation-Linked Bonds

Nominal Fixed Income includes Cash, Cash Equivalents and Other, Canadian Fixed Income and World Government Bonds. Cash Equivalents include short-term instruments having a maximum term to maturity of one year. Floating rate notes are included in Cash, Cash Equivalents and Other, provided the final maturity date does not exceed three years and the coupons reset more than once per year. Bonds reported as Nominal Fixed Income include Canadian government bonds, Canadian provincial and territorial bonds, Canadian municipal bonds and corporate bonds, as well as international sovereign bonds. World Inflation-Linked Bonds reported as Real Return Assets are fixed income securities that earn inflation adjusted returns.

PSP Investments holds ABTNs reported as Canadian Fixed Income in the investment portfolio. The ABTNs were received in exchange for third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007 and were subsequently restructured in January 2009. The ABTNs had an original face value of $1,962 million, of which $393 million has been allocated to the Plan. During the year ended March 31, 2010, PSP Investments received $67 million of principal repayments on the ABTNs. During the year ended March 31, 2010, principal repayments on the ABTNs of $13 million has been allocated to the Plan.

PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $191 million was allocated to the Plan. As at March 31, 2010, the margin funding facilities had not been drawn upon. As part of the exchange of the non-bank ABCP for the ABTNs, it was agreed to include in the agreement a moratorium which prevents collateral calls for a period of 18 months ending July 21, 2010.

Management's best estimate of the fair value of PSP Investments' ABTNs allocated to the Plan as at March 31, 2010 is equal to $233 million (2009 – $207 million). The fair value of the ABTNs allocated to the Plan has been reduced by the impact of the funding facilities amounting to $13 million on March 31, 2010 (2009 – $19 million). PSP Investments recorded an increase of $39 million in the fair value of the ABTNs allocated to the Plan during the year ended March 31, 2010 (decrease of $98 million during the year ended March 31, 2009).

Valuation Techniques

Cash Equivalents are recorded at cost plus accrued interest, which approximate fair value.

Fair values of bonds and floating rate notes are based on prices obtained from third-party pricing sources. They are determined using either an appropriate interest rate curve with a spread associated with the credit quality of the issuer or other generally accepted pricing methodologies.

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Nominal Fixed Income and World Inflation-Linked Bonds (continued)

Valuation Techniques (continued)

ABTNs are measured at fair value using comparable notes with similar credit quality and terms as a proxy, while taking into consideration the impact of the funding facilities. The valuation model used includes certain assumptions that are not fully supported by market observable data. Such assumptions include interest rate spreads, assumed credit rating (ranging from BB to AAA–), expected returns, an average maturity of seven years as well as liquidity estimates.

(iv) Absolute Return

In addition to the different asset classes outlined in the Statement of Investment Policies, Standards and Procedures (SIP&P), PSP Investments employs a number of absolute return strategies through units of externally managed pooled funds.

Valuation Techniques

The fair value of investments in pooled funds is measured by using the unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(v) Amounts Receivable and Payable from Pending Trades

Amounts receivable from pending trades consist of proceeds on sales of investments, excluding derivative financial instruments, which have been traded but remain unsettled at the end of the reporting period.

Amounts payable from pending trades consist of the cost of purchases of investments, excluding derivative financial instruments, which have been traded but remain unsettled at the end of the reporting period.

Valuation Techniques

The fair value of amounts receivable and payable from pending trades reflects the value at which their underlying original sale or purchase transactions were undertaken.

(vi) Securities Sold Short

Securities sold short reflect PSP Investments' commitment to purchasing securities pursuant to short selling transactions. In such transactions, PSP Investments sells securities it does not own with a commitment to purchasing similar securities on the market to cover its position.

Valuation Techniques

Using ask prices as inputs, the fair value of securities sold short is measured using the same method as the similar long positions presented under Nominal Fixed Income, World Inflation-Linked Bonds, Canadian Equity and Foreign Equity.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts, the value of which is derived from changes in underlying assets, interest or exchange rates. PSP Investments uses derivative financial instruments to increase returns or to replicate investments synthetically. Derivatives are also used to reduce the risk associated with existing investments.

PSP Investments uses the following types of derivative financial instruments as described below:

(i) Swaps

Swaps are transactions whereby two counterparties exchange cash flow streams with each other based on predetermined conditions that include a notional amount and a term. Swaps are used to increase returns or to adjust exposures of certain assets without directly purchasing or selling the underlying assets.

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(ii) Futures

Futures are standardized contracts to take or make delivery of an asset (buy or sell) at a specific time in the future for a specific price that has been agreed upon today. Futures are used to adjust exposures to specified assets without directly purchasing or selling the underlying assets.

(iii) Forwards

Forwards are contracts involving the sale by one party and the purchase by another party of a predefined amount of an underlying instrument, at a predefined price and a predefined date in the future. Forwards are used for yield enhancement purposes or to manage exposures to currencies and interest rates.

(iv) Options

Options are the right, but not the obligation, to buy or sell a given amount of an underlying security, index, or commodity, at an agreed-upon price stipulated in advance, either at a determined date or at any time before the predefined maturity date.

(v) Warrants and Rights

Warrants are options on an underlying asset which is in the form of a transferable security and which can be listed on an exchange.

Rights are securities giving shareholders entitlement to purchase new shares issued by a corporation at a predetermined price (normally less than the current market price) in proportion to the number of shares already owned. Rights are issued only for a short period of time, after which they expire.

(vi) Collateralized Debt Obligations

Collateralized debt obligations are a type of asset-backed security that is constructed from a portfolio of credit-related assets. Collateralized debt obligations are usually divided into several tranches with different credit risk levels and corresponding interest payments. Any losses are applied first to the more junior tranches (lowest risk rating) before moving up in seniority.

Valuation Techniques

All listed derivative financial instruments are recorded at fair value using quoted market prices with the bid price for long positions and the ask price for short positions. Except for collateralized debt obligations, OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. For many pricing models there is no material subjectivity because the methodologies employed do not necessitate significant judgment and the pricing inputs are observed from actively quoted markets. Additionally, the pricing models used are widely accepted and used by other market participants.

The fair value of collateralized debt obligations are determined based on valuation techniques that use significant assumptions that are not all directly market observable. Such assumptions include default correlation data and recovery rate which are estimated by management. The instruments are then valued by discounting the expected cash flows using an appropriate discount factor.

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Notional values of derivative financial instruments are not recorded as assets or liabilities as they represent the face amount of the contract. Notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions disclosed below, with the exception of credit derivatives [1]. Rather, they serve as the basis upon which the cash flows and the fair value of the contracts are determined.

The following table summarizes the derivatives portfolio as at March 31:

($ millions)	**2010**				2009	
	Notional Value	**Fair Value**			Notional Value	Fair Value
INVESTMENTS		**Assets**	**Liabilities**	**Net**		
Equity and Commodity Derivatives						
Futures	**$ 22**	**$ –**	**$ –**	**$ –**	$ 126	$ –
Total Return Swaps	**694**	**23**	**–**	**23**	582	21
Variance Swaps	**–**	**–**	**–**	**–**	21	1
Warrants and Rights	**–**	**–**	**–**	**–**	–	–
Options: Listed-written	**1**	**–**	**–**	**–**	–	–
Currency Derivatives						
Forwards	**2,005**	**60**	**(6)**	**54**	4,123	(33)
Options: OTC-purchased	**129**	**1**	**–**	**1**	124	1
OTC-written	**34**	**–**	**–**	**–**	31	(1)
Interest Rate Derivatives						
Bond Forwards	**41**	**–**	**(1)**	**(1)**	70	–
Futures	**103**	**–**	**–**	**–**	–	–
Interest Rate Swaps	**769**	**5**	**(7)**	**(2)**	786	(1)
Total Return Swaps	**554**	**4**	**(3)**	**1**	705	11
Swaptions	**–**	**–**	**–**	**–**	501	–
Options: Listed-purchased	**84**	**–**	**–**	**–**	–	–
Listed-written	**230**	**–**	**–**	**–**	499	–
OTC-written	**–**	**–**	**–**	**–**	300	–
Credit Derivatives [1]:						
Purchased	**6**	**–**	**–**	**–**	13	10
Sold	**146**	**1**	**(65)**	**(64)**	326	(254)
Total	**$ 4,818**	**$ 94**	**$ (82)**	**$ 12**	$ 8,207	$ (245)

[1] Credit derivatives include collateralized debt obligations and a credit default swap. PSP Investments, through sold credit derivatives, indirectly guarantees the underlying reference obligations. The maximum potential exposure is the notional amount of the sold credit derivatives as shown in the table above.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives, as at March 31, is as follows:

($ millions)	2010	2009
Less than 3 months	$ 1,813	$ 4,877
3 to 12 months	2,219	2,375
Over 1 year	786	955
Total	$ 4,818	$ 8,207

(C) FAIR VALUE MEASUREMENT

Financial instruments are classified according to the following hierarchy based on the significant inputs used in measuring their fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities.

Level 2: Valuation is based on quoted market prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active. Level 2 also includes model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is based on model-based techniques for which significant assumptions are not observable in the market. They reflect management's assessment of the assumptions that market participants would use in pricing the financial instruments.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of financial instruments, as at March 31, 2010 based on the methods described above:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 3,471	$ 277	$ –	$ –	$ 3,748
Private Equity	–	–	1,034	–	1,034
Nominal Fixed Income	27	2,246	253	–	2,526
Real Return Assets					
World Inflation-Linked Bonds	–	66	–	–	66
Real Estate	–	–	1,209	–	1,209
Infrastructure	–	–	465	–	465
Absolute Return	–	244	231	–	475
INVESTMENTS	$ 3,498	$ 2,833	$ 3,192	$ –	$ 9,523
Investment-Related Assets					
Amounts receivable from pending trades [1]	$ –	$ –	$ –	$ 29	$ 29
Derivative-related receivables	–	93	1	–	94
Total Investment-Related Assets	$ –	$ 93	$ 1	$ 29	$ 123
Investment-Related Liabilities					
Amounts payable from pending trades [1]	$ –	$ –	$ –	$ (90)	$ (90)
Securities sold short	(22)	–	–	–	(22)
Derivative-related payables	–	(18)	(64)	–	(82)
Capital debt financing:					
Short-term	–	(128)	–	–	(128)
Long-term	–	(211)	–	–	(211)
Total Investment-Related Liabilities	$ (22)	$ (357)	$ (64)	$ (90)	$ (533)
NET INVESTMENTS	$ 3,476	$ 2,569	$ 3,129	$ (61)	$ 9,113

[1] No fair value hierarchy classification is required for these items.

The classification of financial instruments in the levels of the hierarchy is established at the time of the initial valuation of the instrument and reviewed on each subsequent reporting period-end.

There have been no significant transfers between Level 1 and Level 2 during the current fiscal year.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

The following table shows a reconciliation of all movements in the fair value of financial instruments categorized within Level 3 for the year ended March 31:

	2010					
($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Opening Balance	$ 852	$ 225	$ 1,963	$ 136	$ (242)	$ 2,934
Purchases	268	–	225	44	–	537
Sales/Settlements	(165)	(12)	(251)	(2)	–	(430)
Total gains (losses) [1]	79	40	(263)	53	179	88
Transfers into or out of Level 3	–	–	–	–	–	–
Closing Balance	$ 1,034	$ 253	$ 1,674	$ 231	$ (63)	$ 3,129

Total gains (losses), for the year ended March 31, included in investment income (loss) are presented as follows:

	2010					
($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Total realized gains (losses)	$ 7	$ 4	$ 5	$ –	$ –	$ 16
Total unrealized gains (losses)	$ 72	$ 36	$ (268)	$ 53	$ 179	$ 72
Total gains (losses) [1]	$ 79	$ 40	$ (263)	$ 53	$ 179	$ 88

[1] Included in Note 6 (a).

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (a) and (b). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 3% increase/decrease in the fair value of financial instruments categorized as Level 3. This excludes private market fund investments as well as Real Estate Debt, where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of Private Market fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (a). With respect to Real Estate Debt, the fair value is obtained from third-party appraisers as described in Note 3 (a).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(D) INVESTMENT ASSET MIX

The SIP&P sets out the long-term target weights of the assets that shall be invested for the four Plan Accounts. Investments are classified by asset mix category as set out in the SIP&P based on the economic intent of the investment strategies of the underlying assets.

The net investments, as at March 31, are as follows:

	2010			2009		
($ millions)	Fair Value		Policy Portfolio Long-Term Target	Fair Value		Policy Portfolio Long-Term Target
World Equity						
Canadian Equity	$ 2,668	29.2%	30.0%	$ 1,763	26.1%	30.0%
Foreign Equity:						
US Large Cap Equity	416	4.6	5.0	185	2.7	5.0
EAFE Large Cap Equity	402	4.4	5.0	208	3.1	5.0
Small Cap Developed World Equity	389	4.3	5.0	156	2.3	5.0
Emerging Markets Equity	588	6.5	7.0	424	6.3	7.0
Private Equity	1,069	11.7	10.0	838	12.4	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	373	4.1	2.0	15	0.2	2.0
World Government Bonds	419	4.6	5.0	421	6.2	5.0
Canadian Fixed Income	951	10.4	8.0	850	12.6	8.0
Real Return Assets						
World Inflation-Linked Bonds	422	4.6	5.0	478	7.1	5.0
Real Estate	1,008	11.1	10.0	930	13.8	10.0
Infrastructure	408	4.5	8.0	490	7.2	8.0
NET INVESTMENTS	$ 9,113	100.0%	100.0%	$ 6,758	100.0%	100.0%

[1] Includes amounts related to absolute return and real estate debt strategies.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

3. INVESTMENTS (continued)

(E) SECURITIES LENDING & BORROWING PROGRAMS

PSP Investments participates in securities lending and borrowing programs whereby it lends and borrows securities in order to enhance portfolio returns.

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. In the absence of an event of default, the same securities or equivalent securities must be returned to the counterparty at the end of the contract. PSP Investments does not repledge any collateral held.

The following table illustrates the fair values of the Plan's allocated securities and collateral associated with the lending and borrowing programs as at March 31:

($ millions)	2010	2009
Securities Lending		
Securities lent	**$ 789**	$ 540
Collateral contractually receivable [1]	**823**	565
Securities Borrowing		
Securities borrowed	**22**	71
Collateral contractually payable [2]	**23**	73

[1] The minimum fair value of collateral required is equal to 102% of the fair value of the securities lent.

[2] The minimum fair value of collateral required is equal to 100% of the fair value of the securities borrowed.

4. INVESTMENT RISK MANAGEMENT

Risk Management is a central part of PSP Investments' strategic management. It is a continuous process whereby PSP Investments methodically addresses the risks related to its various investment activities with the goal of achieving a maximum rate of return without undue risk of loss and a sustained benefit within each activity and across the total portfolio.

A risk governance structure that includes required reporting on risk to all levels in the organization also ensures that appropriate objectives are pursued and achieved in line with the fulfillment of PSP Investments' legislated mandate. The Board of Directors and its committees oversee various issues related to risk and receive assurance from senior management and an independent internal auditor reporting directly to the Audit and Conflicts Committee.

The use of financial instruments exposes PSP Investments to credit and liquidity risks as well as market risks including foreign exchange and interest rate risks. These risks are managed in accordance with the Investment Risk Management Handbook, which is an integral part of PSP Investments' risk control system. The Investment Risk Management Handbook contains an Investment Risk Management Policy which supplements the SIP&P (Policy Portfolio). The Policy Portfolio determines a diversification strategy to mitigate risk whereby PSP Investments invests in a diversified portfolio of investments based on established criteria. Additionally, the objective of these policies is to provide a framework for the management of credit, liquidity and market risks. Derivative financial instruments, traded either on exchanges or OTC, are one of the vehicles used to mitigate the impact of market risk.

(A) MARKET RISK

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, volatility in share and commodity prices, interest rate, foreign exchange or other factors affecting similar securities traded in the market.

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Market risk is measured using the method known as Value-at-Risk (VaR). VaR is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. PSP Investments has chosen a yearly 95% confidence level to measure and report VaR. PSP Investments uses a Historical VaR model incorporating three years of monthly market returns which are scaled to a twelve-month holding period. Risk Management is responsible for implementing and maintaining a VaR measurement methodology for all asset classes and all financial risk factors.

Historical VaR is statistically valid under normal market conditions and does not specifically consider losses from severe market events. The Historical VaR model also assumes that the future will behave in a similar pattern to the past. If future market conditions differ significantly from those of the past, potential losses may differ from those originally estimated. The VaR is an estimate of a single value in a distribution of potential losses that can be experienced. As a result, it is not an estimate of the maximum potential loss.

The goal of actively managing the portfolio is to outperform the policy portfolio benchmarks while maintaining the active risk under 400 basis points (bps). Relative VaR, as a result, is the maximum amount of loss of total investments, with 95% confidence level, relative to the policy portfolio benchmark over a twelve-month period.

