PUBLIC SECTOR PENSION INVESTMENT BOARD
2011 ANNUAL REPORT

11

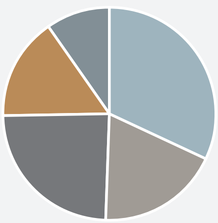
PSP INVESTMENTS

WHO WE ARE AND WHAT WE DO
CORPORATE PROFILE

The Public Sector Pension Investment Board ("PSP Investments" or the "Corporation") is a Canadian Crown corporation established to invest the amounts transferred by the Government of Canada 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 (collectively the "Plans"). The amounts so transferred to the Corporation are to fund the liabilities under the Plans for service after the foregoing dates (the "Post-2000 Liabilities").

Its statutory objects are to manage the funds transferred to it in the best interests of the contributors and beneficiaries under 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.

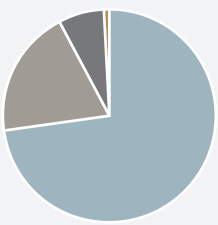
FINANCIAL HIGHLIGHTS



ASSET MIX

As at March 31, 2011 (percent)

CANADIAN EQUITY	REAL-RETURN ASSETS	FOREIGN EQUITY	NOMINAL FIXED INCOME	PRIVATE EQUITY
32.2%	18.4%	24.3%	15.5%	9.6%



NET ASSETS PER PENSION PLAN ACCOUNT

As at March 31, 2011 ($ millions)

PUBLIC SERVICE	CANADIAN FORCES	RCMP	RESERVE FORCE
42,299	11,289	4,102	323
72.9%	19.4%	7.1%	0.6%

NET ASSETS: $58.0 BILLION

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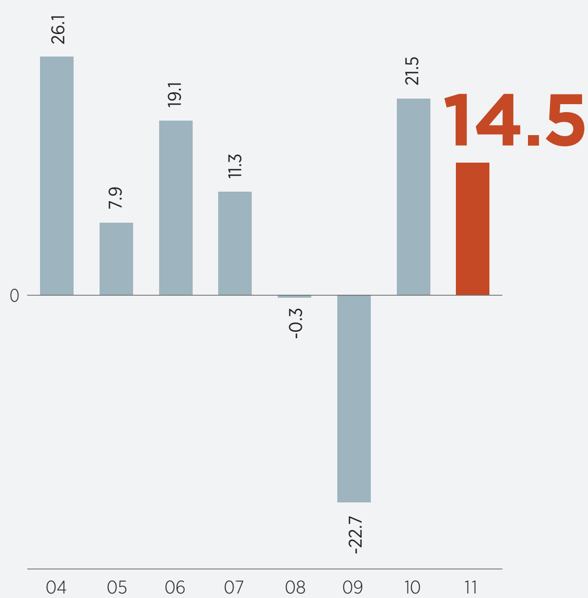
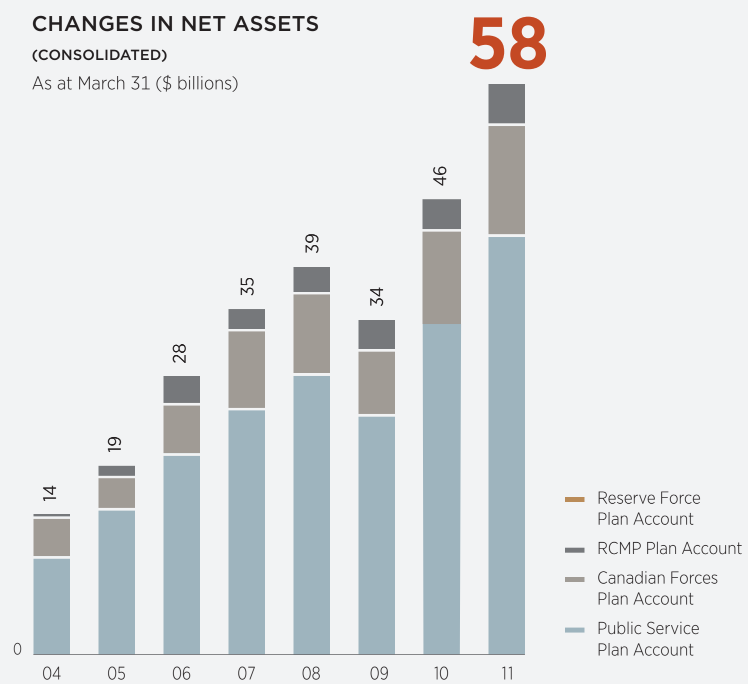
HIGHLIGHTS
FISCAL YEAR 2011

- Consolidated net assets increased 25% to $58.0 billion.
- Investment income of $6.9 billion after expenses and a total portfolio return of 14.5%.
- Public Market equity portfolios achieved returns of 6.6% to 19.7%.
- In Private Markets, Private Equity and Real Estate portfolios recorded robust returns of 20.9% and 13.8%, respectively.
- Proportion of actively managed assets managed internally increased to 58% from 39%. Assets managed internally represent 74% of total assets.
- Positive outcome to Special Examination of PSP Investments' systems and practices.

ANNUAL PERFORMANCE
As at March 31 (percent)



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



CORPORATE OBJECTIVES
FISCAL YEAR 2011

CORPORATE OBJECTIVES FOR FISCAL 2011 WERE BUILT ON THE FOUNDATION OF THE PREVIOUS YEAR'S ACHIEVED OBJECTIVES. THEY WERE DIRECTED AT THE 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.

STATUS: COMPLETED 2011 PHASE

- Increased proportion of assets managed internally from 67% to 74%. Of all actively managed assets, 58% are managed internally, up from 39% a year ago.
- Built internal Active Fixed Income & Indexing as well as Value Opportunity Investment teams.
- Continued to build partner relationships to ensure access to the most attractive direct and co-investment opportunities.

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.

STATUS: COMPLETED 2011 PHASE

- Appointed Chief Risk Officer to oversee financial and non-financial risks.
- Completed comprehensive Risk and Control Self-Assessment exercise across the organization, identifying top risks, their key impacts and mitigating factors and controls.
- Refined quantitative and qualitative investment risk measurement and reporting.

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.

STATUS: COMPLETED 2011 PHASE

- Continued roll-out of leadership development program.
- Strengthened capabilities with recruitment of 15 investment professionals and recruitment of senior leaders in Risk and Legal Affairs.
- Implemented comprehensive electronic talent-management solution for performance management and recruitment.

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.

STATUS: COMPLETED

- Completed annual review of Policy Portfolio within asset-liability framework, taking into account PSP Investments' most recent view of long-term expected market conditions.
- Modified Policy Portfolio (effective April 1, 2011), allowing refined alignment with Plans' Post-2000 Liabilities, taking into account the funding requirements and financial obligations of the Plans.

KEY CORPORATE OBJECTIVES FISCAL YEAR 2012

INTERNAL AND ACTIVE MANAGEMENT

Increase investment activities and level of assets managed internally and actively with the aim of improving overall investment cost structure (expressed as a percentage of assets under management) and increase the probability of meeting or exceeding the desired long-term actuarial rate of return.

TALENT MANAGEMENT

Advance corporate-wide engagement initiatives that strengthen corporate culture. Implement the recruitment and development initiatives required to support the increased internal and active management initiatives in order to maximize our return without undue risk. Produce the programs that develop management capabilities to support the Succession Plan. Ensure that all employees have corporately aligned development plans in place. Implement the human resources systems that provide comprehensive accurate key performance indicators. Provide for Board of Directors transition.

ENTERPRISE RISK MANAGEMENT

Implement the enterprise risk management and reporting measures required for increased internal and active management in order to maximize our return without undue risk. Implement the recommendations from the Special Examination and the Risk Control Self Assessment completed in fiscal year 2011.

STRATEGIC PLAN

Close the 2012 three-year Strategic Plan. Develop and approve the Vision 2015 three-year Strategic Plan recognizing the increasingly complex and challenging investment environment.