The following table shows the total Relative VaR allocated to the Plan and the diversification effect as at March 31 based on the economic intent of the investment strategies of the underlying assets. The diversification effect captures the effect of holding different types of assets which may react differently in various types of situations and thus having the effect of reducing overall Relative VaR.

Active Risk Taken

(Relative VaR – $ millions)	2010	2009
World Equity	$ 135	$ 158
Real Return Assets	171	213
Absolute Return	81	232
Total Relative VaR (Undiversified)	387	603
Diversification Effect	(194)	(332)
Total Relative VaR	**$ 193**	$ 271

Risk Management monitors the absolute risk of the Policy Portfolio on a quarterly basis to ensure no undue loss may be experienced by PSP Investments.

Generally, changes in VaR between reporting periods are due to changes in the level of exposure, volatilities and/or correlations among asset classes. Although VaR is a widely accepted risk measure, it must be complemented by other risk measures. PSP Investments therefore uses stress testing and scenario analysis to examine the impact on financial results of abnormally large movements in risk factors. Stress testing and scenario analysis are used to test a portfolio's sensitivity to various risk factors and key model assumptions. These methods also use historically stressed periods to evaluate how a current portfolio would fare under such circumstances. Stress testing is also deployed to assess new product behaviour. Stress testing and scenario analysis are utilized as a complement to the Historical VaR measure in order to provide greater insight on the size of potential losses that may be experienced. PSP Investments uses the expected shortfall and tail analysis measures to determine this. Expected shortfall is defined as the conditional expectation beyond the VaR level. It is measured by averaging all data points showing a loss greater than VaR measured at a given confidence level. By increasing the confidence level of the VaR measure from 95% to 99%, PSP Investments is able to assess the size of the potential loss that would be exceeded one year out of 100 (instead of one year out of 20). Therefore, there is a greater probability for larger losses, at the 99% confidence level, in extreme market conditions. Risk Management presents a stress testing and scenario analysis report to senior management on a quarterly basis.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(i) Interest Rate Risk

Interest rate risk refers to the risk that fluctuations in interest rates will directly affect the fair value of the Plan's net asset values. The most significant exposure to interest rate risk is related to the investment in bonds, ABTNs and Real Estate Debt.

The terms to maturity of the investments, before allocating the effect of derivative contracts and investment-related assets and liabilities, as at March 31, are as follows:

	Terms to Maturity					
($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	2010 Total	2009 Total
Government of Canada bonds	$ 36	$ 321	$ 68	$ 74	$ 499	$ 611
Provincial and Territorial bonds	36	113	61	104	314	296
Municipal bonds	1	4	10	2	17	17
Corporate bonds	51	120	89	75	335	298
ABTNs	–	9	–	224	233	207
Total Canadian Fixed Income	$ 124	$ 567	$ 228	$ 479	$ 1,398	$ 1,429
Total World Government Bonds	$ 2	$ 93	$ 65	$ 56	$ 216	$ 152
Total World Inflation-Linked Bonds	$ –	$ 16	$ 15	$ 35	$ 66	$ 39
Real Estate Debt [1]	$ 54	$ 35	$ –	$ 6	$ 95	$ 151
Grand Total	$ 180	$ 711	$ 308	$ 576	$ 1,775	$ 1,771

[1] Real Estate Debt is a component of the Real Estate asset class disclosed in Note 3 (a).

The terms to maturity of PSP Investments' capital debt financing are disclosed in Note 8.

Absolute return strategies, as described in Note 3, and derivative contracts are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 4 (a).

Additionally, the exposure to interest rate risk for short-term instruments and amounts receivable from pending trades would not be significant due to their short-term nature.

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts, positions in foreign currencies. PSP Investments' policy is to hedge 50% of its foreign currency investments excluding Emerging Markets Equity.

The underlying net foreign currency exposures for the Plan, after allocating the effect of derivative contracts and investment-related assets and liabilities for both monetary and non-monetary items, as at March 31, are as follows:

	2010		2009	
Currency (in millions of Canadian $)	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 1,236**	**51.2%**	$ 924	52.9%
Euro	**357**	**14.8**	413	23.6
British Pound	**153**	**6.4**	104	5.9
Brazilian Real	**132**	**5.5**	13	0.7
Hong Kong Dollar	**100**	**4.1**	60	3.4
Japanese Yen	**85**	**3.5**	78	4.5
Korean Won	**69**	**2.9**	33	1.9
New Taiwan Dollar	**39**	**1.6**	35	2.0
South African Rand	**31**	**1.3**	19	1.1
Australian Dollar	**30**	**1.2**	33	1.9
Indian Rupee	**29**	**1.2**	17	1.0
Turkish Lira	**21**	**0.9**	12	0.7
Others	**130**	**5.4**	8	0.4
Total	**$ 2,412**	**100.0%**	$ 1,749	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies of $981 million ($804 million US, €114 million and 61 million South African Rands (ZAR)) for the Plan which are not included in the foreign currency exposure table.

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

PSP Investments is exposed to credit risk, that is, the risk that the issuer of a debt security or a counterparty to a derivative contract is unable to meet its financial obligations.

Credit risk encompasses the risk of a deterioration of creditworthiness and the respective concentration risk. Credit risk monitoring entails an evaluation of the credit quality of each issuer to which PSP Investments is exposed. To perform this evaluation, PSP Investments relies on four recognized credit rating agencies. A minimum of two credit ratings are used to classify each security; securities rated by only one agency are classified as "not rated". If the agencies disagree as to a security's credit quality, PSP Investments uses the lowest of the available ratings.

To monitor the evolution of credit risk, PSP Investments periodically produces a concentration report by credit rating of all credit-sensitive financial securities with the exception of securities held in pooled funds or for Private Market Investments.

PSP Investments' concentration of credit risk by credit rating for the Plan, as at March 31, is as follows:

	2010	2009
Investment grade (AAA to BBB–)	**89.9%**	88.7%
Below investment grade (BB+ and below)	**–**	–
Not rated:		
Rated by a single credit rating agency	**8.5**	8.5
Not rated by credit rating agencies	**1.6**	2.8
Total	**100.0%**	100.0%

The breakdown of credit concentration risk for the Plan does not include investments in distressed debt included in pooled funds in the amount of approximately $0.4 billion as at March 31, 2010 (2009 – $0.4 billion). Such investments typically include debt securities of issuers close to default, and the investment in such securities are quasi-equity in nature.

As at March 31, 2010, the Plan also has a net notional exposure of $121 million to collateralized debt obligations, of which approximately 64% of the dollar exposure is rated "Investment grade", as well as funding facilities of a maximum amount of $191 million to support potential margin calls on the ABTNs (Note 3 (a) (iii)).

As at March 31, 2010, the Plan's maximum exposure to credit risk, excluding collateral held and the investments in distressed debt and collateralized debt obligations described above, amounts to approximately $2.6 billion (2009 – approximately $2.2 billion).

(i) Counterparty Risk

Counterparty risk represents the credit risk from current and potential exposure related to transactions involving derivative contracts. In order to minimize derivative contract counterparty risk, PSP Investments deals only with counterparties with a minimum credit rating of "A–" as at the trade date, as provided by a recognized credit rating agency. PSP Investments monitors the credit ratings of counterparties on a daily basis and has the ability to terminate all trades with counterparties who have their credit rating downgraded below "A–" subsequent to the trade date. PSP Investments also uses credit mitigation techniques such as master-netting arrangements and collateral transfers through the use of Credit Support Annexes (CSA).

PSP Investments' policy also requires the use of the International Swaps and Derivative Association (ISDA) Master Agreement with all counterparties to derivative contracts. The ISDA Master Agreement provides the contractual framework within which dealing activities across a full range of OTC products are conducted and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or other pre-determined events occur.

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

Additionally, the CSA to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the event of the failure of the counterparty and requires PSP Investments to contribute further collateral when requested. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold.

On behalf of the Plan, PSP Investments deposited or pledged securities with a fair value of $41 million as collateral with various financial institutions as at March 31, 2010 (2009 – $207 million) while securities with a fair value of $35 million (2009 – $21 million) were received from other counterparties as collateral. PSP Investments does not repledge any collateral held. All collateral deposited, pledged and received were held with counterparties who had a minimum credit rating of “A–” as at March 31, 2010.

Risk Management is responsible for counterparty risk monitoring and mitigation as well as maintaining a comprehensive, disciplined, and enterprise-wide process for tracking and managing counterparty risk. As such, Risk Management measures counterparty risk on an ongoing basis, evaluates and tracks the creditworthiness of current counterparties and mitigates counterparty risk through collateral management.

(C) LIQUIDITY RISK

Liquidity risk corresponds to PSP Investments’ ability to meet its financial obligations when they come due with sufficient and readily available cash resources. PSP Investments’ cash position is monitored on a daily basis. In general, investments in cash, cash equivalents, floating rate notes, debt and public equities are expected to be highly liquid as they will be invested in securities that are actively traded. Risk Management utilizes appropriate measures and controls to monitor liquidity risk in order to ensure that there is sufficient liquidity to meet financial obligations as they come due. A liquidity report taking into consideration future forecasted cash flows is prepared and presented to senior management on a weekly basis. This ensures that sufficient cash reserves are available to meet forecasted cash outflows. Additionally, sufficient sources of liquidity are maintained for deployment in case of market disruption.

PSP Investments has the ability to raise additional capital through the use of its capital debt program. This program allows PSP Investments to issue short-term promissory notes and medium-term notes. Note 8 provides additional information on the usage of the capital debt program.

The terms to maturity of the notional amount of derivatives, including related payable amounts, are disclosed in Note 3 (b).

4. INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial assets and liabilities, aggregated according to their maturities as at March 31, 2010.

Liabilities are presented in the earliest period in which the counterparty can request payment.

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities				
Amounts payable from pending trades	$ (90)	$ –	$ –	$ (90)
Securities sold short	(22)	–	–	(22)
Capital debt financing	(123)	(5)	(211)	(339)
Accounts payable and other liabilities	(7)	–	(2)	(9)
Total	$ (242)	$ (5)	$ (213)	$ (460)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial assets and liabilities				
Derivative-related assets	$ 35	$ 55	$ 4	$ 94
Derivative-related liabilities	(7)	(4)	(71)	(82)
Total	$ 28	$ 51	$ (67)	$ 12

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

5. FUND TRANSFERS

PSP Investments received fund transfers of $866 million for the year ended March 31, 2010 (2009 – $853 million) from the Canadian Forces Pension Fund. The transfers received are comprised of the net employer and employee contributions to the Canadian Forces pension plan in respect of member service after April 1, 2000.

6. INVESTMENT INCOME (LOSS)

(A) INVESTMENT INCOME (LOSS)

Investment income (loss), for the year ended March 31, is as follows:

($ millions)	2010	2009
Interest income	$ 81	$ 94
Dividend income	81	87
Other income	40	48
Security lending income (net) [1]	2	1
Dividend expense	(4)	(5)
Interest expense (Note 8)	(10)	(13)
Transaction costs	(4)	(7)
External investment management fees [2]	(7)	(11)
	179	194
Net realized gains (losses) [3]	302	(1,245)
Net unrealized gains (losses)	1,028	(854)
Investment Income (Loss)	$ 1,509	$ (1,905)

[1] Includes fees on securities borrowed.

[2] These are amounts incurred for public market investments that are paid directly by PSP Investments (Note 1). This excludes amounts incurred for Private Market Investments, disclosed in Note 3 (a) (ii), and certain public market pooled fund investments in the amount of $2 million for the year ended March 31, 2010 (2009 – $1 million) that are not paid directly by PSP Investments.

[3] Includes foreign currency gains (losses) of $124 million for the year ended March 31, 2010 (2009 – $(122) million).

(B) INVESTMENT INCOME (LOSS) BY ASSET MIX

Investment income (loss) by asset mix based on the economic intent of the investment strategies of the underlying assets as outlined in the SIP&P, for the year ended March 31, after allocating net realized and unrealized gains (losses) on investments to the asset classes to which they relate, is as follows:

($ millions)	2010	2009
World Equity		
Canadian Equity	$ 733	$ (723)
Foreign Equity:		
US Large Cap Equity	49	(90)
EAFE Large Cap Equity	50	(120)
Small Cap Developed World Equity	56	(99)
Emerging Markets Equity	201	(198)
Private Equity	239	(318)
Nominal Fixed Income		
Cash & Cash Equivalents	9	7
World Government Bonds	(69)	96
Canadian Fixed Income	38	39
Real Return Assets		
World Inflation-Linked Bonds	(50)	33
Real Estate	6	(156)
Infrastructure	31	22
Absolute Return [1]	216	(398)
Investment Income (Loss)	$ 1,509	$ (1,905)

[1] Includes amounts related to real estate debt strategies.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

7. EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the plans for which it provides investment services. Under section 4(3) of the Act, the President of the Treasury Board shall determine to which plan account these costs will be charged, in consultation with the Minister of National Defence and the Minister of Public Safety. An allocation policy has been developed which allocates the direct costs of investment activities, such as external investment management fees and custodial fees, to each plan account, based upon the asset value of each plan account at the time the expense was incurred.

All other operating expenses, excluding the direct cost of investment activities listed above, for the year ended March 31, have been allocated in proportion to the annual amount of net assets in each Plan Account as follows:

	2010	2009
Public Service Pension Plan Account	**72.5%**	72.6%
Canadian Forces Pension Plan Account	**20.0**	20.1
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.3**	0.1
Total	**100.0%**	100.0%

Expenses are paid by PSP Investments by way of advances from the Public Service Pension Plan Account, which are reimbursed by the other plan accounts on a quarterly basis.

(B) OPERATING EXPENSES

Operating expenses allocated to this Plan account, for the year ended March 31, consist of the following:

($ thousands)	2010	2009
Salaries and benefits	**$ 10,681**	$ 9,706
Professional and consulting fees	**1,857**	2,008
Office supplies and equipment	**2,240**	1,765
Other operating expenses	**840**	1,605
Depreciation of fixed assets	**1,418**	936
Occupancy costs	**864**	726
Custodial fees	**311**	252
Remuneration earned by Directors	**158**	183
Travel and related expenses for Directors	**35**	77
Communication expenses	**63**	19
Total	**$ 18,467**	$ 17,277

8. CAPITAL DEBT FINANCING

As of March 31, 2010, PSP Capital Inc. has $649 million (2009 – $1,579 million) of short-term promissory notes outstanding with maturity dates between 14 and 120 days of issuance, of which $128 million (2009 – $316 million) has been allocated to the Canadian Forces Pension Plan Account and included in Note 3 (a) as a short-term investment-related liability. As at March 31, 2010, PSP Capital Inc. has $1 billion (2009 – $1 billion) of medium-term notes issued and outstanding, of which $200 million (2009 – $200 million) has been allocated to the Canadian Forces Pension Plan Account. These medium-term notes bear interest of 4.57% per annum and have a maturity date of December 9, 2013. These medium-term notes are included in Note 3 (a) as a long-term investment-related liability. As at March 31, 2010, the fair value of these medium-term notes is $1,073 million (2009 – $1,054 million), of which $211 million (2009 – $210 million) has been allocated to the Canadian Forces Pension Plan Account. The maximum authorized by the Board of Directors for both the short-term promissory notes and medium-term notes is $2 billion. The capital raised, primarily used to finance investments in the Real Estate and Infrastructure asset classes, is unconditionally and irrevocably guaranteed by PSP Investments and is in accordance with the approved PSP Investments' corporate policy for leverage.

The operating expenses incurred by PSP Capital Inc. were allocated to each Plan account as described in Note 7 (a).

Interest expense, for the year ended March 31, is as follows:

($ thousands)	**2010**	2009
Short-term promissory notes	**$ 1,473**	$ 11,351
Medium-term notes	**9,045**	2,003
Total	**$ 10,518**	$ 13,354

9. CAPITAL MANAGEMENT

As an investment company, PSP Investments objectives in managing its capital are:

- To invest fund transfers, outlined in Note 5, in the best interests of the beneficiaries and contributors under the Superannuation Acts. The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plans established under the Superannuation Acts. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.
- To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc., and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 8 provides information on the capital debt financing and Note 4 (c) provides information on PSP Investments' liquidity. Additionally, as at March 31, 2010, PSP Investments has an operating line of credit of $10 million (2009 – $10 million). As at March 31, 2010, no amounts have been withdrawn (2009 – nil).

The capital structure of PSP Investments consists of fund transfers and capital debt financing. PSP Investments has no externally imposed restrictions on capital.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

10. GUARANTEES AND INDEMNITY

PSP Investments provides indemnification to its Directors, its Officers and to certain PSP Investments representatives who are asked to serve on boards of directors (or like bodies) or investment advisory boards (or like bodies) of entities in which PSP Investments or its wholly-owned subsidiaries have made an investment or have a financial interest. As a result, but subject to the Act, PSP Investments may be required to indemnify these representatives for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties, unless the liability of such a representative relates to a failure to act honestly and in good faith. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

As part of investment transactions, PSP Investments and its subsidiaries guaranteed letter of credit facilities. The beneficiaries of these letter of credit facilities have the ability to draw against these facilities to the extent that the contractual obligations, as defined in the related agreements, are not met. As at March 31, 2010, the maximum exposure of the Plan was $2 million (2009 – $3 million).

As at March 31, 2010, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan would assume the obligation up to $81 million (2009 – $81 million) plus interest and other related costs.

PSP Investments also unconditionally and irrevocably guarantees all credit facilities, short-term promissory notes and medium-term notes issued by PSP Capital Inc.

11. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, the portion of PSP Investments' commitments that would be assumed by the Plan is as follows:

($ millions)	2010	2009
Private Equity	$ 621	$ 926
Real Estate	274	359
Infrastructure	85	115
Public markets	65	116
Total	**$ 1,045**	$ 1,516

ROYAL CANADIAN MOUNTED POLICE PENSION PLAN ACCOUNT

AUDITORS' REPORT

To the Minister of Public Safety

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Royal Canadian Mounted Police Pension Plan Account (the Royal Canadian Mounted Police Pension Plan Account) as at March 31, 2010, and the Statements of Net Income (Loss) from Operations and Comprehensive Income and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's (PSP Investments) management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Royal Canadian Mounted Police Pension Plan Account as at March 31, 2010, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the Royal Canadian Mounted Police Pension Plan Account that have come to our notice during our audit of the financial statements have, in all significant respects, been in accordance with the applicable provisions of Part X of the *Financial Administration Act* and regulations, the *Public Sector Pension Investment Board Act* and regulations and the by-laws of PSP Investments and its wholly-owned subsidiaries.

Deloitte & Touche LLP[1]

[1] Chartered accountant auditor permit No. 18527

Montreal, Canada
May 10, 2010

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 10, 2010

ROYAL CANADIAN MOUNTED POLICE PENSION PLAN ACCOUNT

BALANCE SHEET

As at March 31

($ millions)	2010	2009
ASSETS		
Investments (Note 3 (a))	**$ 3,420**	$ 2,738
Investment-related assets (Note 3 (a))	**46**	53
Other assets	**3**	2
TOTAL ASSETS	**$ 3,469**	$ 2,793
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 193**	$ 372
Accounts payable and other liabilities	**3**	3
Due to the Public Service Pension Plan Account	**2**	2
TOTAL LIABILITIES	**$ 198**	$ 377
NET ASSETS	**$ 3,271**	$ 2,416
Accumulated net income from operations and comprehensive income	**$ 568**	$ 36
Accumulated fund transfers	**2,703**	2,380
NET ASSETS	**$ 3,271**	$ 2,416

Commitments (Note 11)

The accompanying notes are an integral part of the financial statements.

On behalf of the board of Directors:

Paul Cantor
Chair of the Board

William A. MacKinnon
Chair of the Audit and Conflicts Committee

ROYAL CANADIAN MOUNTED POLICE PENSION PLAN ACCOUNT

STATEMENT OF NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME

For the year ended March 31

($ millions)	2010	2009
INVESTMENT INCOME (LOSS) (Note 6)	**$ 539**	$ (679)
OPERATING EXPENSES (Note 7)	**$ 7**	$ 6
NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ 532**	$ (685)

The accompanying notes are an integral part of the financial statements.

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2010	2009
NET ASSETS, BEGINNING OF YEAR	**$ 2,416**	$ 2,787
Fund transfers (Note 5)	**323**	314
Net income (loss) from operations and comprehensive income	**532**	(685)
Increase (decrease) in net assets for the year	**855**	(371)
NET ASSETS, END OF YEAR	**$ 3,271**	$ 2,416

The accompanying notes are an integral part of the financial statements.

ROYAL CANADIAN MOUNTED POLICE PENSION PLAN ACCOUNT

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) is a crown corporation established under the *Public Sector Pension Investment Board Act* ("the Act") with a mandate to invest the net contributions of the Public Service, Canadian Forces, Royal Canadian Mounted Police and Reserve Force pension plans in financial markets.

The Royal Canadian Mounted Police Pension Fund was established by amendments to the *Royal Canadian Mounted Police Superannuation Act*, to receive contributions and make benefit payments in respect of member service after April 1, 2000. The net contributions are transferred, by the Royal Canadian Mounted Police Pension Fund, to PSP Investments – Royal Canadian Mounted Police Pension Plan Account for investment. PSP Investments maintains records of the pension fund's net contributions, as well as the allocation of its investments and the results of its operations in the plan account.

PSP Investments is responsible for managing amounts that are transferred to it in the best interests of the beneficiaries and contributors under the *Royal Canadian Mounted Police Superannuation Act*. The amounts are to be invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the *Royal Canadian Mounted Police Superannuation Act*.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it from the Royal Canadian Mounted Police Pension Fund in respect of member service after April 1, 2000. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of the Royal Canadian Mounted Police Pension Fund. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and the requirements of the Act. PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value are included in investment income (loss) as net unrealized gains (losses).

Comparative figures have been reclassified to conform to the current year's presentation.

VALUATION OF INVESTMENTS

Investments, investment-related assets and investment-related liabilities are recorded as of the trade date (the date upon which the substantial risks and rewards are transferred) and are stated at fair value. Fair value is an estimate of the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Market prices or rates are used to determine fair value where an active market exists (such as a recognized securities exchange), as it is the best evidence of the fair value of an investment. If quoted market prices or rates are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the end of the reporting period that are derived from observable market data.

Valuation techniques are generally applied to investments in the Private Equity, Real Estate and Infrastructure asset classes (collectively "Private Market Investments"), over-the-counter (OTC) derivatives as well as asset-backed term notes (ABTNs). The values derived from applying these techniques are impacted by the choice of valuation model and the underlying assumptions made concerning factors such as the amounts and timing of future cash flows, discount rates, volatility and credit risk. In certain cases, such assumptions are not supported by market observable data.

The valuation methods of each asset class are described in Notes 3 (a) and (b).

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF CAPITAL DEBT FINANCING

PSP Investments' short-term capital debt financing is recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' long-term capital debt financing is based on prices that are obtained from third-party pricing sources. It is measured using an interest rate curve with a spread consistent with PSP Investments' credit quality.

TRANSACTION COSTS

Transaction costs are incremental costs directly attributable to the acquisition, due diligence, issue, or disposal of a financial asset or financial liability. Transaction costs are expensed as incurred and recorded as a component of investment income (loss).

INVESTMENT MANAGEMENT FEES

Investment management fees are costs directly attributable to the external management of assets on behalf of PSP Investments. Investment management fees incurred for Private Market Investments are paid, as determined by the fund manager, either by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment (Note 3 (a) (ii)). These amounts are recorded against investment income (loss). Investment management fees are also incurred for certain public equity investments and these amounts are paid, either directly by PSP Investments or offset against distributions received from pooled fund investments. In both cases, they are recorded against investment income (loss) (Note 6).

INCOME RECOGNITION

The investment income (loss) has been allocated proportionately based on the asset value held by the Royal Canadian Mounted Police Pension Plan Account ("the Plan").

Investment income (loss) is made up of interest income, dividends, realized gains (losses) on the disposal of investments and unrealized gains (losses) which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Interest income is recognized as earned. Dividends are recognized on the ex-dividend date and are reflected as dividend income. Dividends paid on securities sold short are reflected as dividend expense. Additionally, other income includes the related distributions from pooled funds, limited partnerships as well as from direct and co-investments, all from Private Market Investments.

TRANSLATION OF FOREIGN CURRENCIES

Investment transactions in foreign currencies are recorded at exchange rates prevailing on the transaction date. Investments denominated in foreign currencies and held at the end of the year are translated at exchange rates in effect at the year-end date. The resulting realized and unrealized gains (losses) on foreign exchange are included in investment income (loss).

FUND TRANSFERS

Amounts received from each Pension Fund are recorded in their respective plan account.

INCOME TAXES

PSP Investments and the majority of its subsidiaries are exempt from Part I tax under paragraph 149(1)*(d)* of the *Income Tax Act* (Canada).

USE OF ESTIMATES

In preparing these financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of Private Market Investments, ABTNs, derivatives, related income and expenses and note disclosures. Although estimates and assumptions reflect management's best judgement, actual results may differ from these estimates.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

2. CHANGES IN ACCOUNTING POLICIES

AMENDMENT TO ACCOUNTING STANDARD

In June 2009, the Canadian Institute of Chartered Accountants (CICA) amended Section 3862 "Financial Instruments – Disclosures" of the CICA Handbook. This amendment is effective for annual financial statements relating to fiscal years ending after September 30, 2009.

The amendment enhances disclosures about fair value measurements of financial instruments as well as the liquidity risk of derivative financial liabilities.

The principal disclosures introduced by this amendment require financial instruments measured at fair value to be categorized into one of three fair value hierarchy levels. Such categorization is based on the significance of the inputs used in measuring such value as well as disclosure of movements between levels of the fair value hierarchy.

Additional disclosures for liquidity risk call for a maturity analysis for derivative financial liabilities based on the way in which an entity manages its liquidity risk.

PSP Investments adopted the provisions of such amendments for its March 31, 2010 financial statements. Required disclosures are made in Note 3 (c) and Note 4 (c).

FUTURE CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises will converge with International Financial Reporting Standards (IFRS) effective January 1, 2011. In response to this change, PSP Investments has put in place a transition plan that would allow it to prepare and present its March 31, 2012 financial statements under IFRS.

In analyzing the various impacts of its transition to IFRS, PSP Investments concluded that the requirement to consolidate its controlled investments ranked as one of the most significant of such impacts.

In April 2010, the AcSB issued Section 4600 "Pension Plans" of the CICA Handbook requiring pension plans in Canada to follow this standard rather than convert to IFRS in the same fashion as other publicly accountable enterprises. Under Section 4600, pension plans would continue to account for and report their investments at fair value as was previously done under Section 4100 "Pension Plans" of the CICA Handbook. The provisions of Section 4600 apply to annual financial statements relating to fiscal years beginning on or after January 1, 2011.

Concurrent with the issuance of Section 4600, the AcSB issued an exposure draft that proposed a scope expansion to include entities, such as PSP Investments, that are separate from pension plans and whose sole purpose is to hold and invest assets received from one or more pension plans, but does not itself have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments. The AcSB has indicated that it anticipates reaching a decision concerning the exposure draft in June 2010.

Management is currently monitoring the outcome of this exposure draft and evaluating its impact on PSP Investments' financial statements as well as the IFRS transition plan.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS

(A) INVESTMENT PORTFOLIO

The investment portfolio, before allocating the effect of derivative contracts and investment-related assets and liabilities to the asset classes to which they relate, as at March 31, is as follows:

($ millions)	**2010**		2009	
Asset Class	**Fair Value**	**Cost**	Fair Value	Cost
World Equity				
Canadian Equity	**$ 732**	**$ 639**	$ 453	$ 543
Foreign Equity:				
US Large Cap Equity	**151**	**145**	52	70
EAFE Large Cap Equity	**146**	**168**	83	132
Small Cap Developed World Equity	**138**	**127**	52	70
Emerging Markets Equity	**178**	**160**	105	132
Private Equity	**372**	**399**	304	358
Nominal Fixed Income				
Cash, Cash Equivalents and Other [1]	**327**	**337**	220	238
World Government Bonds	**78**	**84**	54	50
Canadian Fixed Income	**502**	**489**	511	514
Real Return Assets				
World Inflation-Linked Bonds	**24**	**25**	14	15
Real Estate	**434**	**437**	508	461
Infrastructure	**167**	**171**	194	167
Absolute Return	**171**	**159**	188	194
INVESTMENTS	**$ 3,420**	**$ 3,340**	$ 2,738	$ 2,944
Investment-Related Assets				
Amounts receivable from pending trades	**$ 11**	**$ 11**	$ 18	$ 18
Derivative-related receivables	**35**	**–**	35	5
Total Investment-Related Assets	**$ 46**	**$ 11**	$ 53	$ 23
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (33)**	**$ (33)**	$ (36)	$ (36)
Securities sold short	**(9)**	**(9)**	(25)	(31)
Derivative-related payables	**(29)**	**–**	(122)	(8)
Capital debt financing:				
Short-term	**(46)**	**(46)**	(113)	(113)
Long-term	**(76)**	**(72)**	(76)	(74)
Total Investment-Related Liabilities	**$ (193)**	**$ (160)**	$ (372)	$ (262)
NET INVESTMENTS	**$ 3,273**	**$ 3,191**	$ 2,419	$ 2,705

[1] Includes floating rate notes with maturities greater than one year with a fair value of $99 million for the Plan (2009 – $1 million).

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Canadian Equity and Foreign Equity

Canadian Equity and Foreign Equity include direct and indirect investments in common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds, and securities convertible into common shares of publicly listed issuers.

Valuation Techniques

Direct investments in Canadian and Foreign Equities are measured at fair value using quoted market prices, namely, the bid price. In the case of investments in pooled funds, fair value is measured by using unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(ii) Private Equity, Real Estate and Infrastructure

The Private Equity asset class is comprised of direct investments in companies and fund investments. They include investments in private companies, mezzanine debt and distressed debt. The Private Equity asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Private Equity asset class contracted by direct investments controlled by PSP Investments for the Plan is nil (2009 – nil).

The Real Estate asset class is comprised of direct investments in companies, in properties, third-party debts and fund investments in the real estate sector. Real Estate investments are classified into two portfolios (an equity portfolio and a debt portfolio). The equity portfolio is comprised of direct investments in properties and companies in the office, retail, industrial, hospitality and residential sectors, as well as private funds and publicly traded securities invested in real estate assets. The debt portfolio is comprised of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, mezzanine loans and other structured investments (collectively "Real Estate Debt") where significant portions of the value are attributed to the underlying real estate assets. The Real Estate asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Real Estate asset class contracted by direct investments controlled by PSP Investments for the Plan is approximately $150 million (2009 – approximately $150 million).

The Infrastructure asset class is comprised of direct investments in companies and fund investments. They include investments in companies engaged in the management, ownership or operation of assets in power, regulated businesses, transportation, telecom or social infrastructure. The Infrastructure asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Infrastructure asset class contracted by direct investments controlled by PSP Investments for the Plan is approximately $10 million (2009 – approximately $10 million).

Investment management fees, as disclosed in Note 1, are incurred for Private Market Investments and generally vary between 0.1% and 2.1% of the total invested and/or committed amount. Investment management fees of $11 million for the year ended March 31, 2010 (2009 – $11 million) were recorded against investment income (loss).

Valuation Techniques

The fair value of Private Market Investments held directly by PSP Investments is determined at least annually, using acceptable industry valuation methods. For each investment, the relevant methodology is applied consistently over time.

For direct Private Markets Investments as well as investments in Real Estate Debt, management uses the services of third-party appraisers to determine the fair value. In selecting appraisers, management ensures their independence and that valuation methods used are consistent with professional appraisal standards. Such standards include the *International Private Equity and Venture Capital Valuation Guidelines*, the *Canadian Uniform Standards of Professional Appraisal Practice* and the *Uniform Standards of Professional Appraisal Practice* in the United States of America. In validating the work performed by appraisers, management ensures that the assumptions used correspond to financial information and forecasts of the underlying investment.

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(ii) Private Equity, Real Estate and Infrastructure (continued)

Valuation Techniques (continued)

For direct investments in Private Equity and Infrastructure, valuation methods used include discounted cash flows analysis, earnings multiples, prices of recent comparable transactions and publicly traded comparables. Assumptions used in such valuations include discount rates and projected cash flows, which are not fully supported by prices from market observable transactions.

For direct investments in Real Estate, valuation methods used include discounted cash flows as well as recent comparable transactions. Assumptions used in such valuations include capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

The fair value of Real Estate Debt is determined using either a yield-based or collateral-based valuation technique. The yield-based valuation technique involves discounting expected future cash flows that incorporate assumptions with respect to interest rates offered for similar loans to borrowers with similar credit ratings. The collateral-based valuation technique involves assessing the recoverable value of the collateral in question, net of disposal fees.

In the case of Private Equity, Real Estate and Infrastructure fund investments, the fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

(iii) Nominal Fixed Income and World Inflation-Linked Bonds

Nominal Fixed Income includes Cash, Cash Equivalents and Other, Canadian Fixed Income and World Government Bonds. Cash Equivalents include short-term instruments having a maximum term to maturity of one year. Floating rate notes are included in Cash, Cash Equivalents and Other, provided the final maturity date does not exceed three years and the coupons reset more than once per year. Bonds reported as Nominal Fixed Income include Canadian government bonds, Canadian provincial and territorial bonds, Canadian municipal bonds and corporate bonds, as well as international sovereign bonds. World Inflation-Linked Bonds reported as Real Return Assets are fixed income securities that earn inflation adjusted returns.