PAUL CANTOR
Chair

CHAIR'S REPORT

PSP INVESTMENTS RECORDED STRONG INVESTMENT PERFORMANCE AND CONSOLIDATED NET ASSETS REACHED ANOTHER NEW HIGH IN FISCAL YEAR 2011. THESE ROBUST RESULTS AROSE FROM FAVOURABLE MARKETS, COUPLED WITH OUR DIVERSIFICATION STRATEGY AND OUR ACTIVE MANAGEMENT PRACTICES APPLIED TO OUR LONG-TERM INVESTMENT HORIZON.

DIVERSIFICATION CRUCIAL TO INVESTMENT RISK MANAGEMENT

While understandably pleased with this year's strong performance, we must always be mindful of the cyclicality of markets. We will always be exposed to market volatility even as we maintain a sharp focus on risk management.

Our diversification strategy is derived from our long-term target asset mix. This is what we call the Policy Portfolio. It is designed with the goal of achieving the long-term returns that are used by the Chief Actuary of Canada to calculate the sustainability of the Plans as it relates to the Post-2000 Liabilities.

During fiscal year 2011, we undertook a comprehensive review of the Policy Portfolio to ensure that it remains effective in delivering the targeted return. Factored into the review were our most recent expectations of long-term market conditions. Other factors taken into account included the inflation-sensitive nature of the Plans' Post-2000 Liabilities and the net positive inflows expected for at least the next 15 years.

As a result, effective April 1, 2011, we made significant changes that increased the allocation to Real Return Assets such as Real Estate and Infrastructure. Real Return Assets are a good match for the inflation-sensitive nature of the Plans' Post-2000 Liabilities and will thus contribute to reducing funding risk. This change contributed to an overall shift in our asset mix from publicly traded securities to Private Markets, which will move over time from 28% to 40% of our overall portfolio.

SPECIAL EXAMINATION

I am pleased to note the positive outcome of a Special Examination carried out during fiscal year 2011 jointly by the Office of the Auditor General of Canada and Deloitte & Touche LLP (the "Examiners") in accordance with applicable legislation, which requires such an examination at least once every 10 years.

The Examiners concluded that PSP Investments maintains systems and practices that provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. This is the best possible conclusion to such an examination.

Given that PSP Investments has existed for little more than a decade, has experienced tremendous growth, and is engaged in a business where the requisite systems and controls tend to be both complex and constantly evolving, this finding is a testament to the strength and rigour of our organization.

The Examiners also identified a few areas in which our practices could be strengthened.

One of these recommendations calls for improvements in the Board selection process, including the staggering of appointments to the Board to avoid significant turnover of membership in any given year.

Appointments to the Board do not fall within the Corporation's purview although we seek to assist the independent Nominating Committee, Treasury Board and the Privy Council Office in expediting the process. We share the Special Examiners' view that improvements are required to ensure that vacancies are filled and we will be proposing changes designed to improve the appointment process.

PSP Investments also concurs with the Examiners' other recommendations and will be taking appropriate steps to implement them. I invite readers to review the full report from the Examiners, as well the Corporation's response, can be found beginning on page 101.

The Examiners concluded that PSP Investments maintains systems and practices that provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

ACKNOWLEDGEMENTS

On behalf of the Board, I would like to commend Gordon Fyfe and the entire management team for their performance in fiscal year 2011. In the course of my duties over the past year, I had the opportunity to observe first-hand the enthusiasm and commitment of our employees as they build partner relationships, identify and negotiate deals, improve the quality of our investments, provide stewardship over our more than $50 billion in assets, and ensure that human resources development, risk management and financial controls are among the best in the world. Therefore, I wish to thank all of our employees, who are the key to our success.

I am grateful, as well, to my fellow Board members for their support and commitment. Particular thanks are due to Jamie Baillie and Jean Lefebvre, who left the Board this past year after providing stalwart service to the organization. I would also like to take this opportunity to formally welcome Diane Bean, who joined our Board in June 2010.

Finally, I wish to acknowledge the new Chair of the independent Nominating Committee, William Saunderson, a former Ontario cabinet minister and former PSP Investments Board member. Mr. Saunderson's first-hand understanding of the role and responsibilities of our organization will unquestionably be an asset when it comes to reviewing, revising, and overseeing the appointment process.

Paul Cantor
Chair

GORDON J. FYFE
President and Chief Executive Officer

PRESIDENT'S REPORT

PSP INVESTMENTS TURNED IN ANOTHER STRONG PERFORMANCE IN FISCAL YEAR 2011, GENERATING A TOTAL PORTFOLIO RETURN OF

14.5%

VERSUS 12.7% FOR THE POLICY PORTFOLIO BENCHMARK.

This follows on the heels of the 21.5% total return posted in fiscal year 2010. The fact that we were able to achieve these excellent results — in both absolute and relative terms — in two consecutive years highlights the success of the diversification strategy we began implementing in 2004, with the introduction of private market asset classes such as Real Estate, Private Equity and Infrastructure.

Taking into account investment income of $6.9 billion after expenses as well as $4.8 billion of contributions from the Plans, PSP Investments' consolidated net assets increased by 25% to $58.0 billion as at March 31, 2011. That compares with the previous peak of $46.3 billion at the end of fiscal year 2010.

The latest results reflect solid performances and contributions from every part of the organization. They also illustrate the effectiveness of our active investment management approach. Active management added $879 million to the fund during the latest fiscal year.

More importantly, during the past four years, building a team with deep investment expertise and exceptional operational capabilities has been – and remains – a top priority. The impressive results of the past two years, and our ability to capitalize on the market recovery, clearly illustrate the success of our focus on assembling this high-quality team.

KEY INVESTMENT STRATEGIES

Contributing to PSP Investments' strong performance in fiscal year 2011 was the success of two key investment strategies implemented over the past several years.

One such strategy entails expansion into high-growth emerging markets, primarily developing countries that are experiencing robust expansion of their domestic economies. For instance, PSP Investments was among the first foreign institutional investors to take advantage of real estate opportunities in Brazil and Colombia, where rapidly expanding middle-class populations have been driving demand for new housing, retail and, more recently, office space.

Over the past five years, our Real Estate Group has developed solid partnerships in Brazil and Colombia and assembled an attractive portfolio of shopping centers and office buildings, mainly in the metropolitan areas of Sao Paulo and Rio de Janeiro, Brazil. During fiscal year 2011, we were able to realize significant gains from the divesture of some of the Brazilian retail properties. We intend to continue investing in these markets, where sustained economic growth is certain to create new needs — and new opportunities.

Another strategy that has paid off entails capitalizing on PSP Investments' exceptional liquidity to acquire quality "distressed assets" in developed markets, where sellers are seeking to monetize their investments. Our decision to allocate capital to distressed debt in public markets back in the 2007-2008 period has generated solid added value, and we are continuing to seek and find additional opportunities.

We also expect that several noteworthy private-market transactions completed by our PSP Investments teams during fiscal year 2011 will yield considerable gains down the road. Among them was the acquisition of a significant participation in five container-terminal ports in Australia — which have approximately 50% of that country's container terminal capacity. We also acquired a 40-story Class-A office tower in Manhattan, in collaboration with local partners that have extensive experience in the New York City real estate market.

STRATEGIC PLAN INTERIM REVIEW

In late September 2010, our management team met with the Board of Directors to conduct an interim review of PSP Investments' three-year strategic plan, Vision 2012. The review confirmed that, at mid-point, we were on track to meet all four strategic goals set out in the plan. Those goals include: increasing control over investment decisions with respect to our portfolio through the implementation of internal active management; better alignment of the Policy Portfolio; the development of scalable and efficient operations; and building the best team and leadership in our business.

As of March 31, 2011, assets managed internally represented **74%** of total assets under management, compared with 67% at the end of the previous fiscal year.

INCREASED FOCUS ON INTERNAL ACTIVE MANAGEMENT

As of March 31, 2011, assets managed internally represented 74% percent of total assets under management, compared with 67% at the end of the previous fiscal year and 62% in fiscal year 2009, when we introduced our strategic plan. One example of on-going progress with respect to increasing the proportion of assets under internal active management is the fact that a significant portion of our public fixed-income investments are now actively managed. At the end of fiscal year 2011, 58% of all actively managed assets were managed internally, compared to 39% at the end of fiscal year 2010.