PSP Investments holds ABTNs reported as Canadian Fixed Income in the investment portfolio. The ABTNs were received in exchange for third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007 and were subsequently restructured in January 2009. The ABTNs had an original face value of $1,962 million, of which $141 million has been allocated to the Plan. During the year ended March 31, 2010, PSP Investments received $67 million of principal repayments on the ABTNs. During the year ended March 31, 2010, principal repayments on the ABTNs of $5 million has been allocated to the Plan.

PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $69 million was allocated to the Plan. As at March 31, 2010, the margin funding facilities had not been drawn upon. As part of the exchange of the non-bank ABCP for the ABTNs, it was agreed to include in the agreement a moratorium which prevents collateral calls for a period of 18 months ending July 21, 2010.

Management's best estimate of the fair value of PSP Investments' ABTNs allocated to the Plan as at March 31, 2010 is equal to $84 million (2009 – $74 million). The fair value of the ABTNs allocated to the Plan has been reduced by the impact of the funding facilities amounting to $5 million on March 31, 2010 (2009 – $7 million). PSP Investments recorded an increase of $15 million in the fair value of the ABTNs allocated to the Plan during the year ended March 31, 2010 (decrease of $34 million during the year ended March 31, 2009).

Valuation Techniques

Cash Equivalents are recorded at cost plus accrued interest, which approximate fair value.

Fair values of bonds and floating rate notes are based on prices obtained from third-party pricing sources. They are determined using either an appropriate interest rate curve with a spread associated with the credit quality of the issuer or other generally accepted pricing methodologies.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Nominal Fixed Income and World Inflation-Linked Bonds (continued)

Valuation Techniques (continued)

ABTNs are measured at fair value using comparable notes with similar credit quality and terms as a proxy, while taking into consideration the impact of the funding facilities. The valuation model used includes certain assumptions that are not fully supported by market observable data. Such assumptions include interest rate spreads, assumed credit rating (ranging from BB to AAA–), expected returns, an average maturity of seven years as well as liquidity estimates.

(iv) Absolute Return

In addition to the different asset classes outlined in the Statement of Investment Policies, Standards and Procedures (SIP&P), PSP Investments employs a number of absolute return strategies through units of externally managed pooled funds.

Valuation Techniques

The fair value of investments in pooled funds is measured by using the unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(v) Amounts Receivable and Payable from Pending Trades

Amounts receivable from pending trades consist of proceeds on sales of investments, excluding derivative financial instruments, which have been traded but remain unsettled at the end of the reporting period.

Amounts payable from pending trades consist of the cost of purchases of investments, excluding derivative financial instruments, which have been traded but remain unsettled at the end of the reporting period.

Valuation Techniques

The fair value of amounts receivable and payable from pending trades reflects the value at which their underlying original sale or purchase transactions were undertaken.

(vi) Securities Sold Short

Securities sold short reflect PSP Investments' commitment to purchasing securities pursuant to short selling transactions. In such transactions, PSP Investments sells securities it does not own with a commitment to purchasing similar securities on the market to cover its position.

Valuation Techniques

Using ask prices as inputs, the fair value of securities sold short is measured using the same method as the similar long positions presented under Nominal Fixed Income, World Inflation-Linked Bonds, Canadian Equity and Foreign Equity.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts, the value of which is derived from changes in underlying assets, interest or exchange rates. PSP Investments uses derivative financial instruments to increase returns or to replicate investments synthetically. Derivatives are also used to reduce the risk associated with existing investments.

PSP Investments uses the following types of derivative financial instruments as described below:

(i) Swaps

Swaps are transactions whereby two counterparties exchange cash flow streams with each other based on predetermined conditions that include a notional amount and a term. Swaps are used to increase returns or to adjust exposures of certain assets without directly purchasing or selling the underlying assets.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(ii) Futures

Futures are standardized contracts to take or make delivery of an asset (buy or sell) at a specific time in the future for a specific price that has been agreed upon today. Futures are used to adjust exposures to specified assets without directly purchasing or selling the underlying assets.

(iii) Forwards

Forwards are contracts involving the sale by one party and the purchase by another party of a predefined amount of an underlying instrument, at a predefined price and a predefined date in the future. Forwards are used for yield enhancement purposes or to manage exposures to currencies and interest rates.

(iv) Options

Options are the right, but not the obligation, to buy or sell a given amount of an underlying security, index, or commodity, at an agreed-upon price stipulated in advance, either at a determined date or at any time before the predefined maturity date.

(v) Warrants and Rights

Warrants are options on an underlying asset which is in the form of a transferable security and which can be listed on an exchange.

Rights are securities giving shareholders entitlement to purchase new shares issued by a corporation at a predetermined price (normally less than the current market price) in proportion to the number of shares already owned. Rights are issued only for a short period of time, after which they expire.

(vi) Collateralized Debt Obligations

Collateralized debt obligations are a type of asset-backed security that is constructed from a portfolio of credit-related assets. Collateralized debt obligations are usually divided into several tranches with different credit risk levels and corresponding interest payments. Any losses are applied first to the more junior tranches (lowest risk rating) before moving up in seniority.

Valuation Techniques

All listed derivative financial instruments are recorded at fair value using quoted market prices with the bid price for long positions and the ask price for short positions. Except for collateralized debt obligations, OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. For many pricing models there is no material subjectivity because the methodologies employed do not necessitate significant judgment and the pricing inputs are observed from actively quoted markets. Additionally, the pricing models used are widely accepted and used by other market participants.

The fair value of collateralized debt obligations are determined based on valuation techniques that use significant assumptions that are not all directly market observable. Such assumptions include default correlation data and recovery rate which are estimated by management. The instruments are then valued by discounting the expected cash flows using an appropriate discount factor.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Notional values of derivative financial instruments are not recorded as assets or liabilities as they represent the face amount of the contract. Notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions disclosed below, with the exception of credit derivatives [1]. Rather, they serve as the basis upon which the cash flows and the fair value of the contracts are determined.

The following table summarizes the derivatives portfolio as at March 31:

($ millions)	2010				2009	
INVESTMENTS	Notional Value	Fair Value Assets	Fair Value Liabilities	Fair Value Net	Notional Value	Fair Value
Equity and Commodity Derivatives						
Futures	$ 8	$ –	$ –	$ –	$ 45	$ –
Total Return Swaps	249	9	–	9	208	8
Variance Swaps	–	–	–	–	8	–
Warrants and Rights	–	–	–	–	–	–
Options: Listed-written	–	–	–	–	–	–
Currency Derivatives						
Forwards	720	23	(2)	21	1,476	(12)
Options: OTC-purchased	46	–	–	–	44	1
OTC-written	12	–	–	–	11	–
Interest Rate Derivatives						
Bond Forwards	15	–	–	–	25	–
Futures	37	–	–	–	–	–
Interest Rate Swaps	276	2	(3)	(1)	282	–
Total Return Swaps	199	1	(1)	–	252	4
Swaptions	–	–	–	–	179	–
Options: Listed-purchased	30	–	–	–	–	–
Listed-written	82	–	–	–	179	–
OTC-written	–	–	–	–	107	–
Credit Derivatives [1]:						
Purchased	2	–	–	–	5	4
Sold	53	–	(23)	(23)	117	(92)
Total	$ 1,729	$ 35	$ (29)	$ 6	$ 2,938	$ (87)

[1] Credit derivatives include collateralized debt obligations and a credit default swap. PSP Investments, through sold credit derivatives, indirectly guarantees the underlying reference obligations. The maximum potential exposure is the notional amount of the sold credit derivatives as shown in the table above.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives, as at March 31, is as follows:

($ millions)	2010	2009
Less than 3 months	$ 650	$ 1,746
3 to 12 months	797	850
Over 1 year	282	342
Total	**$ 1,729**	$ 2,938

(C) FAIR VALUE MEASUREMENT

Financial instruments are classified according to the following hierarchy based on the significant inputs used in measuring their fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities.

Level 2: Valuation is based on quoted market prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active. Level 2 also includes model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is based on model-based techniques for which significant assumptions are not observable in the market. They reflect management's assessment of the assumptions that market participants would use in pricing the financial instruments.

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of financial instruments, as at March 31, 2010 based on the methods described above:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 1,245	$ 100	$ –	$ –	$ 1,345
Private Equity	–	–	372	–	372
Nominal Fixed Income	9	807	91	–	907
Real Return Assets					
World Inflation-Linked Bonds	–	24	–	–	24
Real Estate	–	–	434	–	434
Infrastructure	–	–	167	–	167
Absolute Return	–	88	83	–	171
INVESTMENTS	$ 1,254	$ 1,019	$ 1,147	$ –	$ 3,420
Investment-Related Assets					
Amounts receivable from pending trades [1]	$ –	$ –	$ –	$ 11	$ 11
Derivative-related receivables	–	35	–	–	35
Total Investment-Related Assets	$ –	$ 35	$ –	$ 11	$ 46
Investment-Related Liabilities					
Amounts payable from pending trades [1]	$ –	$ –	$ –	$ (33)	$ (33)
Securities sold short	(9)	–	–	–	(9)
Derivative-related payables	–	(6)	(23)	–	(29)
Capital debt financing:					
Short-term	–	(46)	–	–	(46)
Long-term	–	(76)	–	–	(76)
Total Investment-Related Liabilities	$ (9)	$ (128)	$ (23)	$ (33)	$ (193)
NET INVESTMENTS	$ 1,245	$ 926	$ 1,124	$ (22)	$ 3,273

[1] No fair value hierarchy classification is required for these items.

The classification of financial instruments in the levels of the hierarchy is established at the time of the initial valuation of the instrument and reviewed on each subsequent reporting period-end.

There have been no significant transfers between Level 1 and Level 2 during the current fiscal year.

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

The following table shows a reconciliation of all movements in the fair value of financial instruments categorized within Level 3 for the year ended March 31:

	2010					
($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Opening Balance	$ 304	$ 81	$ 702	$ 49	$ (87)	$ 1,049
Purchases	95	–	84	16	–	195
Sales/Settlements	(58)	(4)	(95)	–	–	(157)
Total gains (losses) [1]	31	14	(90)	18	64	37
Transfers into or out of Level 3	–	–	–	–	–	–
Closing Balance	$ 372	$ 91	$ 601	$ 83	$ (23)	$ 1,124

Total gains (losses), for the year ended March 31, included in investment income (loss) are presented as follows:

	2010					
($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Total realized gains (losses)	$ 3	$ 1	$ 2	$ –	$ –	$ 6
Total unrealized gains (losses)	$ 28	$ 13	$ (92)	$ 18	$ 64	$ 31
Total gains (losses) [1]	$ 31	$ 14	$ (90)	$ 18	$ 64	$ 37

[1] Included in Note 6 (a).

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (a) and (b). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 3% increase/decrease in the fair value of financial instruments categorized as Level 3. This excludes private market fund investments as well as Real Estate Debt, where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of Private Market fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (a). With respect to Real Estate Debt, the fair value is obtained from third-party appraisers as described in Note 3 (a).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(D) INVESTMENT ASSET MIX

The SIP&P sets out the long-term target weights of the assets that shall be invested for the four Plan Accounts. Investments are classified by asset mix category as set out in the SIP&P based on the economic intent of the investment strategies of the underlying assets.

The net investments, as at March 31, are as follows:

	2010			2009		
($ millions)	Fair Value		Policy Portfolio Long-Term Target	Fair Value		Policy Portfolio Long-Term Target
World Equity						
Canadian Equity	$ 958	29.2%	30.0%	$ 631	26.1%	30.0%
Foreign Equity:						
US Large Cap Equity	149	4.6	5.0	66	2.7	5.0
EAFE Large Cap Equity	145	4.4	5.0	75	3.1	5.0
Small Cap Developed World Equity	140	4.3	5.0	56	2.3	5.0
Emerging Markets Equity	211	6.5	7.0	152	6.3	7.0
Private Equity	384	11.7	10.0	300	12.4	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	134	4.1	2.0	5	0.2	2.0
World Government Bonds	150	4.6	5.0	151	6.2	5.0
Canadian Fixed Income	342	10.4	8.0	304	12.6	8.0
Real Return Assets						
World Inflation-Linked Bonds	152	4.6	5.0	171	7.1	5.0
Real Estate	362	11.1	10.0	333	13.8	10.0
Infrastructure	146	4.5	8.0	175	7.2	8.0
NET INVESTMENTS	$ 3,273	100.0%	100.0%	$ 2,419	100.0%	100.0%

[1] Includes amounts related to absolute return and real estate debt strategies.

3. INVESTMENTS (continued)

(E) SECURITIES LENDING & BORROWING PROGRAMS

PSP Investments participates in securities lending and borrowing programs whereby it lends and borrows securities in order to enhance portfolio returns.

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. In the absence of an event of default, the same securities or equivalent securities must be returned to the counterparty at the end of the contract. PSP Investments does not repledge any collateral held.

The following table illustrates the fair values of the Plan's allocated securities and collateral associated with the lending and borrowing programs as at March 31:

($ millions)	2010	2009
Securities Lending		
Securities lent	$ 283	$ 194
Collateral contractually receivable [1]	296	202
Securities Borrowing		
Securities borrowed	8	26
Collateral contractually payable [2]	8	26

[1] The minimum fair value of collateral required is equal to 102% of the fair value of the securities lent.

[2] The minimum fair value of collateral required is equal to 100% of the fair value of the securities borrowed.

4. INVESTMENT RISK MANAGEMENT

Risk Management is a central part of PSP Investments' strategic management. It is a continuous process whereby PSP Investments methodically addresses the risks related to its various investment activities with the goal of achieving a maximum rate of return without undue risk of loss and a sustained benefit within each activity and across the total portfolio.

A risk governance structure that includes required reporting on risk to all levels in the organization also ensures that appropriate objectives are pursued and achieved in line with the fulfillment of PSP Investments' legislated mandate. The Board of Directors and its committees oversee various issues related to risk and receive assurance from senior management and an independent internal auditor reporting directly to the Audit and Conflicts Committee.

The use of financial instruments exposes PSP Investments to credit and liquidity risks as well as market risks including foreign exchange and interest rate risks. These risks are managed in accordance with the Investment Risk Management Handbook, which is an integral part of PSP Investments' risk control system. The Investment Risk Management Handbook contains an Investment Risk Management Policy which supplements the SIP&P (Policy Portfolio). The Policy Portfolio determines a diversification strategy to mitigate risk whereby PSP Investments invests in a diversified portfolio of investments based on established criteria. Additionally, the objective of these policies is to provide a framework for the management of credit, liquidity and market risks. Derivative financial instruments, traded either on exchanges or OTC, are one of the vehicles used to mitigate the impact of market risk.

(A) MARKET RISK

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, volatility in share and commodity prices, interest rate, foreign exchange or other factors affecting similar securities traded in the market.

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Market risk is measured using the method known as Value-at-Risk (VaR). VaR is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. PSP Investments has chosen a yearly 95% confidence level to measure and report VaR. PSP Investments uses a Historical VaR model incorporating three years of monthly market returns which are scaled to a twelve-month holding period. Risk Management is responsible for implementing and maintaining a VaR measurement methodology for all asset classes and all financial risk factors.

Historical VaR is statistically valid under normal market conditions and does not specifically consider losses from severe market events. The Historical VaR model also assumes that the future will behave in a similar pattern to the past. If future market conditions differ significantly from those of the past, potential losses may differ from those originally estimated. The VaR is an estimate of a single value in a distribution of potential losses that can be experienced. As a result, it is not an estimate of the maximum potential loss.

The goal of actively managing the portfolio is to outperform the policy portfolio benchmarks while maintaining the active risk under 400 basis points (bps). Relative VaR, as a result, is the maximum amount of loss of total investments, with 95% confidence level, relative to the policy portfolio benchmark over a twelve-month period.

The following table shows the total Relative VaR allocated to the Plan and the diversification effect as at March 31 based on the economic intent of the investment strategies of the underlying assets. The diversification effect captures the effect of holding different types of assets which may react differently in various types of situations and thus having the effect of reducing overall Relative VaR.

Active Risk Taken

(Relative VaR – $ millions)	2010	2009
World Equity	$ 49	$ 56
Real Return Assets	62	76
Absolute Return	29	83
Total Relative VaR (Undiversified)	140	215
Diversification Effect	(69)	(119)
Total Relative VaR	**$ 71**	$ 96

Risk Management monitors the absolute risk of the Policy Portfolio on a quarterly basis to ensure no undue loss may be experienced by PSP Investments.