Internal active management brings two major benefits: lower overall costs and a strong alignment of interests between our assets and our sponsors.

Although the shift does impact operating expenses, on balance internal active management is approximately three to seven times less expensive than external active management, depending on the type of asset and implementation style involved.

As we enhance our internal active-management capabilities, we are continuing to reach out and build investment opportunities and partnerships — relationships that are of crucial importance in terms of gaining market intelligence and ensuring access to the most attractive investment opportunities.

Establishing PSP Investments' presence in global investment markets via the partnership route has been very effective and remains our preferred approach. In most instances, PSP Investments' role is that of an investor as opposed to a hands-on manager, which minimizes the need for a local presence. Operating from a single office with clear-cut lines of authority and effective communications — including with the Board — makes for a nimble organization that is able to move quickly to capitalize on opportunities as they arise.

ENHANCED ORGANIZATIONAL EFFECTIVENESS

In lock step with our transition to increased internal active management, we have significantly enhanced PSP Investments' capabilities in key operational departments like Legal Affairs, Internal Audit and Compliance, Risk Management and Information Technology while continuing to assemble and develop a superior team of investment and leadership professionals.

John Valentini, Executive Vice President, Chief Operating Officer and Chief Financial Officer, and Guy Archambault, First Vice President, Human Resources, have been instrumental in ensuring that we have the support teams required to keep up with our asset growth and investment strategies. I am referring here not just to the numbers but, more importantly, to the quality of people we have been able to recruit, thanks in part to a highly structured recruitment process and the internal training and development programs that enable us to effectively identify and retain the top candidates for a given job.

A comprehensive talent-development program has been implemented to ensure that employees at all levels have the skills, knowledge and desire to support the achievement of current and future business plan goals.

INFLOW OF CONTRIBUTIONS: A COMPETITIVE EDGE

Unlike most major pension funds, which face annual net cash outflows to pensioners, PSP Investments faces no pressing near-term obligations. Due to the unique characteristics of the Plans' liabilities that are being funded, which are very young in nature, the prospects are for a steady cash inflow of new funds — and no net outflows — for at least the next 15 years. This exceptional situation represents a major competitive edge, enabling the Corporation to maintain a long-term perspective and capitalize on investment opportunities of varying degrees of magnitude and liquidity.

According to recent calculations by the Chief Actuary's office, we can expect continued net inflows every year that will total approximately $60 billion between now and 2030 — an amount greater than the current overall value of the portfolio. Factoring in cash inflows and investment income, the Chief Actuary's office estimates that PSP Investments' consolidated net assets are likely to reach some $300 billion by 2030.

REALIGNMENT OF POLICY PORTFOLIO

Continuing the diversification strategy we began implementing in 2004, the Board of Directors, with the input and support of management, recently approved changes to the Policy Portfolio, which lies at the heart of PSP Investments' Statement of Investment Policies, Standards and Procedures and dictates our long-term asset mix.

Realignment of the Policy Portfolio reflects current expectations of long-term market conditions. It is designed to further leverage the exceptional liquidity provided by the very substantial cash inflows outlined above and further refine the alignment of our Policy Portfolio with the Plans' Post-2000 Liabilities. Essentially, we are increasing our overall allocation to Private Markets, to 40% from the previous 28% level, while reducing the exposure to public equity markets. The changes include increasing from 23% to 31% the allocations to Real Return assets, which are a suitable match for the inflation-sensitive nature of the Plans' Post-2000 Liabilities. More specifically, allocations to Real Estate and Infrastructure, both part of the Real Return asset class, were increased from 10% to 13% and 8% to 13%, respectively. Additionally, the allocation to Private Equity was increased from 10% to 14%.

The realigned asset allocations will be implemented gradually over a number of years by drawing on new contributions and asset-class transfers, with the pace of transition largely driven by deal flows within Private Markets.

We have also updated PSP Investments' Currency Hedging Policy. The success of our currency-hedging activities has been beneficial in both the management of portfolio risk, and a contributor to overall performance.

The Chief Actuary's office estimates that PSP Investments' consolidated net assets are likely to reach some

$300 billion

by 2030.

RISK-REWARD EQUATION

The changes to the Policy Portfolio are the latest reflection of PSP Investments' strategy to tailor a diversified portfolio that will be more efficient and generate better returns for the same or a lower level of risk.

Over the eight-year span since we began the move to diversification, PSP Investments has exceeded the targeted "actuarial rate of return" — 4.3% after inflation — despite the impact of the global financial crisis. One hundred dollars invested in PSP Investments eight years ago would have been worth $189 at the end of fiscal year 2011, whereas that same $100 earning the actuarial rate of return would have been worth $161.

The fact remains, though, that we cannot avoid risk if we are to achieve the actuarial rate of return over the long-term, which the Chief Actuary has determined is needed to sustain the current level of funding requirements and pension benefits for the Plans. A good illustration of the inherent risk is the financial crisis of 2007-2008 which, notwithstanding the eight-year compound returns cited above, clearly had an impact on PSP Investments — as it did on all major pension funds around the globe. During that shorter term period, the investment return was below the actuarial rate of return. This is likely to deteriorate the financial position of the Plans as it relates to the Post-2000 Liabilities, which, at the time of the last actuarial valuation (March 31, 2008), were fully funded.

It should be noted that investment returns on the cash inflows received by PSP Investments are just one of several factors impacting the funding of the Plans. Among other factors are the timing of such inflows, the actuarial value placed on the assets and the evolution of the Plans' Post-2000 Liabilities due to demographic factors such as longevity. It is likely that results of the next actuarial valuations, due later in 2011 and in 2012, will show actuarial deficits in the Plans for the Post-2000 Liabilities.

ENTERPRISE RISK MANAGEMENT

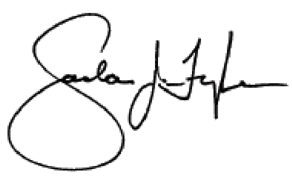
Augmentation of our Enterprise Risk Management framework was a priority during fiscal year 2011, beginning with the appointment of a Chief Risk Officer. Over the course of the year, we completed a comprehensive Risk Control Self Assessment (RCSA). This is a triennial process aimed at identifying the top risks across the organization, their key impacts and mitigating factors and controls. This exercise will further enhance risk reporting and help us develop appropriate operational key risk indicators. Action items from the RCSA will feed into PSP Investments' next strategic-planning process.

ACKNOWLEDGEMENTS

Team building is crucial not only to realizing our investment objectives but also to the development of a solid organizational base that enables scalable and efficient operations. In that respect, I have no doubts that our strong investment performance and the positive outcome of the Special Examination conducted in fiscal year 2011 by the Office of the Auditor General of Canada and Deloitte & Touche LLP resulted from the cumulative efforts of all PSP Investments' employees, focused on the singular goal of high-quality, sustainable returns to fulfill our long-term mandate.

Accordingly, I wish to take this opportunity to thank employees throughout the organization for their hard work and commitment — and to assure them that we remain committed to making PSP Investments an employer of choice in the world of investment management and an organization that they can be proud to be associated with.

Finally, I would like to thank all Board members, but particularly our Chair, Paul Cantor, for their wise counsel and support over the course of this successful year.



Gordon J. Fyfe
President and Chief Executive Officer

MANAGEMENT'S DISCUSSION OF FUND PERFORMANCE AND RESULTS

INVESTMENT APPROACH, OBJECTIVES, THE POLICY PORTFOLIO AND ACTIVE MANAGEMENT

INVESTMENT APPROACH AND OBJECTIVES

PSP Investments' mandate is described in Section 4 of the *Public Sector Pension Investment Board Act* (the "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 objects, PSP Investments' Board of Directors implemented an investment approach around two key pillars:

1. A Policy Portfolio (defining the asset mix — how assets will be allocated among various asset classes), which is expected to achieve a return at least equal to the actuarial rate of return used by the Chief Actuary of Canada in his latest actuarial valuations of the Plans (i.e. a real return of 4.3%, after inflation). In the absence of other factors affecting the funding of the Plans, it is the rate of return required to maintain funding requirements and pension benefits at their current levels.
2. Active management activities, which are designed to generate returns over and above the Policy Portfolio and assist in attaining the actuarial rate of return within an active risk budget.

The success of the investment approach is measured by the following investment objectives:

- Absolute Return: achieve a long-term return (net of expenses) at least equal to the actuarial rate of return;
- Relative Performance: achieve a target return exceeding the Policy Portfolio return.

POLICY PORTFOLIO

A key element of PSP Investments' approach is the Policy Portfolio. The Policy Portfolio is reviewed at least annually within an asset-liability framework, ensuring a thorough understanding of the linkage between the Policy Portfolio and the Plans' Post-2000 Liabilities. Understanding this linkage 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 framework also ensures proper alignment of interests between PSP Investments and the Plans' stakeholders.

- PSP Investments' Policy Portfolio is expected 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%).

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 approximately 2%, well short of the required 4.3%. Accordingly, PSP Investments' Policy Portfolio is developed recognizing the level of market risk required in order to earn a sufficient return to finance the Plans' Post-2000 Liabilities.

- PSP Investments' Policy Portfolio also recognizes the unique characteristics of the Plans' Post-2000 Liabilities and its contribution to funding risks.

Because of the young nature of such liabilities, PSP Investments is expected to receive positive net inflows over at least the next 15 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 the Post-2000 Liabilities.

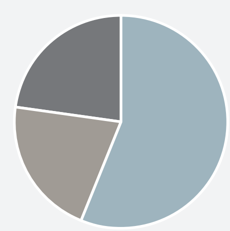
A portfolio composed of public, liquid asset classes would miss out on opportunities afforded by the unique characteristics of the Plans' Post-2000 Liabilities. Asset-liability studies conducted on behalf of the Board of Directors indicate that the increased diversification and the better match with liability characteristics of the Policy Portfolio are expected to provide for:

- a better likelihood of meeting the actuarial target rate of return;
- the same or even lower funding risks over time.

POLICY PORTFOLIO

As at March 31, 2011 (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



- Effective April 1, 2011, key changes were made to the Policy Portfolio following a thorough review and reflecting PSP Investments' current expectations of long-term market conditions.

The principal changes made to the Policy Portfolio are the following: (i) reducing the allocation to World Equity to 56%; (ii) increasing the allocation to Real Return Assets to 31%; and (iii) increasing the allocation to private asset classes (Private Equity, Real Estate and Infrastructure) to 40%. The increase in allocation to the private asset classes leverages the competitive advantages of PSP Investments (e.g. the scale of assets under management and the net inflows which are expected to remain positive over the long term). The increase in allocation to Real Return Assets is expected to provide a better match with the inflation-sensitive nature of the Plans' Post-2000 Liabilities, thus reducing the funding risk to the Plans.

Overall, the changes are expected to reduce funding risk while increasing the probability of attaining the actuarial rate of return over the long-term.

PSP Investments believes that its size offers strong competitive advantages in deploying active management strategies.

ACTIVE MANAGEMENT

The second pillar to PSP Investments' approach is active management activities. They are designed to generate returns over and above the Policy Portfolio and assist in attaining the actuarial rate of return within an active risk budget. These activities typically involve the creation of portfolios that are different from the Policy Portfolio benchmarks. In equities, this is usually accomplished by overweighting or underweighting specific sectors or securities relative to the Policy Portfolio equity benchmarks.

PSP Investments believes that its size offers strong competitive advantages in deploying active management strategies. Notably, it offers economies of scale and allows for an increased scope of activities in selected asset classes. As such, PSP Investments has been increasing the proportion of its assets under internal active management and expanding relationships with selected partners. Bringing more investment decision making in-house provides for better control in terms of risk, investment cost savings and increased influence over major decisions.

CHANGE IN NET ASSETS AND FUND PERFORMANCE

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 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 the actual portfolio asset class weightings. 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.

The following benchmarks were used to measure relative performance for each asset class and for the Policy Benchmark return for fiscal year 2011.

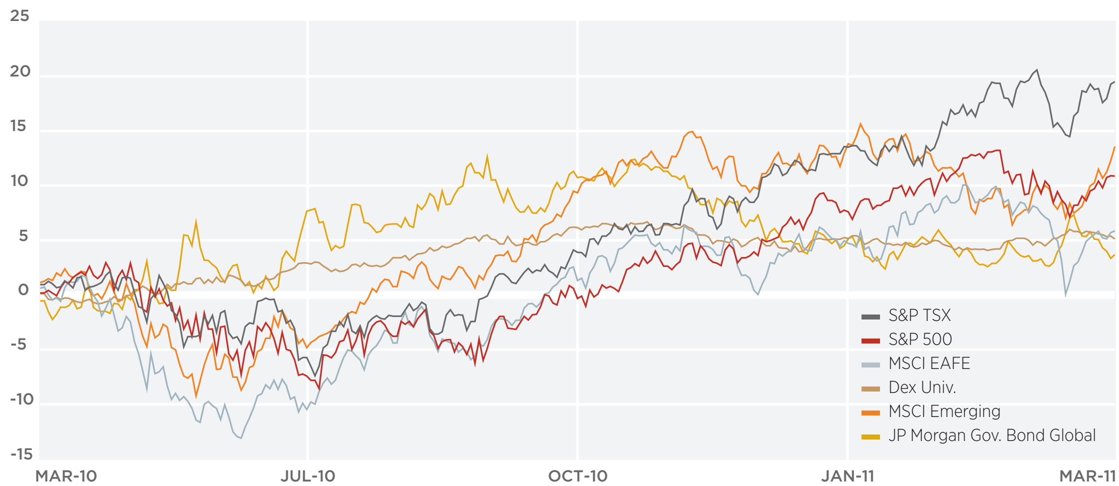
Asset Class	Benchmark
World Equity	
Canadian Equity	S&P/TSX Equity Index
Foreign Equity	
– US Large Cap Equity	S&P 500 Index
– EAFE Large Cap Equity	MSCI EAFE Index
– Small Cap Developed World Equity	S&P 600 Index and MSCI EAFE Small Cap Index
– Emerging Markets Equity	MSCI EMF Index
Private Equity	Private Equity Fund Universe and Private Equity Cost of Capital[1]
Nominal Fixed Income	
Cash & Cash Equivalents	DEX 91 Day T-Bill Index
World Government Bonds	JP Morgan Government Bond Index Global
Canadian Fixed Income	DEX Universe Bond Index
Real Return Assets (Total)	
World Inflation-Linked Bonds	Barclays Global Inflation-Linked Bonds
Real Estate	Real Estate Cost of Capital[1]
Infrastructure	Inflation Adjusted Infrastructure Risk Premium and Infrastructure Cost of Capital[1]

[1] Customized benchmark.

MARKET OVERVIEW

PERFORMANCE OF MAJOR WORLD INDICES

Fiscal year 2011 (percent)



In the wake of the recession and global financial crisis, the central focus of world markets over the past year was on the sustainability of the recovery – and its legacy, from sovereign debt issues to deflation risks and the growing gap between developed economies and emerging markets. Global economic growth firmed up noticeably, with world GDP growing at about a 5% pace during calendar 2010, in line with the average growth recorded in the four years prior to the recession. Equity markets continued to register solid gains on the back of strong earnings growth, and bond yields trekked modestly higher as growth expectations firmed up and deflation fears waned. Commodity prices surged on the back of strong demand and in the case of oil, which rose above $100 per barrel, as a result of geopolitical developments in the Middle East and North Africa.

While fears that the global economy would relapse into recession finally dissipated, what has emerged is essentially a two-speed economy. Developed economies expanded at a lacklustre pace of about 3% in calendar 2010, while emerging economies grew by more than 7%, with China leading the pack at almost 10% growth. Not surprisingly, equity markets followed suit. The MSCI World Index gained 8.9% and the MSCI Emerging Market index recorded a hefty 13.3% advance in local-currency terms, despite a clear loss of momentum in the second half of the fiscal year.

While most advanced-economy central banks kept interest rates at extremely low levels and the US Federal Reserve undertook a new round of quantitative easing, many emerging economies — running close to or at full capacity — began tightening their monetary policies.