Generally, changes in VaR between reporting periods are due to changes in the level of exposure, volatilities and/or correlations among asset classes. Although VaR is a widely accepted risk measure, it must be complemented by other risk measures. PSP Investments therefore uses stress testing and scenario analysis to examine the impact on financial results of abnormally large movements in risk factors. Stress testing and scenario analysis are used to test a portfolio's sensitivity to various risk factors and key model assumptions. These methods also use historically stressed periods to evaluate how a current portfolio would fare under such circumstances. Stress testing is also deployed to assess new product behaviour. Stress testing and scenario analysis are utilized as a complement to the Historical VaR measure in order to provide greater insight on the size of potential losses that may be experienced. PSP Investments uses the expected shortfall and tail analysis measures to determine this. Expected shortfall is defined as the conditional expectation beyond the VaR level. It is measured by averaging all data points showing a loss greater than VaR measured at a given confidence level. By increasing the confidence level of the VaR measure from 95% to 99%, PSP Investments is able to assess the size of the potential loss that would be exceeded one year out of 100 (instead of one year out of 20). Therefore, there is a greater probability for larger losses, at the 99% confidence level, in extreme market conditions. Risk Management presents a stress testing and scenario analysis report to senior management on a quarterly basis.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(i) Interest Rate Risk

Interest rate risk refers to the risk that fluctuations in interest rates will directly affect the fair value of the Plan's net asset values. The most significant exposure to interest rate risk is related to the investment in bonds, ABTNs and Real Estate Debt.

The terms to maturity of the investments, before allocating the effect of derivative contracts and investment-related assets and liabilities, as at March 31, are as follows:

	Terms to Maturity					
($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	2010 Total	2009 Total
Government of Canada bonds	$ 13	$ 115	$ 24	$ 27	$ 179	$ 219
Provincial and Territorial bonds	13	41	21	38	113	106
Municipal bonds	–	2	4	–	6	6
Corporate bonds	18	43	32	27	120	106
ABTNs	–	3	–	81	84	74
Total Canadian Fixed Income	$ 44	$ 204	$ 81	$ 173	$ 502	$ 511
Total World Government Bonds	$ 1	$ 34	$ 23	$ 20	$ 78	$ 54
Total World Inflation-Linked Bonds	$ –	$ 6	$ 6	$ 12	$ 24	$ 14
Real Estate Debt [1]	$ 20	$ 12	$ –	$ 2	$ 34	$ 54
Grand Total	$ 65	$ 256	$ 110	$ 207	$ 638	$ 633

[1] Real Estate Debt is a component of the Real Estate asset class disclosed in Note 3 (a).

The terms to maturity of PSP Investments' capital debt financing are disclosed in Note 8.

Absolute return strategies, as described in Note 3, and derivative contracts are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 4 (a).

Additionally, the exposure to interest rate risk for short-term instruments and amounts receivable from pending trades would not be significant due to their short-term nature.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts, positions in foreign currencies. PSP Investments' policy is to hedge 50% of its foreign currency investments excluding Emerging Markets Equity.

The underlying net foreign currency exposures for the Plan, after allocating the effect of derivative contracts and investment-related assets and liabilities for both monetary and non-monetary items, as at March 31, are as follows:

	2010		2009	
Currency (in millions of Canadian $)	Fair Value	% of Total	Fair Value	% of Total
US Dollar	$ 444	51.2%	$ 331	52.9%
Euro	128	14.8	148	23.6
British Pound	55	6.4	37	5.9
Brazilian Real	47	5.5	5	0.7
Hong Kong Dollar	36	4.1	22	3.4
Japanese Yen	30	3.5	28	4.5
Korean Won	25	2.9	12	1.9
New Taiwan Dollar	15	1.6	12	2.0
South African Rand	11	1.3	6	1.1
Australian Dollar	10	1.2	12	1.9
Indian Rupee	11	1.2	6	1.0
Turkish Lira	8	0.9	4	0.7
Others	47	5.4	3	0.4
Total	$ 867	100.0%	$ 626	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies of $352 million ($289 million US, €41 million and 22 million South African Rands (ZAR)) for the Plan which are not included in the foreign currency exposure table.

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

PSP Investments is exposed to credit risk, that is, the risk that the issuer of a debt security or a counterparty to a derivative contract is unable to meet its financial obligations.

Credit risk encompasses the risk of a deterioration of creditworthiness and the respective concentration risk. Credit risk monitoring entails an evaluation of the credit quality of each issuer to which PSP Investments is exposed. To perform this evaluation, PSP Investments relies on four recognized credit rating agencies. A minimum of two credit ratings are used to classify each security; securities rated by only one agency are classified as "not rated". If the agencies disagree as to a security's credit quality, PSP Investments uses the lowest of the available ratings.

To monitor the evolution of credit risk, PSP Investments periodically produces a concentration report by credit rating of all credit-sensitive financial securities with the exception of securities held in pooled funds or for Private Market Investments.

PSP Investments' concentration of credit risk by credit rating for the Plan, as at March 31, is as follows:

	2010	2009
Investment grade (AAA to BBB–)	**89.9%**	88.7%
Below investment grade (BB+ and below)	**–**	–
Not rated:		
Rated by a single credit rating agency	**8.5**	8.5
Not rated by credit rating agencies	**1.6**	2.8
Total	**100.0%**	100.0%

The breakdown of credit concentration risk for the Plan does not include investments in distressed debt included in pooled funds in the amount of approximately $0.1 billion as at March 31, 2010 (2009 – $0.1 billion). Such investments typically include debt securities of issuers close to default, and the investment in such securities are quasi-equity in nature.

As at March 31, 2010, the Plan also has a net notional exposure of $43 million to collateralized debt obligations, of which approximately 64% of the dollar exposure is rated "Investment grade", as well as funding facilities of a maximum amount of $69 million to support potential margin calls on the ABTNs (Note 3 (a) (iii)).

As at March 31, 2010, the Plan's maximum exposure to credit risk, excluding collateral held and the investments in distressed debt and collateralized debt obligations described above, amounts to approximately $0.9 billion (2009 – approximately $0.8 billion).

(i) Counterparty Risk

Counterparty risk represents the credit risk from current and potential exposure related to transactions involving derivative contracts. In order to minimize derivative contract counterparty risk, PSP Investments deals only with counterparties with a minimum credit rating of "A–" as at the trade date, as provided by a recognized credit rating agency. PSP Investments monitors the credit ratings of counterparties on a daily basis and has the ability to terminate all trades with counterparties who have their credit rating downgraded below "A–" subsequent to the trade date. PSP Investments also uses credit mitigation techniques such as master-netting arrangements and collateral transfers through the use of Credit Support Annexes (CSA).

PSP Investments' policy also requires the use of the International Swaps and Derivative Association (ISDA) Master Agreement with all counterparties to derivative contracts. The ISDA Master Agreement provides the contractual framework within which dealing activities across a full range of OTC products are conducted and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or other pre-determined events occur.

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

Additionally, the CSA to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the event of the failure of the counterparty and requires PSP Investments to contribute further collateral when requested. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold.

On behalf of the Plan, PSP Investments deposited or pledged securities with a fair value of $15 million as collateral with various financial institutions as at March 31, 2010 (2009 – $74 million) while securities with a fair value of $13 million (2009 – $8 million) were received from other counterparties as collateral. PSP Investments does not repledge any collateral held. All collateral deposited, pledged and received were held with counterparties who had a minimum credit rating of "A–" as at March 31, 2010.

Risk Management is responsible for counterparty risk monitoring and mitigation as well as maintaining a comprehensive, disciplined, and enterprise-wide process for tracking and managing counterparty risk. As such, Risk Management measures counterparty risk on an ongoing basis, evaluates and tracks the creditworthiness of current counterparties and mitigates counterparty risk through collateral management.

(C) LIQUIDITY RISK

Liquidity risk corresponds to PSP Investments' ability to meet its financial obligations when they come due with sufficient and readily available cash resources. PSP Investments' cash position is monitored on a daily basis. In general, investments in cash, cash equivalents, floating rate notes, debt and public equities are expected to be highly liquid as they will be invested in securities that are actively traded. Risk Management utilizes appropriate measures and controls to monitor liquidity risk in order to ensure that there is sufficient liquidity to meet financial obligations as they come due. A liquidity report taking into consideration future forecasted cash flows is prepared and presented to senior management on a weekly basis. This ensures that sufficient cash reserves are available to meet forecasted cash outflows. Additionally, sufficient sources of liquidity are maintained for deployment in case of market disruption.

PSP Investments has the ability to raise additional capital through the use of its capital debt program. This program allows PSP Investments to issue short-term promissory notes and medium-term notes. Note 8 provides additional information on the usage of the capital debt program.

The terms to maturity of the notional amount of derivatives, including related payable amounts, are disclosed in Note 3 (b).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial assets and liabilities, aggregated according to their maturities as at March 31, 2010.

Liabilities are presented in the earliest period in which the counterparty can request payment.

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities				
Amounts payable from pending trades	$ (33)	$ –	$ –	$ (33)
Securities sold short	(9)	–	–	(9)
Capital debt financing	(44)	(2)	(76)	(122)
Accounts payable and other liabilities	(2)	–	(1)	(3)
Total	$ (88)	$ (2)	$ (77)	$ (167)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial assets and liabilities				
Derivative-related assets	$ 12	$ 20	$ 2	$ 34
Derivative-related liabilities	(2)	(1)	(26)	(29)
Total	$ 10	$ 19	$ (24)	$ 5

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

5. FUND TRANSFERS

PSP Investments received fund transfers of $323 million for the year ended March 31, 2010 (2009 – $314 million) from the Royal Canadian Mounted Police Pension Fund. The transfers received are comprised of the net employer and employee contributions to the Royal Canadian Mounted Police pension plan in respect of member service after April 1, 2000.

6. INVESTMENT INCOME (LOSS)

(A) INVESTMENT INCOME (LOSS)

Investment income (loss), for the year ended March 31, is as follows:

($ millions)	2010	2009
Interest income	$ 29	$ 33
Dividend income	29	31
Other income	15	17
Security lending income (net) [1]	1	1
Dividend expense	(2)	(2)
Interest expense (Note 8)	(4)	(5)
Transaction costs	(2)	(4)
External investment management fees [2]	(2)	(4)
	64	67
Net realized gains (losses) [3]	108	(440)
Net unrealized gains (losses)	367	(306)
Investment Income (Loss)	**$ 539**	**$ (679)**

[1] Includes fees on securities borrowed.

[2] These are amounts incurred for public market investments that are paid directly by PSP Investments (Note 1). This excludes amounts incurred for Private Market Investments, disclosed in Note 3 (a) (ii), and certain public market pooled fund investments in the amount of $1 million for the year ended March 31, 2010 (2009 – $1 million) that are not paid directly by PSP Investments.

[3] Includes foreign currency gains (losses) of $44 million for the year ended March 31, 2010 (2009 – $(44) million).

(B) INVESTMENT INCOME (LOSS) BY ASSET MIX

Investment income (loss) by asset mix based on the economic intent of the investment strategies of the underlying assets as outlined in the SIP&P, for the year ended March 31, after allocating net realized and unrealized gains (losses) on investments to the asset classes to which they relate, is as follows:

($ millions)	2010	2009
World Equity		
Canadian Equity	$ 262	$ (256)
Foreign Equity:		
US Large Cap Equity	18	(32)
EAFE Large Cap Equity	17	(42)
Small Cap Developed World Equity	20	(35)
Emerging Markets Equity	72	(70)
Private Equity	86	(115)
Nominal Fixed Income		
Cash & Cash Equivalents	3	3
World Government Bonds	(25)	34
Canadian Fixed Income	14	13
Real Return Assets		
World Inflation-Linked Bonds	(18)	11
Real Estate	2	(57)
Infrastructure	11	9
Absolute Return [1]	77	(142)
Investment Income (Loss)	**$ 539**	**$ (679)**

[1] Includes amounts related to real estate debt strategies.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

7. EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the plans for which it provides investment services. Under section 4(3) of the Act, the President of the Treasury Board shall determine to which plan account these costs will be charged, in consultation with the Minister of National Defence and the Minister of Public Safety. An allocation policy has been developed which allocates the direct costs of investment activities, such as external investment management fees and custodial fees, to each plan account, based upon the asset value of each plan account at the time the expense was incurred.

All other operating expenses, excluding the direct cost of investment activities listed above, for the year ended March 31, have been allocated in proportion to the annual amount of net assets in each Plan Account as follows:

	2010	2009
Public Service Pension Plan Account	**72.5%**	72.6%
Canadian Forces Pension Plan Account	**20.0**	20.1
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.3**	0.1
Total	**100.0%**	100.0%

Expenses are paid by PSP Investments by way of advances from the Public Service Pension Plan Account, which are reimbursed by the other plan accounts on a quarterly basis.

(B) OPERATING EXPENSES

Operating expenses allocated to this Plan account, for the year ended March 31, consist of the following:

($ thousands)	**2010**	2009
Salaries and benefits	**$ 3,826**	$ 3,458
Professional and consulting fees	**665**	716
Office supplies and equipment	**802**	629
Other operating expenses	**301**	572
Depreciation of fixed assets	**508**	333
Occupancy costs	**309**	259
Custodial fees	**111**	89
Remuneration earned by Directors	**58**	66
Travel and related expenses for Directors	**12**	27
Communication expenses	**23**	6
Total	**$ 6,615**	$ 6,155

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

8. CAPITAL DEBT FINANCING

As of March 31, 2010, PSP Capital Inc. has $649 million (2009 – $1,579 million) of short-term promissory notes outstanding with maturity dates between 14 and 120 days of issuance, of which $46 million (2009 – $113 million) has been allocated to the Royal Canadian Mounted Police Pension Plan Account and included in Note 3 (a) as a short-term investment-related liability. As at March 31, 2010, PSP Capital Inc. has $1 billion (2009 – $1 billion) of medium-term notes issued and outstanding, of which $72 million (2009 – $72 million) has been allocated to the Royal Canadian Mounted Police Pension Plan Account. These medium-term notes bear interest of 4.57% per annum and have a maturity date of December 9, 2013. These medium-term notes are included in Note 3 (a) as a long-term investment-related liability. As at March 31, 2010, the fair value of these medium-term notes is $1,073 million (2009 – $1,054 million), of which $76 million (2009 – $76 million) has been allocated to the Royal Canadian Mounted Police Pension Plan Account. The maximum authorized by the Board of Directors for both the short-term promissory notes and medium-term notes is $2 billion. The capital raised, primarily used to finance investments in the Real Estate and Infrastructure asset classes, is unconditionally and irrevocably guaranteed by PSP Investments and is in accordance with the approved PSP Investments' corporate policy for leverage.

The operating expenses incurred by PSP Capital Inc. were allocated to each Plan account as described in Note 7 (a).

Interest expense, for the year ended March 31, is as follows:

($ thousands)	**2010**	2009
Short-term promissory notes	**$ 527**	$ 4,039
Medium-term notes	**3,235**	717
Total	**$ 3,762**	$ 4,756

9. CAPITAL MANAGEMENT

As an investment company, PSP Investments objectives in managing its capital are:

- To invest fund transfers, outlined in Note 5, in the best interests of the beneficiaries and contributors under the *Superannuation Acts.* The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plans established under the *Superannuation Acts.* The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.
- To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc., and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 8 provides information on the capital debt financing and Note 4 (c) provides information on PSP Investments' liquidity. Additionally, as at March 31, 2010, PSP Investments has an operating line of credit of $10 million (2009 – $10 million). As at March 31, 2010, no amounts have been withdrawn (2009 – nil).

The capital structure of PSP Investments consists of fund transfers and capital debt financing. PSP Investments has no externally imposed restrictions on capital.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

10. GUARANTEES AND INDEMNITY

PSP Investments provides indemnification to its Directors, its Officers and to certain PSP Investments representatives who are asked to serve on boards of directors (or like bodies) or investment advisory boards (or like bodies) of entities in which PSP Investments or its wholly-owned subsidiaries have made an investment or have a financial interest. As a result, but subject to the Act, PSP Investments may be required to indemnify these representatives for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties, unless the liability of such a representative relates to a failure to act honestly and in good faith. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

As part of investment transactions, PSP Investments and its subsidiaries guaranteed letter of credit facilities. The beneficiaries of these letter of credit facilities have the ability to draw against these facilities to the extent that the contractual obligations, as defined in the related agreements, are not met. As at March 31, 2010, the maximum exposure of the Plan was $1 million (2009 – $1 million).

As at March 31, 2010, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan would assume the obligation up to $29 million (2009 – $29 million) plus interest and other related costs.

PSP Investments also unconditionally and irrevocably guarantees all credit facilities, short-term promissory notes and medium-term notes issued by PSP Capital Inc.

11. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, the portion of PSP Investments' commitments that would be assumed by the Plan is as follows:

($ millions)	**2010**	2009
Private Equity	**$ 223**	$ 331
Real Estate	**99**	129
Infrastructure	**30**	41
Public markets	**23**	41
Total	**$ 375**	$ 542

RESERVE FORCE PENSION PLAN ACCOUNT

AUDITORS' REPORT

To the Minister of National Defence

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Reserve Force Pension Plan Account (the Reserve Force Pension Plan Account) as at March 31, 2010, and the Statements of Net Income (Loss) from Operations and Comprehensive Income and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's (PSP Investments) management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Reserve Force Pension Plan Account as at March 31, 2010, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in our opinion, the transactions of the Reserve Force Pension Plan Account that have come to our notice during our audit of the financial statements have, in all significant respects, been in accordance with the applicable provisions of Part X of the *Financial Administration Act* and regulations, the *Public Sector Pension Investment Board Act* and regulations and the by-laws of PSP Investments and its wholly-owned subsidiaries.

Deloitte & Touche LLP[1]

[1] Chartered accountant auditor permit No. 18527

Montreal, Canada
May 10, 2010

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 10, 2010

RESERVE FORCE PENSION PLAN ACCOUNT

BALANCE SHEET

As at March 31

($ thousands)	2010	2009
ASSETS		
Investments (Note 3 (a))	**$ 241,523**	$ 130,550
Investment-related assets (Note 3 (a))	**3,131**	2,528
Other assets	**63**	36
TOTAL ASSETS	**$ 244,717**	$ 133,114
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 13,529**	$ 17,753
Accounts payable and other liabilities	**61**	72
Due to the Public Service Pension Plan Account	**114**	51
TOTAL LIABILITIES	**$ 13,704**	$ 17,876
NET ASSETS	**$ 231,013**	$ 115,238
Accumulated net loss from operations and comprehensive income	**$ 5,541**	$ (25,998)
Accumulated fund transfers	**225,472**	141,236
NET ASSETS	**$ 231,013**	$ 115,238

Commitments (Note 11)

The accompanying notes are an integral part of the financial statements.

On behalf of the board of Directors:

Paul Cantor
Chair of the Board

William A. MacKinnon
Chair of the Audit and Conflicts Committee

RESERVE FORCE PENSION PLAN ACCOUNT

STATEMENT OF NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME

For the year ended March 31

($ thousands)	**2010**	2009
INVESTMENT INCOME (LOSS) (Note 6)	**$ 31,854**	$ (25,172)
OPERATING EXPENSES (Note 7)	**$ 315**	$ 122
NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ 31,539**	$ (25,294)

The accompanying notes are an integral part of the financial statements.

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ thousands)	**2010**	2009
NET ASSETS, BEGINNING OF YEAR	**$ 115,238**	$ 55,019
Fund transfers (Note 5)	**84,236**	85,513
Net income (loss) from operations and comprehensive income	**31,539**	(25,294)
Increase in net assets for the year	**115,775**	60,219
NET ASSETS, END OF YEAR	**$ 231,013**	$ 115,238

The accompanying notes are an integral part of the financial statements.

RESERVE FORCE PENSION PLAN ACCOUNT

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) is a crown corporation established under the *Public Sector Pension Investment Board Act* ("the Act") with a mandate to invest the net contributions of the Public Service, Canadian Forces, Royal Canadian Mounted Police and Reserve Force pension plans in financial markets.

The Reserve Force Pension Fund was established by amendments to the *Canadian Forces Superannuation Act*, to receive contributions and make benefit payments in respect of member service after March 1, 2007. The net contributions are transferred, by the Reserve Force Pension Fund, to PSP Investments – Reserve Force Pension Plan Account for investment. PSP Investments maintains records of the pension fund's net contributions, as well as the allocation of its investments and the results of its operations in the plan account.

PSP Investments is responsible for managing amounts that are transferred to it in the best interests of the beneficiaries and contributors under the *Canadian Forces Superannuation Act*. The amounts are to be invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the *Canadian Forces Superannuation Act*.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it from the Reserve Force Pension Fund in respect of member service after March 1, 2007. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of the Reserve Force Pension Fund. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and the requirements of the Act. PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value are included in investment income (loss) as net unrealized gains (losses).

Comparative figures have been reclassified to conform to the current year's presentation.

VALUATION OF INVESTMENTS

Investments, investment-related assets and investment-related liabilities are recorded as of the trade date (the date upon which the substantial risks and rewards are transferred) and are stated at fair value. Fair value is an estimate of the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Market prices or rates are used to determine fair value where an active market exists (such as a recognized securities exchange), as it is the best evidence of the fair value of an investment. If quoted market prices or rates are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the end of the reporting period that are derived from observable market data.

Valuation techniques are generally applied to investments in the Private Equity, Real Estate and Infrastructure asset classes (collectively "Private Market Investments"), over-the-counter (OTC) derivatives as well as asset-backed term notes (ABTNs). The values derived from applying these techniques are impacted by the choice of valuation model and the underlying assumptions made concerning factors such as the amounts and timing of future cash flows, discount rates, volatility and credit risk. In certain cases, such assumptions are not supported by market observable data.

The valuation methods of each asset class are described in Notes 3 (a) and (b).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF CAPITAL DEBT FINANCING

PSP Investments' short-term capital debt financing is recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' long-term capital debt financing is based on prices that are obtained from third-party pricing sources. It is measured using an interest rate curve with a spread consistent with PSP Investments' credit quality.

TRANSACTION COSTS

Transaction costs are incremental costs directly attributable to the acquisition, due diligence, issue, or disposal of a financial asset or financial liability. Transaction costs are expensed as incurred and recorded as a component of investment income (loss).

INVESTMENT MANAGEMENT FEES

Investment management fees are costs directly attributable to the external management of assets on behalf of PSP Investments. Investment management fees incurred for Private Market Investments are paid, as determined by the fund manager, either by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment (Note 3 (a) (ii)). These amounts are recorded against investment income (loss). Investment management fees are also incurred for certain public equity investments and these amounts are paid, either directly by PSP Investments or offset against distributions received from pooled fund investments. In both cases, they are recorded against investment income (loss) (Note 6).

INCOME RECOGNITION

The investment income (loss) has been allocated proportionately based on the asset value held by the Reserve Force Pension Plan Account ("the Plan").

Investment income (loss) is made up of interest income, dividends, realized gains (losses) on the disposal of investments and unrealized gains (losses) which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Interest income is recognized as earned. Dividends are recognized on the ex-dividend date and are reflected as dividend income. Dividends paid on securities sold short are reflected as dividend expense. Additionally, other income includes the related distributions from pooled funds, limited partnerships as well as from direct and co-investments, all from Private Market Investments.

TRANSLATION OF FOREIGN CURRENCIES

Investment transactions in foreign currencies are recorded at exchange rates prevailing on the transaction date. Investments denominated in foreign currencies and held at the end of the year are translated at exchange rates in effect at the year-end date. The resulting realized and unrealized gains (losses) on foreign exchange are included in investment income (loss).

FUND TRANSFERS

Amounts received from each Pension Fund are recorded in their respective plan account.

INCOME TAXES

PSP Investments and the majority of its subsidiaries are exempt from Part I tax under paragraph 149(1)*(d)* of the *Income Tax Act* (Canada).

USE OF ESTIMATES

In preparing these financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of Private Market Investments, ABTNs, derivatives, related income and expenses and note disclosures. Although estimates and assumptions reflect management's best judgement, actual results may differ from these estimates.

2. CHANGES IN ACCOUNTING POLICIES

AMENDMENT TO ACCOUNTING STANDARD

In June 2009, the Canadian Institute of Chartered Accountants (CICA) amended Section 3862 "Financial Instruments – Disclosures" of the CICA Handbook. This amendment is effective for annual financial statements relating to fiscal years ending after September 30, 2009.

The amendment enhances disclosures about fair value measurements of financial instruments as well as the liquidity risk of derivative financial liabilities.

The principal disclosures introduced by this amendment require financial instruments measured at fair value to be categorized into one of three fair value hierarchy levels. Such categorization is based on the significance of the inputs used in measuring such value as well as disclosure of movements between levels of the fair value hierarchy.

Additional disclosures for liquidity risk call for a maturity analysis for derivative financial liabilities based on the way in which an entity manages its liquidity risk.

PSP Investments adopted the provisions of such amendments for its March 31, 2010 financial statements. Required disclosures are made in Note 3 (c) and Note 4 (c).

FUTURE CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises will converge with International Financial Reporting Standards (IFRS) effective January 1, 2011. In response to this change, PSP Investments has put in place a transition plan that would allow it to prepare and present its March 31, 2012 financial statements under IFRS.

In analyzing the various impacts of its transition to IFRS, PSP Investments concluded that the requirement to consolidate its controlled investments ranked as one of the most significant of such impacts.

In April 2010, the AcSB issued Section 4600 "Pension Plans" of the CICA Handbook requiring pension plans in Canada to follow this standard rather than convert to IFRS in the same fashion as other publicly accountable enterprises. Under Section 4600, pension plans would continue to account for and report their investments at fair value as was previously done under Section 4100 "Pension Plans" of the CICA Handbook. The provisions of Section 4600 apply to annual financial statements relating to fiscal years beginning on or after January 1, 2011.

Concurrent with the issuance of Section 4600, the AcSB issued an exposure draft that proposed a scope expansion to include entities, such as PSP Investments, that are separate from pension plans and whose sole purpose is to hold and invest assets received from one or more pension plans, but does not itself have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments. The AcSB has indicated that it anticipates reaching a decision concerning the exposure draft in June 2010.

Management is currently monitoring the outcome of this exposure draft and evaluating its impact on PSP Investments' financial statements as well as the IFRS transition plan.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS

(A) INVESTMENT PORTFOLIO

The investment portfolio, before allocating the effect of derivative contracts and investment-related assets and liabilities to the asset classes to which they relate, as at March 31, is as follows:

($ thousands)	2010		2009	
Asset Class	**Fair Value**	**Cost**	Fair Value	Cost
World Equity				
Canadian Equity	**$ 51,705**	**$ 47,249**	$ 21,589	$ 27,345
Foreign Equity:				
US Large Cap Equity	**10,670**	**10,138**	2,442	3,273
EAFE Large Cap Equity	**10,321**	**10,683**	3,962	5,715
Small Cap Developed World Equity	**9,766**	**8,889**	2,491	3,149
Emerging Markets Equity	**12,594**	**10,686**	4,984	5,500
Private Equity	**26,224**	**26,786**	14,525	17,271
Nominal Fixed Income				
Cash, Cash Equivalents and Other [1]	**23,125**	**23,790**	10,476	11,344
World Government Bonds	**5,475**	**5,651**	2,588	2,069
Canadian Fixed Income	**35,444**	**34,345**	24,380	24,313
Real Return Assets				
World Inflation-Linked Bonds	**1,683**	**1,562**	669	415
Real Estate	**30,669**	**34,434**	24,245	24,882
Infrastructure	**11,791**	**12,278**	9,252	7,970
Absolute Return	**12,056**	**6,629**	8,947	6,415
INVESTMENTS	**$ 241,523**	**$ 233,120**	$ 130,550	$ 139,661
Investment-Related Assets				
Amounts receivable from pending trades	**$ 744**	**$ 744**	$ 874	$ 874
Derivative-related receivables	**2,387**	**27**	1,654	222
Total Investment-Related Assets	**$ 3,131**	**$ 771**	$ 2,528	$ 1,096
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (2,288)**	**$ (2,288)**	$ (1,725)	$ (1,725)
Securities sold short	**(564)**	**(656)**	(1,211)	(1,512)
Derivative-related payables	**(2,075)**	**(13)**	(5,834)	(334)
Capital debt financing:				
Short-term	**(3,243)**	**(3,243)**	(5,386)	(5,386)
Long-term	**(5,359)**	**(5,122)**	(3,597)	(3,494)
Total Investment-Related Liabilities	**$ (13,529)**	**$ (11,322)**	$ (17,753)	$ (12,451)
NET INVESTMENTS	**$ 231,125**	**$ 222,569**	$ 115,325	$ 128,306

[1] Includes floating rate notes with maturities greater than one year with a fair value of $6,974 thousand for the Plan (2009 – $63 thousand).

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Canadian Equity and Foreign Equity

Canadian Equity and Foreign Equity include direct and indirect investments in common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds, and securities convertible into common shares of publicly listed issuers.

Valuation Techniques

Direct investments in Canadian and Foreign Equities are measured at fair value using quoted market prices, namely, the bid price. In the case of investments in pooled funds, fair value is measured by using unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(ii) Private Equity, Real Estate and Infrastructure

The Private Equity asset class is comprised of direct investments in companies and fund investments. They include investments in private companies, mezzanine debt and distressed debt. The Private Equity asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Private Equity asset class contracted by direct investments controlled by PSP Investments for the Plan is nil (2009 – nil).

The Real Estate asset class is comprised of direct investments in companies, in properties, third-party debts and fund investments in the real estate sector. Real Estate investments are classified into two portfolios (an equity portfolio and a debt portfolio). The equity portfolio is comprised of direct investments in properties and companies in the office, retail, industrial, hospitality and residential sectors, as well as private funds and publicly traded securities invested in real estate assets. The debt portfolio is comprised of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, mezzanine loans and other structured investments (collectively "Real Estate Debt") where significant portions of the value are attributed to the underlying real estate assets. The Real Estate asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Real Estate asset class contracted by direct investments controlled by PSP Investments for the Plan is approximately $10,750 thousand (2009 – approximately $7,150 thousand).

The Infrastructure asset class is comprised of direct investments in companies and fund investments. They include investments in companies engaged in the management, ownership or operation of assets in power, regulated businesses, transportation, telecom or social infrastructure. The Infrastructure asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Infrastructure asset class contracted by direct investments controlled by PSP Investments for the Plan is approximately $500 thousand (2009 – approximately $500 thousand).

Investment management fees, as disclosed in Note 1, are incurred for Private Market Investments and generally vary between 0.1% and 2.1% of the total invested and/or committed amount. Investment management fees of $759 thousand for the year ended March 31, 2010 (2009 – $545 thousand) were recorded against investment income (loss).

Valuation Techniques

The fair value of Private Market Investments held directly by PSP Investments is determined at least annually, using acceptable industry valuation methods. For each investment, the relevant methodology is applied consistently over time.

For direct Private Markets Investments as well as investments in Real Estate Debt, management uses the services of third-party appraisers to determine the fair value. In selecting appraisers, management ensures their independence and that valuation methods used are consistent with professional appraisal standards. Such standards include the *International Private Equity and Venture Capital Valuation Guidelines*, the *Canadian Uniform Standards of Professional Appraisal Practice* and the *Uniform Standards of Professional Appraisal Practice* in the United States of America. In validating the work performed by appraisers, management ensures that the assumptions used correspond to financial information and forecasts of the underlying investment.

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(ii) Private Equity, Real Estate and Infrastructure (continued)

Valuation Techniques (continued)

For direct investments in Private Equity and Infrastructure, valuation methods used include discounted cash flows analysis, earnings multiples, prices of recent comparable transactions and publicly traded comparables. Assumptions used in such valuations include discount rates and projected cash flows, which are not fully supported by prices from market observable transactions.

For direct investments in Real Estate, valuation methods used include discounted cash flows as well as recent comparable transactions. Assumptions used in such valuations include capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

The fair value of Real Estate Debt is determined using either a yield-based or collateral-based valuation technique. The yield-based valuation technique involves discounting expected future cash flows that incorporate assumptions with respect to interest rates offered for similar loans to borrowers with similar credit ratings. The collateral-based valuation technique involves assessing the recoverable value of the collateral in question, net of disposal fees.

In the case of Private Equity, Real Estate and Infrastructure fund investments, the fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

(iii) Nominal Fixed Income and World Inflation-Linked Bonds

Nominal Fixed Income includes Cash, Cash Equivalents and Other, Canadian Fixed Income and World Government Bonds. Cash Equivalents include short-term instruments having a maximum term to maturity of one year. Floating rate notes are included in Cash, Cash Equivalents and Other, provided the final maturity date does not exceed three years and the coupons reset more than once per year. Bonds reported as Nominal Fixed Income include Canadian government bonds, Canadian provincial and territorial bonds, Canadian municipal bonds and corporate bonds, as well as international sovereign bonds. World Inflation-Linked Bonds reported as Real Return Assets are fixed income securities that earn inflation adjusted returns.

PSP Investments holds ABTNs reported as Canadian Fixed Income in the investment portfolio. The ABTNs were received in exchange for third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007 and were subsequently restructured in January 2009. The ABTNs had an original face value of $1,962 million, of which $5,934 thousand has been allocated to the Plan. During the year ended March 31, 2010, PSP Investments received $67 million of principal repayments on the ABTNs. During the year ended March 31, 2010, principal repayments on the ABTNs of $334 thousand has been allocated to the Plan.

PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $4,840 thousand was allocated to the Plan. As at March 31, 2010, the margin funding facilities had not been drawn upon. As part of the exchange of the non-bank ABCP for the ABTNs, it was agreed to include in the agreement a moratorium which prevents collateral calls for a period of 18 months ending July 21, 2010.

Management's best estimate of the fair value of PSP Investments' ABTNs allocated to the Plan as at March 31, 2010 is equal to $5,919 thousand (2009 – $3,145 thousand). The fair value of the ABTNs allocated to the Plan has been reduced by the impact of the funding facilities amounting to $325 thousand on March 31, 2010 (2009 – $321 thousand). PSP Investments recorded an increase of $3,108 thousand in the fair value of the ABTNs allocated to the Plan during the year ended March 31, 2010 (decrease of $638 thousand during the year ended March 31, 2009).