Government bond yields continued to be anchored by very low policy interest rates and ongoing asset purchases by the US Federal Reserve. But firming growth prospects, mounting inflation expectations and concerns about sovereign debt put upward pressure on yields. As a result, government bonds generated only modest positive returns, with the JP Morgan Global bond index returning 2.4% in local-currency terms and 3.7% in Canadian dollars for fiscal year 2011.

CANADA

After recording solid growth coming out of the recession, the Canadian economy cooled in the second and third quarters of calendar 2010, in line with the slowdown in US growth. However, the domestic sector of the Canadian economy continued to fare well, prompting the Bank of Canada to hike its policy rate by 75 basis points, which, in turn, helped push the Canadian dollar above parity with its US counterpart. Nonetheless, Canadian equities returned a strong 19.5%, riding the wave of rising commodity prices and solid earnings expectations. Despite considerable volatility, Canadian government bond yields ended the year slightly lower, while corporate credit and provincial yield spreads narrowed, propelling the DEX Universe index to a 5.1% gain for fiscal year 2011.

UNITED STATES

After a relatively strong start to calendar 2010, the US economy rapidly lost momentum. By the end of the summer, talk of a double-dip recession had returned, fuelled by meagre job gains, a sky-high unemployment rate, tight credit conditions and little evidence of a recovery in the housing market. With the economy saddled with substantial excess capacity and core inflation still declining, fears of deflation resurfaced. In response, the US Federal Reserve initiated another round of quantitative easing – dubbed QE2. Equity markets responded favourably and the S&P 500 registered a gain of 15.6% for the fiscal year, in local-currency terms, or 10.9% in Canadian dollars.

EUROPE

The economic backdrop in the euro zone was dominated by the sovereign-debt crisis, beginning in Greece and spreading to Ireland and, eventually, Portugal, which led investors to demand huge premiums for holding their sovereign bonds. Despite a joint EU and IMF bailout package for Greece, and the launch of a facility to provide financial assistance to other member states, sovereign spreads remained elevated, fuelled by concerns about long-term fiscal sustainability. The European fiscal crisis was one factor behind the relatively poor performance of the MSCI EAFE index for fiscal year 2011, which returned only 1.5% in local-currency terms and 5.9% in Canadian-dollar terms.

JAPAN

After rebounding strongly from the depths reached during the global downturn, the Japanese economy slowed and then actually contracted in the final quarter of calendar 2010. The devastating March 2011 earthquake will only add to that weakness. Although Japanese equities slumped in the wake of the disaster, they had already declined on a fiscal-year-to-date basis before the quake struck. This was another key factor behind the lacklustre performance of the MSCI EAFE Index.

EMERGING MARKETS

Emerging market equities continued to soar during the first half of the fiscal year, but stalled out during the fall and winter months over concerns about valuations, mounting inflation pressures and rising interest rates. On a regional basis, the most visible inflationary pressures have come from emerging Asia. As a result, several central banks, including China's, have started to tighten monetary policy. In Latin America, the picture has been more mixed. Most notably, Brazil – which continues to grapple with capacity constraints, strong capital inflows and an appreciating currency – imposed taxes on capital inflows and resumed the interest rate hikes it had initiated early in the fiscal year. Overall, the MSCI Emerging Market Index returned 13.3% in local currency terms and 13.6% in Canadian dollars for fiscal year 2011.

PSP INVESTMENTS
As at March 31, 2011

14.5% ONE YEAR RATE OF RETURN

NET INCOME FROM OPERATIONS
$6.9 billion

CONTRIBUTIONS
$4.8 billion

NET ASSETS
$58.0 billion

PRIVATE MARKETS

Private asset classes benefited from the recovery in global growth, continued low interest rates, and a gradual improvement in credit conditions. For private equity investments, the beginning of the year saw lower transaction volumes with reasonable support from debt refinancing. However, as the year progressed, a $1 trillion "overhang" of uninvested private equity capital waiting to be deployed, along with a continued improvement in debt markets, made for a more active environment. A high level of strategic M&A activity drove acquisition multiples towards record levels similar to those reached in 2007.

With respect to real estate, transaction volumes in major industrialized countries picked up in the second half of the year, as institutional investors increased their real estate allocations. At the same time, capitalization rates were compressed by close to 100 basis points in core markets. In emerging economies, demand has been strong, despite considerable new supply and many other development projects in the pipeline. Real Estate Investment Trusts (REITs) have performed well because of their superior access to capital. Although the MSCI REIT index remains well below its pre-recession peak, it recorded a 19.7% gain for fiscal year 2011.

Infrastructure investment activity increased in 2010, fuelled by stronger debt and equity markets. Many companies took advantage of the markets to refinance bank acquisition debt via long-term bonds but more still face challenges as the combined markets of banks and bonds generally do not support the levels of financing recorded prior to the financial crisis. This is in part because rating agencies continue to tighten their standards and that banks' overall lending capacity has decreased since the financial crisis.

Corporate operators, especially in the energy sector, have been more active in M&A activity and long-term institutional investors continued to increase their direct investments in infrastructure assets.

CHANGE IN NET ASSETS

The net assets of PSP Investments increased by $11.7 billion during fiscal year 2011, a gain of 25% that was mainly attributable to strong investment performance. Net assets at the end of fiscal year 2011 were $58.0 billion, up from $46.3 billion at the end of the previous fiscal year.

PSP Investments generated net income from operations of $6.9 billion during the latest fiscal year, a continuation of the strong performance of fiscal year 2010, when the Corporation generated $7.5 billion of income. These results for fiscal year 2011 represent a consolidated rate of return of 14.5%, compared to 21.5% in fiscal year 2010. PSP Investments received $4.8 billion in contributions during fiscal year 2011.

CONSOLIDATED RETURNS

The 14.5% rate of return recorded by PSP Investments in fiscal year 2011 exceeded the Policy Benchmark rate of return by 1.8% and added $879 million in value over and above the Policy Benchmark return. Over the past five fiscal years, PSP Investments has recorded a compound annualized rate of return of 3.6%, compared to the Policy Benchmark rate of return of 4.4% for that same period.

The robust overall performance for fiscal year 2011 was driven primarily by strong results in Public Markets equities, the Private Equity portfolio and the Real Estate portfolio. Investment returns for all the World Equity portfolios were positive, ranging from 6.6% for the EAFE Equity portfolio to 20.9% for the Private Equity portfolio. The returns generated by the equity portfolios reflected the strong performance of global stock markets, as outlined in the Market Overview. The overall return also benefited from 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 in fiscal year 2011, the Currency Hedging Policy had a positive impact on the overall rate of return of 0.3%.

The excess return of 1.8% (relative to the Policy Benchmark) achieved during fiscal year 2011 was generated primarily by absolute-return mandates as well as the Real Estate and Private Equity portfolios. Major contributors among the absolute-return mandates included externally managed debt portfolios that benefited from the effect of narrowing credit spreads. PSP Investments' holdings in asset-backed term notes were also contributors to the fiscal 2011 excess return. For the fiscal year ended March 31, 2011, investments in asset-backed term notes generated investment income of $128 million, increasing the overall rate of return by 0.2%. Tightening credit spreads and continuing favorable market conditions were the primary reasons for the increase in value of these investments.

PORTFOLIO AND BENCHMARK RETURNS

As at March 31, 2011

	Fiscal Year 2011		5-year	
Asset Class	Portfolio Returns %	Benchmark Returns %	Portfolio Returns %	Benchmark Returns %
World Equity				
Canadian Equity	**19.3**	**19.5**	5.8	6.0
Foreign Equity				
– US Large Cap Equity	**11.0**	**10.9**	(3.8)	(1.0)
– EAFE Large Cap Equity	**6.6**	**5.9**	(2.2)	(2.3)
– Small Cap Developed World Equity	**19.7**	**20.1**	(2.5)	(0.2)
– Emerging Markets Equity	**12.9**	**13.6**	6.9	6.7
Private Equity	**20.9**	**18.3**	4.7	(0.3)
Nominal Fixed Income				
Cash & Cash Equivalents	**1.1**	**0.8**	2.5	2.4
World Government Bonds (4 years)	**2.7**	**3.7**	2.4[1]	2.6[1]
Canadian Fixed Income	**5.4**	**5.1**	5.3	5.3
Real Return Assets				
World Inflation-Linked Bonds	**4.7**	**4.9**	0.9	0.9
Real Estate	**13.8**	**6.2**	7.2	6.9
Infrastructure (4.75 years)	**(1.6)**	**6.8**	4.1[1]	4.1[1]
Total Return	**14.5**	**12.7**	3.6	4.4

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

Except otherwise indicated, returns are time-weighted rate of return and 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.