Valuation Techniques

Cash Equivalents are recorded at cost plus accrued interest, which approximate fair value.

Fair values of bonds and floating rate notes are based on prices obtained from third-party pricing sources. They are determined using either an appropriate interest rate curve with a spread associated with the credit quality of the issuer or other generally accepted pricing methodologies.

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Nominal Fixed Income and World Inflation-Linked Bonds (continued)

Valuation Techniques (continued)

ABTNs are measured at fair value using comparable notes with similar credit quality and terms as a proxy, while taking into consideration the impact of the funding facilities. The valuation model used includes certain assumptions that are not fully supported by market observable data. Such assumptions include interest rate spreads, assumed credit rating (ranging from BB to AAA–), expected returns, an average maturity of seven years as well as liquidity estimates.

(iv) Absolute Return

In addition to the different asset classes outlined in the Statement of Investment Policies, Standards and Procedures (SIP&P), PSP Investments employs a number of absolute return strategies through units of externally managed pooled funds.

Valuation Techniques

The fair value of investments in pooled funds is measured by using the unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(v) Amounts Receivable and Payable from Pending Trades

Amounts receivable from pending trades consist of proceeds on sales of investments, excluding derivative financial instruments, which have been traded but remain unsettled at the end of the reporting period.

Amounts payable from pending trades consist of the cost of purchases of investments, excluding derivative financial instruments, which have been traded but remain unsettled at the end of the reporting period.

Valuation Techniques

The fair value of amounts receivable and payable from pending trades reflects the value at which their underlying original sale or purchase transactions were undertaken.

(vi) Securities Sold Short

Securities sold short reflect PSP Investments' commitment to purchasing securities pursuant to short selling transactions. In such transactions, PSP Investments sells securities it does not own with a commitment to purchasing similar securities on the market to cover its position.

Valuation Techniques

Using ask prices as inputs, the fair value of securities sold short is measured using the same method as the similar long positions presented under Nominal Fixed Income, World Inflation-Linked Bonds, Canadian Equity and Foreign Equity.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts, the value of which is derived from changes in underlying assets, interest or exchange rates. PSP Investments uses derivative financial instruments to increase returns or to replicate investments synthetically. Derivatives are also used to reduce the risk associated with existing investments.

PSP Investments uses the following types of derivative financial instruments as described below:

(i) Swaps

Swaps are transactions whereby two counterparties exchange cash flow streams with each other based on predetermined conditions that include a notional amount and a term. Swaps are used to increase returns or to adjust exposures of certain assets without directly purchasing or selling the underlying assets.

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(ii) Futures

Futures are standardized contracts to take or make delivery of an asset (buy or sell) at a specific time in the future for a specific price that has been agreed upon today. Futures are used to adjust exposures to specified assets without directly purchasing or selling the underlying assets.

(iii) Forwards

Forwards are contracts involving the sale by one party and the purchase by another party of a predefined amount of an underlying instrument, at a predefined price and a predefined date in the future. Forwards are used for yield enhancement purposes or to manage exposures to currencies and interest rates.

(iv) Options

Options are the right, but not the obligation, to buy or sell a given amount of an underlying security, index, or commodity, at an agreed-upon price stipulated in advance, either at a determined date or at any time before the predefined maturity date.

(v) Warrants and Rights

Warrants are options on an underlying asset which is in the form of a transferable security and which can be listed on an exchange.

Rights are securities giving shareholders entitlement to purchase new shares issued by a corporation at a predetermined price (normally less than the current market price) in proportion to the number of shares already owned. Rights are issued only for a short period of time, after which they expire.

(vi) Collateralized Debt Obligations

Collateralized debt obligations are a type of asset-backed security that is constructed from a portfolio of credit-related assets. Collateralized debt obligations are usually divided into several tranches with different credit risk levels and corresponding interest payments. Any losses are applied first to the more junior tranches (lowest risk rating) before moving up in seniority.

Valuation Techniques

All listed derivative financial instruments are recorded at fair value using quoted market prices with the bid price for long positions and the ask price for short positions. Except for collateralized debt obligations, OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. For many pricing models there is no material subjectivity because the methodologies employed do not necessitate significant judgment and the pricing inputs are observed from actively quoted markets. Additionally, the pricing models used are widely accepted and used by other market participants.

The fair value of collateralized debt obligations are determined based on valuation techniques that use significant assumptions that are not all directly market observable. Such assumptions include default correlation data and recovery rate which are estimated by management. The instruments are then valued by discounting the expected cash flows using an appropriate discount factor.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Notional values of derivative financial instruments are not recorded as assets or liabilities as they represent the face amount of the contract. Notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions disclosed below, with the exception of credit derivatives [1]. Rather, they serve as the basis upon which the cash flows and the fair value of the contracts are determined.

The following table summarizes the derivatives portfolio as at March 31:

($ millions)	**2010**				2009	
	Notional Value	**Fair Value**			Notional Value	Fair Value
INVESTMENTS		**Assets**	**Liabilities**	**Net**		
Equity and Commodity Derivatives						
Futures	$ 565	$ –	$ –	$ –	$ 2,143	$ –
Total Return Swaps	17,602	578	(6)	572	9,926	362
Variance Swaps	–	–	–	–	365	20
Warrants and Rights	6	5	–	5	3	3
Options: Listed-written	26	–	–	–	–	–
Currency Derivatives						
Forwards	50,860	1,548	(139)	1,409	70,363	(583)
Options: OTC-purchased	3,267	20	–	20	2,112	24
OTC-written	853	–	(4)	(4)	532	(7)
Interest Rate Derivatives						
Bond Forwards	1,027	–	(11)	(11)	1,191	–
Futures	2,605	–	–	–	–	–
Interest Rate Swaps	19,498	121	(192)	(71)	13,422	(14)
Total Return Swaps	14,041	93	(68)	25	12,029	188
Swaptions	–	–	–	–	8,551	–
Options: Listed-purchased	2,120	–	–	–	–	–
Listed-written	5,817	–	(2)	(2)	8,510	–
OTC-written	–	–	–	–	5,118	–
Credit Derivatives [1]:						
Purchased	142	6	–	6	218	177
Sold	3,714	16	(1,653)	(1,637)	5,569	(4,350)
Total	$ 122,143	$ 2,387	$ (2,075)	$ 312	$ 140,052	$ (4,180)

[1] Credit derivatives include collateralized debt obligations and a credit default swap. PSP Investments, through sold credit derivatives, indirectly guarantees the underlying reference obligations. The maximum potential exposure is the notional amount of the sold credit derivatives as shown in the table above.

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives, as at March 31, is as follows:

($ thousands)	2010	2009
Less than 3 months	**$ 45,948**	$ 83,233
3 to 12 months	**56,272**	40,518
Over 1 year	**19,923**	16,301
Total	**$ 122,143**	$ 140,052

(C) FAIR VALUE MEASUREMENT

Financial instruments are classified according to the following hierarchy based on the significant inputs used in measuring their fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities.

Level 2: Valuation is based on quoted market prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active. Level 2 also includes model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is based on model-based techniques for which significant assumptions are not observable in the market. They reflect management's assessment of the assumptions that market participants would use in pricing the financial instruments.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of financial instruments, as at March 31, 2010 based on the methods described above:

($ thousands)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 88,027	$ 7,029	$ –	$ –	$ 95,056
Private Equity	–	–	26,224	–	26,224
Nominal Fixed Income	674	56,952	6,418	–	64,044
Real Return Assets					
World Inflation-Linked Bonds	–	1,683	–	–	1,683
Real Estate	–	–	30,669	–	30,669
Infrastructure	–	–	11,791	–	11,791
Absolute Return	–	6,187	5,869	–	12,056
INVESTMENTS	$ 88,701	$ 71,851	$ 80,971	$ –	$ 241,523
Investment-Related Assets					
Amounts receivable from pending trades [1]	$ –	$ –	$ –	$ 744	$ 744
Derivative-related receivables	–	2,361	26	–	2,387
Total Investment-Related Assets	$ –	$ 2,361	$ 26	$ 744	$ 3,131
Investment-Related Liabilities					
Amounts payable from pending trades [1]	$ –	$ –	$ –	$ (2,288)	$ (2,288)
Securities sold short	(564)	–	–	–	(564)
Derivative-related payables	(2)	(444)	(1,629)	–	(2,075)
Capital debt financing:					
Short-term	–	(3,243)	–	–	(3,243)
Long-term	–	(5,359)	–	–	(5,359)
Total Investment-Related Liabilities	$ (566)	$ (9,046)	$ (1,629)	$ (2,288)	$ (13,529)
NET INVESTMENTS	$ 88,135	$ 65,166	$ 79,368	$ (1,544)	$ 231,125

[1] No fair value hierarchy classification is required for these items.

The classification of financial instruments in the levels of the hierarchy is established at the time of the initial valuation of the instrument and reviewed on each subsequent reporting period-end.

There have been no significant transfers between Level 1 and Level 2 during the current fiscal year.

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

The following table shows a reconciliation of all movements in the fair value of financial instruments categorized within Level 3 for the year ended March 31:

	2010					
($ thousands)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Opening Balance	$ 14,525	$ 3,847	$ 33,497	$ 2,329	$ (4,135)	$ 50,063
Purchases	23,369	–	21,913	5,479	8	50,769
Sales/Settlements	(15,025)	(1,411)	(25,061)	(102)	(3)	(41,602)
Total gains (losses) [1]	3,355	3,982	12,111	(1,837)	2,527	20,138
Transfers into or out of Level 3	–	–	–	–	–	–
Closing Balance	$ 26,224	$ 6,418	$ 42,460	$ 5,869	$ (1,603)	$ 79,368

Total gains (losses), for the year ended March 31, included in investment income (loss) are presented as follows:

	2010					
($ thousands)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Total realized gains (losses)	$ 577	$ 2	$ 219	$ (1)	$ 1	$ 798
Total unrealized gains (losses)	$ 2,778	$ 3,980	$ 11,892	$ (1,836)	$ 2,526	$ 19,340
Total gains (losses) [1]	$ 3,355	$ 3,982	$ 12,111	$ (1,837)	$ 2,527	$ 20,138

[1] Included in Note 6 (a).

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (a) and (b). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 3% increase/decrease in the fair value of financial instruments categorized as Level 3. This excludes private market fund investments as well as Real Estate Debt, where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of Private Market fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (a). With respect to Real Estate Debt, the fair value is obtained from third-party appraisers as described in Note 3 (a).

3. INVESTMENTS (continued)

(D) INVESTMENT ASSET MIX

The SIP&P sets out the long-term target weights of the assets that shall be invested for the four Plan Accounts. Investments are classified by asset mix category as set out in the SIP&P based on the economic intent of the investment strategies of the underlying assets.

The net investments, as at March 31, are as follows:

	2010			2009		
($ thousands)		Fair Value	Policy Portfolio Long-Term Target		Fair Value	Policy Portfolio Long-Term Target
World Equity						
Canadian Equity	$ 67,657	29.2%	30.0%	$ 30,079	26.1%	30.0%
Foreign Equity:						
US Large Cap Equity	10,544	4.6	5.0	3,161	2.7	5.0
EAFE Large Cap Equity	10,205	4.4	5.0	3,559	3.1	5.0
Small Cap Developed World Equity	9,873	4.3	5.0	2,666	2.3	5.0
Emerging Markets Equity	14,920	6.5	7.0	7,241	6.3	7.0
Private Equity	27,096	11.7	10.0	14,300	12.4	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	9,451	4.1	2.0	250	0.2	2.0
World Government Bonds	10,626	4.6	5.0	7,181	6.2	5.0
Canadian Fixed Income	24,124	10.4	8.0	14,511	12.6	8.0
Real Return Assets						
World Inflation-Linked Bonds	10,714	4.6	5.0	8,153	7.1	5.0
Real Estate	25,562	11.1	10.0	15,878	13.8	10.0
Infrastructure	10,353	4.5	8.0	8,346	7.2	8.0
NET INVESTMENTS	$ 231,125	100.0%	100.0%	$ 115,325	100.0%	100.0%

[1] Includes amounts related to absolute return and real estate debt strategies.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(E) SECURITIES LENDING & BORROWING PROGRAMS

PSP Investments participates in securities lending and borrowing programs whereby it lends and borrows securities in order to enhance portfolio returns.

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. In the absence of an event of default, the same securities or equivalent securities must be returned to the counterparty at the end of the contract. PSP Investments does not repledge any collateral held.

The following table illustrates the fair values of the Plan's allocated securities and collateral associated with the lending and borrowing programs as at March 31:

($ thousands)	**2010**	2009
Securities Lending		
Securities lent	**$ 20,003**	$ 9,217
Collateral contractually receivable [1]	**20,873**	9,647
Securities Borrowing		
Securities borrowed	**564**	1,211
Collateral contractually payable [2]	**595**	1,240

[1] The minimum fair value of collateral required is equal to 102% of the fair value of the securities lent.

[2] The minimum fair value of collateral required is equal to 100% of the fair value of the securities borrowed.

4. INVESTMENT RISK MANAGEMENT

Risk Management is a central part of PSP Investments' strategic management. It is a continuous process whereby PSP Investments methodically addresses the risks related to its various investment activities with the goal of achieving a maximum rate of return without undue risk of loss and a sustained benefit within each activity and across the total portfolio.

A risk governance structure that includes required reporting on risk to all levels in the organization also ensures that appropriate objectives are pursued and achieved in line with the fulfillment of PSP Investments' legislated mandate. The Board of Directors and its committees oversee various issues related to risk and receive assurance from senior management and an independent internal auditor reporting directly to the Audit and Conflicts Committee.

The use of financial instruments exposes PSP Investments to credit and liquidity risks as well as market risks including foreign exchange and interest rate risks. These risks are managed in accordance with the Investment Risk Management Handbook, which is an integral part of PSP Investments' risk control system. The Investment Risk Management Handbook contains an Investment Risk Management Policy which supplements the SIP&P (Policy Portfolio). The Policy Portfolio determines a diversification strategy to mitigate risk whereby PSP Investments invests in a diversified portfolio of investments based on established criteria. Additionally, the objective of these policies is to provide a framework for the management of credit, liquidity and market risks. Derivative financial instruments, traded either on exchanges or OTC, are one of the vehicles used to mitigate the impact of market risk.

(A) MARKET RISK

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, volatility in share and commodity prices, interest rate, foreign exchange or other factors affecting similar securities traded in the market.

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Market risk is measured using the method known as Value-at-Risk (VaR). VaR is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. PSP Investments has chosen a yearly 95% confidence level to measure and report VaR. PSP Investments uses a Historical VaR model incorporating three years of monthly market returns which are scaled to a twelve-month holding period. Risk Management is responsible for implementing and maintaining a VaR measurement methodology for all asset classes and all financial risk factors.

Historical VaR is statistically valid under normal market conditions and does not specifically consider losses from severe market events. The Historical VaR model also assumes that the future will behave in a similar pattern to the past. If future market conditions differ significantly from those of the past, potential losses may differ from those originally estimated. The VaR is an estimate of a single value in a distribution of potential losses that can be experienced. As a result, it is not an estimate of the maximum potential loss.

The goal of actively managing the portfolio is to outperform the policy portfolio benchmarks while maintaining the active risk under 400 basis points (bps). Relative VaR, as a result, is the maximum amount of loss of total investments, with 95% confidence level, relative to the policy portfolio benchmark over a twelve-month period.

The following table shows the total Relative VaR allocated to the Plan and the diversification effect as at March 31 based on the economic intent of the investment strategies of the underlying assets. The diversification effect captures the effect of holding different types of assets which may react differently in various types of situations and thus having the effect of reducing overall Relative VaR.

Active Risk Taken

(Relative VaR – $ thousands)	2010	2009
World Equity	$ 3,436	$ 2,689
Real Return Assets	4,335	3,634
Absolute Return	2,053	3,958
Total Relative VaR (Undiversified)	9,824	10,281
Diversification Effect	(4,914)	(5,664)
Total Relative VaR	**$ 4,910**	$ 4,617

Risk Management monitors the absolute risk of the Policy Portfolio on a quarterly basis to ensure no undue loss may be experienced by PSP Investments.

Generally, changes in VaR between reporting periods are due to changes in the level of exposure, volatilities and/or correlations among asset classes. Although VaR is a widely accepted risk measure, it must be complemented by other risk measures. PSP Investments therefore uses stress testing and scenario analysis to examine the impact on financial results of abnormally large movements in risk factors. Stress testing and scenario analysis are used to test a portfolio's sensitivity to various risk factors and key model assumptions. These methods also use historically stressed periods to evaluate how a current portfolio would fare under such circumstances. Stress testing is also deployed to assess new product behaviour. Stress testing and scenario analysis are utilized as a complement to the Historical VaR measure in order to provide greater insight on the size of potential losses that may be experienced. PSP Investments uses the expected shortfall and tail analysis measures to determine this. Expected shortfall is defined as the conditional expectation beyond the VaR level. It is measured by averaging all data points showing a loss greater than VaR measured at a given confidence level. By increasing the confidence level of the VaR measure from 95% to 99%, PSP Investments is able to assess the size of the potential loss that would be exceeded one year out of 100 (instead of one year out of 20). Therefore, there is a greater probability for larger losses, at the 99% confidence level, in extreme market conditions. Risk Management presents a stress testing and scenario analysis report to senior management on a quarterly basis.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(i) Interest Rate Risk

Interest rate risk refers to the risk that fluctuations in interest rates will directly affect the fair value of the Plan's net asset values. The most significant exposure to interest rate risk is related to the investment in bonds, ABTNs and Real Estate Debt.