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
As at March 31, 2011

15.1% ONE YEAR RATE OF RETURN

INVESTMENT INCOME*

$5.5 billion

NET ASSETS

$43.5 billion

75.0% OF TOTAL NET ASSETS

* Excluding external investment management fees.

PUBLIC MARKETS

Public Markets is composed of Canadian Equity, Foreign Equity, World Government Bonds, Canadian Fixed Income and World Inflation-Linked bonds. Net assets in Public Markets totalled $43.5 billion at the end of fiscal year 2011, an increase of $11.7 billion from $31.8 billion at the end of fiscal year 2010. Public Markets recorded investment income of $5.5 billion, excluding external investment management fees, for a return of 15.1% compared to a benchmark return of 13.5%.

Net assets in Public Markets equities totalled $32.8 billion at the end of fiscal year 2011, an increase of $10.1 billion from the $22.7 billion total at the end of fiscal year 2010.

Public Markets equities earned $4.4 billion in investment income for a return of 16.4% in fiscal year 2011, versus a benchmark return of 16.6%. The slight underperformance of the Public Markets equities portfolio was mainly due to relative underweighting in the materials sector.

As indicated in the market overview, economic fundamentals improved during fiscal year 2011, and stock markets around the world rallied. PSP Investments' public-equities portfolios recorded substantial gains in fiscal year 2011, adding to the strong performance of fiscal year 2010. During fiscal year 2011, the Canadian Equity portfolio was up 19.3%; the US Large Cap Equity portfolio was up 11.0%; and the EAFE Large Cap Equity portfolio was up 6.6%, while the Small Cap Developed World Equity and Emerging Markets Equity asset classes posted investment returns of 19.7% and 12.9%, respectively.

Net assets in World Government Bonds, Canadian Fixed Income and World Inflation-Linked Bonds totalled $10.7 billion at the end of fiscal year 2011, up from $9.1 billion at the end of fiscal year 2010. Overall, these fixed-income portfolios earned $374 million in investment income for a return of 4.6% in fiscal year 2011, versus a benchmark return of 4.4%. During fiscal year 2011, Public Markets began to actively manage the Nominal Fixed Income portfolio (composed of Canadian Fixed Income and World Government bonds). The over-performance was mainly due to an overweight position in corporate credit and relative value strategies on interest rates.

Public Markets investments are overseen by both internal and external managers using a combination of active and index-replication strategies. The proportion of actively-managed assets with Public Markets increased to 40% at the end of fiscal year 2011, from 30% at the end of the previous fiscal year. Approximately 53% of actively-managed assets are managed internally.

External fixed-income, global macro and foreign currency absolute-return strategies added $377 million of relative value, mainly as a result of the effect of decreased credit spreads. External equity managers subtracted $59 million of relative value during fiscal year 2011, mainly as a result of relative underweighting in the materials sector. Internal active management added $84 million of value, generated mainly from tactical equity positions and fixed-income strategies. Asset-backed term notes were positively impacted by the contracting credit spreads and contributed $118 million of relative value.

PRIVATE EQUITY

Net assets of the Private Equity portfolio totalled $5.6 billion at the end of fiscal year 2011, an increase of $0.2 billion from $5.4 billion at the end of fiscal year 2010.

Private Equity generated $1.05 billion in investment income, excluding transaction costs, for a rate of return of 20.9% for fiscal year 2011, compared to the benchmark return of 18.3%. The robust Private Equity performance was driven by both direct and co-investments, as well as by the fund investment strategies. The two strategies contributed proportionately to the overall portfolio return, with fund investments recording their best ever one-year return since the inception of the Private Equity asset class. Fund exposures to both the US and European markets performed particularly well as they benefited from the strong recovery of the equity and debt markets. The strong performance of the direct and co-investment strategy is mainly attributable to Telesat, which recorded continued growth in revenue and operating profits. Since 2007, Telesat has represented a significant investment in the Private Equity portfolio and has shown strong resilience throughout this most recent economic cycle. On a five-year basis, Private Equity investments generated a positive 4.7% compound annualized return, compared to the benchmark negative return of 0.3% for the same period.

The Private Equity portfolio has a long-term focus with investments held for an average of 5 to 10 years. The 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.

During the past fiscal year, the portfolio reduced its exposure to the "mega-buyout" segment of the Private Equity market through a secondary sale of fund investments and future commitments for proceeds of more than $800 million. The Private Equity Group continues to invest strategically in fund opportunities, and has selectively made new commitments to managers with unique and specialized investment strategies underpinned by a strong alignment of interests.

As at March 31, 2011, direct and co-investments accounted for 32% of assets of the Private Equity portfolio, up from 27% at the end of the previous fiscal year. Direct and co-investments amounted to $1.8 billion at the end of fiscal year 2011.

Overall, the Private Equity portfolio is well diversified both from a geographic and sector perspective. As a result of portfolio divestures, there has been a slight increase in both Asian and Canadian exposure at the expense of US market exposure. Increased exposure in Canadian and telecom assets is mainly related to the strong performance of Telesat.

PRIVATE EQUITY
As at March 31, 2011

20.9% ONE YEAR RATE OF RETURN

INVESTMENT INCOME*

$1.05 billion

NET ASSETS

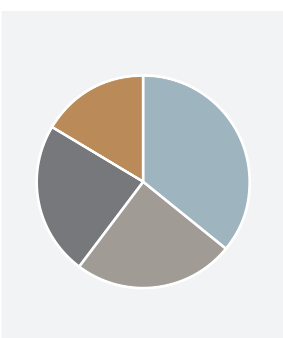
$5.6 billion

9.6% OF TOTAL NET ASSETS

* Excluding transaction costs.

PRIVATE EQUITY – DIVERSIFICATION BY GEOGRAPHY
As at March 31, 2011 (percent)

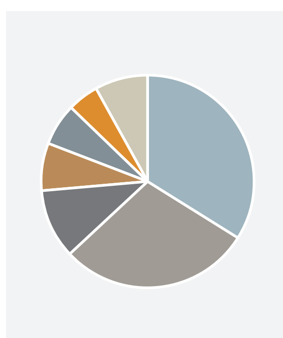
United States	36.0
Canada	24.4
Europe	23.2
Asia	16.4



The majority of the Private Equity portfolio exposure is in North America.

PRIVATE EQUITY – DIVERSIFICATION BY SECTOR
As at March 31, 2011 (percent)

Telecom	33.9
Consumer Discretionary	29.2
Information Technology	10.6
Materials and Industrial	7.2
Financial	6.5
Health Care	4.8
Other	7.8



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

REAL ESTATE
As at March 31, 2011

13.8% ONE YEAR RATE OF RETURN

INVESTMENT INCOME*

$644 million

NET ASSETS

$5.3 billion

9.1% OF TOTAL NET ASSETS

* Excluding transaction costs.

REAL ESTATE

Net assets of the Real Estate portfolio totalled $5.3 billion at the end of fiscal year 2011, an increase of $0.2 billion from the $5.1 billion at the end of fiscal year 2010.

Real Estate earned $644 million in investment income, excluding transaction costs, for a return of 13.8% in fiscal year 2011, compared to a benchmark of 6.2%.

The robust returns for fiscal year 2011 are attributable to approximately 50% of the portfolio being allocated to the relatively strong and stable Canadian market as well as strategic investments in distressed real-estate debt instruments. As well, the Real Estate Group adopted a defensive strategy over the past five years, with an overweight in more stable types of property, namely seniors' facilities and apartments, which performed well in the past year.

On a five-year basis, Real Estate investments generated a 7.2% compound annualized return, compared to a benchmark return of 6.9% for the same period.

The year-over-year increase in net assets came mainly from an increase in the value of existing investments, particularly in the hotel, retirement and long-term-care sectors, due primarily to our ownership of Revera Inc., Real Estate's largest investment, which owns and operates a portfolio of retirement and long-term care facilities. The successful completion of Revera's capital projects, cost containment and market improvement initiatives has led to an increase in value. The Canadian hotel portfolio also regained strength this year as demand increased and capital programs were completed. In fiscal year 2011, the Real Estate Group continued to make new direct investments in core assets in developed markets, as well as additional investments in emerging markets. Over the course of the year, several retail properties in Brazil and residential properties in Canada, where the respective business plans had been achieved and markets were offering attractive valuations, were sold, realizing significant gains within the Real Estate portfolio.

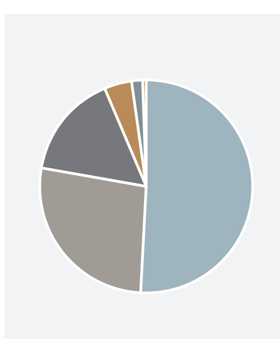
The impact of the new investment activities, combined with the divestments and a re-leveraging of the portfolio, resulted in the net value of the Real Estate portfolio at the end of fiscal year 2011 being only slightly higher than in the previous year.

As at March 31, 2011, direct ownership and co-investments accounted for 75% of the assets in Real Estate, up from 72% at the end of the previous fiscal year.

REAL ESTATE – DIVERSIFICATION BY GEOGRAPHY

As at March 31, 2011 (percent)

Canada	51.1
United States	26.9
Europe	15.7
Latin America	4.3
Asia	1.6
Other	0.4

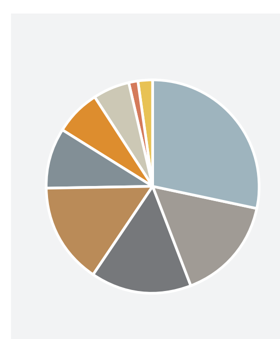


The majority of the Real Estate portfolio exposure is in North America, mainly in Canada.

REAL ESTATE – DIVERSIFICATION BY SECTOR

As at March 31, 2011 (percent)

Retirement	28.6
Residential	15.6
Office	15.4
Long-Term Care	15.2
Hotel	9.2
High-Yield Debt	7.1
Retail	5.5
Industrial	1.4
Other	2.0



INFRASTRUCTURE

The net assets of the Infrastructure portfolio totalled $2.4 billion at the end of fiscal year 2011, an increase of $0.3 billion from the $2.1 billion at the end of fiscal year 2010.

Infrastructure generated negative $35 million in investment income, excluding transaction costs, for a negative return of 1.6% in fiscal year 2011, compared to the benchmark return of 6.8%. The negative return was driven by markdowns in the value of certain assets, mainly in the energy sector, partially offset by distributions of $79 million from direct or co-investments. Since inception (4.75 years), Infrastructure investments have generated a 4.1% compound annualized return, in line with the Policy Benchmark return of 4.1% for the same period.

The year-over-year increase in net assets in Infrastructure came mainly from new direct investments. During fiscal year 2011, the Infrastructure Group completed a follow-on investment in an existing portfolio company in the water-utilities sector in the United Kingdom. It also acquired a significant participation in five container-terminal ports in Australia in partnership with two other major investors. The nature of these investments as well as their sectors and regions enhanced portfolio diversification.

INFRASTRUCTURE
As at March 31, 2011

-1.6% ONE YEAR RATE OF RETURN

INVESTMENT INCOME*
$-35 million

NET ASSETS
$2.4 billion

4.1% OF TOTAL NET ASSETS

* Excluding transaction costs.

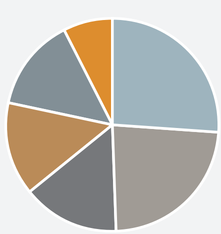
The value of some of the energy investments in the portfolio was affected by soft demand in their local economies as well as changing supply patterns. These trends in fundamental sectors of the economy reflect the continuing challenge that developed countries in North America and Western Europe face getting out of the major financial crisis. These private investments are long-term in nature and their valuation tends to reflect key underlying drivers of the assets rather than short-term disruption of the financial markets, which explains in part the relative lack of correlation with public equities.

As at March 31, 2011, direct and co-investments accounted for 76% of the assets of the Infrastructure Portfolio, slightly down from 78% at the end of the previous fiscal year.

INFRASTRUCTURE – DIVERSIFICATION BY GEOGRAPHY

As at March 31, 2011 (percent)

United States	26.3
United Kingdom	23.3
Europe	14.8
Australia	14.2
South America	13.9
Canada	7.5

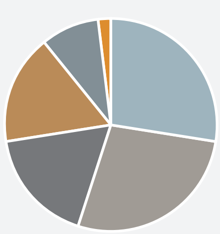


The Infrastructure portfolio is diversified mostly across the Americas and Europe.

INFRASTRUCTURE – DIVERSIFICATION BY SECTOR

As at March 31, 2011 (percent)

Oil & Gas Storage and Transport	27.6
Transportation	27.5
Water Utilities	17.4
Electric Transmission	16.8
Oil & Gas Exploration and Production	8.9
Other	1.8



OPERATING EXPENSES AND INVESTMENT COSTS

Operating expenses and investment costs (i.e. external investment management fees and transaction 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.

PSP Investments' operating expenses during fiscal year 2011 totalled $114 million, compared to $92 million in fiscal year 2010. The increase in operating expenses in fiscal year 2011 can be attributed to the increase in internal actively managed assets, which are more expensive than passive mandates, as well as increased headcount and related expenses. As a percentage of net investment assets, operating expenses decreased to 22.3 basis points, or 22.3 cents per $100 of average net investment assets, compared to 22.9 basis points in fiscal year 2010. PSP Investments managed 74% of its assets internally at the end of fiscal 2011 compared to 67% in fiscal 2010.

Operating expenses for fiscal year 2012 are expected to increase as a result of the expected growth in assets under management and a continued shift towards internal 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.

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

Operating expenses decreased to **22.3** basis points, or 22.3 cents per $100 of average net investment assets in fiscal year 2011.

PSP Investments' cost ratio (which represents operating expenses plus investment costs unrelated to performance as a percentage of average net investment assets) has been gradually declining over the last three years. PSP Investments' cost ratio of 67.0 basis points has declined in fiscal 2011 compared to fiscal 2010's cost ratio of 73.8 basis points, due to increased efficiencies and economies of scale driven by higher net investment assets. Transaction costs are included in PSP Investments' cost ratio and can vary significantly year over year depending on the complexity and size of our Private Markets investment activities. Performance fees during fiscal 2011 totalled $92 million, compared to $11 million for the prior year, due to strong investment returns earned by external investment managers on behalf of PSP Investments.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian Generally Accepted Accounting Principles (GAAP) for publicly accountable enterprises would converge with International Financial Reporting Standards (IFRS) effective January 1, 2011.

In April 2010, the AcSB issued an exposure draft that proposed a scope expansion to Section 4600 "Pension Plans" of the Canadian Institute of Chartered Accountants (CICA) Handbook 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 do not themselves have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments and would continue to account for and report its investments at fair value.

Concurrent with the aforementioned standard-setting activities in Canada, the International Accounting Standards Board (IASB) had announced that it intended to propose that investment companies, such as PSP Investments, be exempt from consolidation and should account for their controlled investments at fair value.

In light of the announcement from the IASB, the AcSB announced in June 2010 that it would reconsider the need for the scope expansion of Section 4600 once the IASB finalizes its standard. If an investment company standard is issued as proposed by the IASB, Canadian investment companies would be exempt from consolidation and would continue to account for their controlled investments at fair value. This would be expected to eliminate the need for the scope expansion of Section 4600 proposed by the AcSB.