The terms to maturity of the investments, before allocating the effect of derivative contracts and investment-related assets and liabilities, as at March 31, are as follows:

	Terms to Maturity					
($ thousands)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	2010 Total	2009 Total
Government of Canada bonds	$ 925	$ 8,142	$ 1,711	$ 1,872	$ 12,650	$ 10,423
Provincial and Territorial bonds	907	2,881	1,540	2,651	7,979	5,052
Municipal bonds	20	112	251	38	421	286
Corporate bonds	1,283	3,034	2,250	1,908	8,475	5,474
ABTNs	–	224	–	5,695	5,919	3,145
Total Canadian Fixed Income	$ 3,135	$ 14,393	$ 5,752	$ 12,164	$ 35,444	$ 24,380
Total World Government Bonds	$ 42	$ 2,369	$ 1,641	$ 1,423	$ 5,475	$ 2,588
Total World Inflation-Linked Bonds	$ –	$ 407	$ 388	$ 888	$ 1,683	$ 669
Real Estate Debt [1]	$ 1,373	$ 875	$ –	$ 163	$ 2,411	$ 2,566
Grand Total	$ 4,550	$ 18,044	$ 7,781	$ 14,638	$ 45,013	$ 30,203

[1] Real Estate Debt is a components of the Real Estate asset class disclosed in Note 3 (a).

The terms to maturity of PSP Investments' capital debt financing are disclosed in Note 8.

Absolute return strategies, as described in Note 3, and derivative contracts are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 4 (a).

Additionally, the exposure to interest rate risk for short-term instruments and amounts receivable from pending trades would not be significant due to their short-term nature.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts, positions in foreign currencies. PSP Investments' policy is to hedge 50% of its foreign currency investments excluding Emerging Markets Equity.

The underlying net foreign currency exposures for the Plan, after allocating the effect of derivative contracts and investment-related assets and liabilities for both monetary and non-monetary items, as at March 31, are as follows:

	2010		2009	
Currency (in thousands of Canadian $)	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 31,343**	**51.2%**	$ 15,778	52.9%
Euro	**9,066**	**14.8**	7,051	23.6
British Pound	**3,883**	**6.4**	1,769	5.9
Brazilian Real	**3,342**	**5.5**	222	0.7
Hong Kong Dollar	**2,527**	**4.1**	1,023	3.4
Japanese Yen	**2,143**	**3.5**	1,326	4.5
Korean Won	**1,753**	**2.9**	568	1.9
New Taiwan Dollar	**997**	**1.6**	595	2.0
South African Rand	**786**	**1.3**	317	1.1
Australian Dollar	**756**	**1.2**	562	1.9
Indian Rupee	**749**	**1.2**	289	1.0
Turkish Lira	**545**	**0.9**	206	0.7
Others	**3,285**	**5.4**	137	0.4
Total	**$ 61,175**	**100.0%**	$ 29,843	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies of $24,875 thousand ($20,380 thousand US, €2,896 thousand, £6 thousand and 1,559 thousand South African Rands (ZAR)) for the Plan which are not included in the foreign currency exposure table.

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

PSP Investments is exposed to credit risk, that is, the risk that the issuer of a debt security or a counterparty to a derivative contract is unable to meet its financial obligations.

Credit risk encompasses the risk of a deterioration of creditworthiness and the respective concentration risk. Credit risk monitoring entails an evaluation of the credit quality of each issuer to which PSP Investments is exposed. To perform this evaluation, PSP Investments relies on four recognized credit rating agencies. A minimum of two credit ratings are used to classify each security; securities rated by only one agency are classified as "not rated". If the agencies disagree as to a security's credit quality, PSP Investments uses the lowest of the available ratings.

To monitor the evolution of credit risk, PSP Investments periodically produces a concentration report by credit rating of all credit-sensitive financial securities with the exception of securities held in pooled funds or for Private Market Investments.

PSP Investments' concentration of credit risk by credit rating for the Plan, as at March 31, is as follows:

	2010	2009
Investment grade (AAA to BBB–)	**89.9%**	88.7%
Below investment grade (BB+ and below)	**–**	–
Not rated:		
Rated by a single credit rating agency	**8.5**	8.5
Not rated by credit rating agencies	**1.6**	2.8
Total	**100.0%**	100.0%

The breakdown of credit concentration risk for the Plan does not include investments in distressed debt included in pooled funds in the amount of $9,989 thousand as at March 31, 2010 (2009 — $6,825 thousand). Such investments typically include debt securities of issuers close to default, and the investment in such securities are quasi-equity in nature.

As at March 31, 2010, the Plan also has a net notional exposure of $3,067 thousand to collateralized debt obligations, of which approximately 64% of the dollar exposure is rated "Investment grade", as well as funding facilities of a maximum amount of $4,840 thousand to support potential margin calls on the ABTNs (Note 3 (a) (iii)).

As at March 31, 2010, the Plan's maximum exposure to credit risk, excluding collateral held and the investments in distressed debt and collateralized debt obligations described above, amounts to $64,927 thousand (2009 — $37,536 thousand).

(i) Counterparty Risk

Counterparty risk represents the credit risk from current and potential exposure related to transactions involving derivative contracts. In order to minimize derivative contract counterparty risk, PSP Investments deals only with counterparties with a minimum credit rating of "A–" as at the trade date, as provided by a recognized credit rating agency. PSP Investments monitors the credit ratings of counterparties on a daily basis and has the ability to terminate all trades with counterparties who have their credit rating downgraded below "A–" subsequent to the trade date. PSP Investments also uses credit mitigation techniques such as master-netting arrangements and collateral transfers through the use of Credit Support Annexes (CSA).

PSP Investments' policy also requires the use of the International Swaps and Derivative Association (ISDA) Master Agreement with all counterparties to derivative contracts. The ISDA Master Agreement provides the contractual framework within which dealing activities across a full range of OTC products are conducted and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or other pre-determined events occur.

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

Additionally, the CSA to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the event of the failure of the counterparty and requires PSP Investments to contribute further collateral when requested. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold.

On behalf of the Plan, PSP Investments deposited or pledged securities with a fair value of $1,043 thousand as collateral with various financial institutions as at March 31, 2010 (2009 – $3,535 thousand) while securities with a fair value of $892 thousand (2009 – $361 thousand) were received from other counterparties as collateral. PSP Investments does not repledge any collateral held. All collateral deposited, pledged and received were held with counterparties who had a minimum credit rating of "A–" as at March 31, 2010.

Risk Management is responsible for counterparty risk monitoring and mitigation as well as maintaining a comprehensive, disciplined, and enterprise-wide process for tracking and managing counterparty risk. As such, Risk Management measures counterparty risk on an ongoing basis, evaluates and tracks the creditworthiness of current counterparties and mitigates counterparty risk through collateral management.

(C) LIQUIDITY RISK

Liquidity risk corresponds to PSP Investments' ability to meet its financial obligations when they come due with sufficient and readily available cash resources. PSP Investments' cash position is monitored on a daily basis. In general, investments in cash, cash equivalents, floating rate notes, debt and public equities are expected to be highly liquid as they will be invested in securities that are actively traded. Risk Management utilizes appropriate measures and controls to monitor liquidity risk in order to ensure that there is sufficient liquidity to meet financial obligations as they come due. A liquidity report taking into consideration future forecasted cash flows is prepared and presented to senior management on a weekly basis. This ensures that sufficient cash reserves are available to meet forecasted cash outflows. Additionally, sufficient sources of liquidity are maintained for deployment in case of market disruption.

PSP Investments has the ability to raise additional capital through the use of its capital debt program. This program allows PSP Investments to issue short-term promissory notes and medium-term notes. Note 8 provides additional information on the usage of the capital debt program.

The terms to maturity of the notional amount of derivatives, including related payable amounts, are disclosed in Note 3 (b).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial assets and liabilities, aggregated according to their maturities as at March 31, 2010.

Liabilities are presented in the earliest period in which the counterparty can request payment.

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities				
Amounts payable from pending trades	$ (2,288)	$ –	$ –	$ (2,288)
Securities sold short	(564)	–	–	(564)
Capital debt financing	(3,118)	(125)	(5,359)	(8,602)
Accounts payable and other liabilities	(47)	–	(14)	(61)
Total	$ (6,017)	$ (125)	$ (5,373)	$ (11,515)

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial assets and liabilities				
Derivative-related assets	$ 878	$ 1,398	$ 111	$ 2,387
Derivative-related liabilities	(163)	(97)	(1,815)	(2,075)
Total	$ 715	$ 1,301	$ (1,704)	$ 312

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

5. FUND TRANSFERS

PSP Investments received fund transfers of $84,236 thousand for the year ended March 31, 2010 (2009 – $85,513 thousand) from the Reserve Force Pension Fund. The transfers received are comprised of the net employer and employee contributions to the Reserve Force pension plan in respect of member service after March 1, 2007.

6. INVESTMENT INCOME (LOSS)

(A) INVESTMENT INCOME (LOSS)

Investment income (loss), for the year ended March 31, is as follows:

($ thousands)	2010	2009
Interest income	$ 1,781	$ 1,132
Dividend income	1,789	1,136
Other income	890	617
Security lending income (net) [1]	41	17
Dividend expense	(112)	(89)
Interest expense (Note 8)	(237)	(184)
Transaction costs	(89)	(77)
External investment management fees [2]	(141)	(125)
	3,922	2,427
Net realized gains (losses) [3]	6,395	(17,810)
Net unrealized gains (losses)	21,537	(9,789)
Investment Income (Loss)	$ 31,854	$ (25,172)

[1] Includes fees on securities borrowed.

[2] These are amounts incurred for public market investments that are paid directly by PSP Investments (Note 1). This excludes amounts incurred for Private Market Investments, disclosed in Note 3 (a) (ii), and certain public market pooled fund investments in the amount of $56 thousand for the year ended March 31, 2010 (2009 – $22 thousand) that are not paid directly by PSP Investments.

[3] Includes foreign currency gains (losses) of $2,468 thousand for the year ended March 31, 2010 (2009 – $(1,555) thousand).

(B) INVESTMENT INCOME (LOSS) BY ASSET MIX

Investment income (loss) by asset mix based on the economic intent of the investment strategies of the underlying assets as outlined in the SIP&P, for the year ended March 31, after allocating net realized and unrealized gains (losses) on investments to the asset classes to which they relate, is as follows:

($ thousands)	2010	2009
World Equity		
Canadian Equity	$ 15,035	$ (9,071)
Foreign Equity:		
US Large Cap Equity	1,088	(1,091)
EAFE Large Cap Equity	964	(1,414)
Small Cap Developed World Equity	1,246	(1,246)
Emerging Markets Equity	4,002	(2,146)
Private Equity	5,865	(5,178)
Nominal Fixed Income		
Cash & Cash Equivalents	170	68
World Government Bonds	(1,471)	1,396
Canadian Fixed Income	813	643
Real Return Assets		
World Inflation-Linked Bonds	(1,104)	628
Real Estate	213	(2,739)
Infrastructure	743	424
Absolute Return [1]	4,290	(5,446)
Investment Income (Loss)	$ 31,854	$ (25,172)

[1] Includes amounts related to real estate debt strategies.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

7. EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the plans for which it provides investment services. Under section 4(3) of the Act, the President of the Treasury Board shall determine to which plan account these costs will be charged, in consultation with the Minister of National Defence and the Minister of Public Safety. An allocation policy has been developed which allocates the direct costs of investment activities, such as external investment management fees and custodial fees, to each plan account, based upon the asset value of each plan account at the time the expense was incurred.

All other operating expenses, excluding the direct cost of investment activities listed above, for the year ended March 31, have been allocated in proportion to the annual amount of net assets in each Plan Account as follows:

	2010	2009
Public Service Pension Plan Account	**72.5%**	72.6%
Canadian Forces Pension Plan Account	**20.0**	20.1
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.3**	0.1
Total	**100.0%**	100.0%

Expenses are paid by PSP Investments by way of advances from the Public Service Pension Plan Account, which are reimbursed by the other plan accounts on a quarterly basis.

(B) OPERATING EXPENSES

Operating expenses allocated to this Plan account, for the year ended March 31, consist of the following:

($ thousands)	**2010**	2009
Salaries and benefits	**$ 182**	$ 68
Professional and consulting fees	**32**	14
Office supplies and equipment	**38**	12
Other operating expenses	**14**	12
Depreciation of fixed assets	**24**	7
Occupancy costs	**15**	5
Custodial fees	**5**	2
Remuneration earned by Directors	**3**	1
Travel and related expenses for Directors	**1**	1
Communication expenses	**1**	–
Total	**$ 315**	$ 122

8. CAPITAL DEBT FINANCING

As of March 31, 2010, PSP Capital Inc. has $649 million (2009 – $1,579 million) of short-term promissory notes outstanding with maturity dates between 14 and 120 days of issuance, of which $3,243 thousand (2009 – $5,386 thousand) has been allocated to the Reserve Force Pension Plan Account and included in Note 3 (a) as a short-term investment-related liability. As at March 31, 2010, PSP Capital Inc. has $1 billion (2009 – $1 billion) of medium-term notes issued and outstanding, of which $3,412 thousand (2009 – $3,412 thousand) has been allocated to the Reserve Force Pension Plan Account. These medium-term notes bear interest of 4.57% per annum and have a maturity date of December 9, 2013. These medium-term notes are included in Note 3 (a) as a long-term investment-related liability. As at March 31, 2010, the fair value of these medium-term notes is $1,073 million (2009 – $1,054 million), of which $5,359 thousand (2009 – $3,597 thousand) has been allocated to the Reserve Force Pension Plan Account. The maximum authorized by the Board of Directors for both the short-term promissory notes and medium-term notes is $2 billion. The capital raised, primarily used to finance investments in the Real Estate and Infrastructure asset classes, is unconditionally and irrevocably guaranteed by PSP Investments and is in accordance with the approved PSP Investments' corporate policy for leverage.

The operating expenses incurred by PSP Capital Inc. were allocated to each Plan account as described in Note 7 (a).

Interest expense, for the year ended March 31, is as follows:

($ thousands)	**2010**	2009
Short-term promissory notes	**$ 31**	$ 150
Medium-term notes	**206**	34
Total	**$ 237**	$ 184

9. CAPITAL MANAGEMENT

As an investment company, PSP Investments objectives in managing its capital are:

- To invest fund transfers, outlined in Note 5, in the best interests of the beneficiaries and contributors under the *Superannuation Acts*. The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plans established under the *Superannuation Acts*. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.
- To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc., and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 8 provides information on the capital debt financing and Note 4 (c) provides information on PSP Investments' liquidity. Additionally, as at March 31, 2010, PSP Investments has an operating line of credit of $10 million (2009 – $10 million). As at March 31, 2010, no amounts have been withdrawn (2009 – nil).

The capital structure of PSP Investments consists of fund transfers and capital debt financing. PSP Investments has no externally imposed restrictions on capital.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

10. GUARANTEES AND INDEMNITY

PSP Investments provides indemnification to its Directors, its Officers and to certain PSP Investments representatives who are asked to serve on boards of directors (or like bodies) or investment advisory boards (or like bodies) of entities in which PSP Investments or its wholly-owned subsidiaries have made an investment or have a financial interest. As a result, but subject to the Act, PSP Investments may be required to indemnify these representatives for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties, unless the liability of such a representative relates to a failure to act honestly and in good faith. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

As part of investment transactions, PSP Investments and its subsidiaries guaranteed letter of credit facilities. The beneficiaries of these letter of credit facilities have the ability to draw against these facilities to the extent that the contractual obligations, as defined in the related agreements, are not met. As at March 31, 2010, the maximum exposure of the Plan was $49 thousand (2009 – $50 thousand).

As at March 31, 2010, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan would assume the obligation up to $1,375 thousand (2009 – $1,375 thousand) plus interest and other related costs.

PSP Investments also unconditionally and irrevocably guarantees all credit facilities, short-term promissory notes and medium-term notes issued by PSP Capital Inc.

11. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, the portion of PSP Investments' commitments that would be assumed by the Plan is as follows:

($ thousands)	**2010**	2009
Private Equity	**$ 15,755**	$ 15,796
Real Estate	**6,960**	6,125
Infrastructure	**2,136**	1,966
Public markets	**1,637**	1,972
Total	**$ 26,488**	$ 25,859

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