In January 2011, the AcSB decided to defer the adoption of IFRS by investment companies currently applying Accounting Guideline 18 "Investment Companies" to annual periods starting on or after January 1, 2013. This deferral delays PSP Investments' transition to IFRS until the March 31, 2014 annual consolidated financial statements. PSP Investments will finalize its assessment of the impact of its transition to IFRS once the investment company standard is issued.

RISK MANAGEMENT

ENTERPRISE RISK MANAGEMENT

As the manager of public pension assets, PSP Investments is responsible for acting in the best interests 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.

PSP Investments faces risk in all aspects of its activities and places emphasis on continuous improvement of its risk management capabilities. 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 deal with the specific characteristics 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, evaluate, manage, monitor and report on enterprise risks;
- Integrate enterprise risk management into strategic and financial objectives;
- Operationalize sound risk management processes.

PSP Investments periodically reviews its risk management policies ensuring governance for all of the Corporation's risks.

PSP Investments also performed a Risk and Control Self-Assessment exercise in fiscal year 2011. The Corporation's enterprise risk categories are defined as:

- Investment risk: the risk of loss inherent in achieving investment objectives, including market, credit and counterparty, 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.
- Governance risk: the risk of a lack of consistent corporate management, cohesive policies and organizational structure alignment to efficiently operate, regulate, and control PSP Investments' environment.
- 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, non-compliance with internal rules, or from external events.
- Stakeholder risk: the risk of not maintaining efficient relations with PSP Investments' plan sponsors and key business partners.
- Legal and regulatory risk: the risk associated with the potential impact of a change in legislation, regulations or other mandatory industry practices.
- Reputational 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.

ENTERPRISE RISK MANAGEMENT FRAMEWORK

PSP Investments' Enterprise Risk Categories

<table>
<tr><th colspan="12">INVESTMENT RISK</th></tr>
<tr><td colspan="3">MARKET RISK</td><td colspan="3">LIQUIDITY AND FINANCING RISK</td><td colspan="3">CREDIT AND COUNTERPARTY RISK</td><td colspan="3">LEVERAGE RISK</td></tr>
<tr><td colspan="2">Governance Risk</td><td colspan="2">Strategic Risk</td><td colspan="2">Operational Risk</td><td colspan="2">Stakeholder Risk</td><td colspan="2">Legal and Regulatory Risk</td><td colspan="2">Reputational Risk</td></tr>
</table>

In fiscal year 2011, PSP Investments continued the implementation of its enterprise risk management framework, aligned with its three-year strategic plan.

Key accomplishments for the fiscal year include the following:

- Further refined risk limits and attributed active risk across asset classes through a structured risk budget process;
- Enhanced monitoring and reporting of risk drivers by portfolio via new risk metrics;
- Completed a Risk Control and Self Assessment exercise across the organization to identify and evaluate the risks faced by PSP Investments as well as the effectiveness of their control environment.

RISK MANAGEMENT GOVERNANCE MODEL

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;
- Being aware of 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, Valuation Committee, New Product Committee and Information Technology Governance Committee.

INVESTMENT RISK MANAGEMENT

The Investment Risk Management Policy 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 six types of risk:

- People management;
- Process and information management;
- Systems and data management;
- Theft and fraud;
- Business disruption; and
- Model and valuation.

INTERNAL AUDIT AND COMPLIANCE

INTERNAL AUDIT

Internal Audit is an independent, objective assurance and advisory 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 design and implementation of processes and controls and the effectiveness of operations, providing continuous feedback in the areas of governance, risk management and control processes. In order to ensure the independence required for the Internal Audit Department to play its role effectively, the department reports functionally to the Audit Committee of the Board of Directors and administratively to the Executive Vice President, Chief Operating Officer and Chief Financial Officer.

INTERNAL CONTROLS

The internal controls environment is derived from the Committee of Sponsoring Organizations of the Treadway Commission (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:

- Strategic – High-level goals, aligned with and supporting its mission;
- Operational – Effectiveness and efficiency of operations;
- Reporting – Reliability of financial reporting;
- Compliance – Compliance with applicable laws and regulations.

PSP Investments annually reviews 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, 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.

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 Affairs Department, is to ensure stringent compliance of PSP Investments with its policies and procedures, including the Code of Conduct for Officers, Employees and Others (the “Employee Code”), as well as relevant laws and statutory requirements.

Compliance with internal investment policies and procedures is achieved primarily through daily monitoring of transactions and quarterly reporting to the Audit Committee which is responsible for monitoring the compliance function. Processes are also in place to monitor compliance with the Employee Code. The Employee Code serves as a framework to provide those subject to its provisions 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 Employee Code 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, it deals with overall honesty and integrity; personal and professional conduct; compliance with the Code itself and with the law; conflicts of interest; the pre-authorization and 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.

PSP Investments must act with integrity and maintain high ethical standards at all times.

The Governance Committee is responsible for monitoring the application of the Employee Code. Management reports quarterly to the Governance Committee on compliance with the Employee Code. The Employee Code may be viewed on PSP Investments’ website **www.investpsp.ca**.

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 framework, including its mandate, the roles of the Board of Directors and Board committees and key policies that guide the organization's activities and behaviour.

MANDATE

PSP Investments is a Crown corporation created in 1999 by Act of Parliament (the *Public Sector Pension Investment Board Act,* or the "Act"). PSP Investments' mandate is twofold: managing the funds transferred to it by the Government of Canada for the Canadian Forces, the Reserve Force, the Public Service and the Royal Canadian Mounted Police ("RCMP") pension plans in the best interests of the contributors and beneficiaries; and investing its assets 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 their ability to meet their financial obligations.

Effective April 1, 2000, the Government of Canada created three new pension fund accounts (the "Pension Fund Accounts"), one for each of the Public Service, the Canadian Forces and the RCMP Plans. On March 1, 2007, the Government established the Reserve Force Pension Plan and created a Pension Fund Account for it as well. Employer and employee contributions in respect of service after the date of creation of a particular Pension Fund Account ("post-funding service") are credited to the respective accounts. Amounts equal to the net balances in these Pension Fund Accounts (that is contributions minus benefits payments for post-funding service, as well as plan administration expenses) are then transferred to separate accounts at PSP Investments (the "Pension Plan Accounts"), to be invested in accordance with the approved investment policy and strategy.

The Government of Canada manages and administers the Plans. The President of the Treasury Board is responsible for the Public Service Pension Plan, the Minister of National Defence for the Canadian Forces Pension Plan and the Reserve Force Pension Plan, and the Minister of Public Safety for the RCMP Pension Plan. PSP Investments is the exclusive investment manager of the amounts credited to the Pension Fund Accounts.

BOARD OF DIRECTORS

PSP Investments' operations and activities are overseen by a Board of Directors comprised of 11 members, including the Chair of the Board[1]. Directors are appointed by the Governor in Council on the recommendation of the President of the Treasury Board to hold office during good behaviour for a term not exceeding four years. Candidates for directorships are selected from a list of qualified individuals proposed by an independent nominating committee established by the President of the Treasury Board (the "Nominating Committee") pursuant to the Act. The Nominating Committee operates separately from the Board of Directors and the Treasury Board. Members of the Senate, the House of Commons and provincial legislatures, as well as employees of PSP Investments or the Government of Canada and those entitled to benefits from the Plans, are disqualified from serving as Directors. The Chair of the Board is appointed from among the Directors by the Governor in Council on the recommendation of the President of the Treasury Board, after consultation with the Board of Directors, the Minister of National Defence and the Minister of Public Safety. On the expiry of the term of an incumbent Director, the incumbent may be reappointed and, in any event, continues in office until a successor is appointed.

The Board of Directors plays an active role in guiding PSP Investments. Therefore, a substantial time commitment is expected of Directors, particularly the Chair of the Board and the Chairs of Board committees, for meetings, travel and preparation for meetings.

In fiscal year 2011, one Director was appointed and two Directors left PSP Investments' Board. On June 18, 2010 the Governor in Council appointed Ms. Diane Bean as a Director for a term of four years. On July 29 and August 21, 2010, respectively, Mr. Jean Lefebvre and Mr. Jamie Baillie resigned as Directors of PSP Investments for personal reasons. On March 5, 2011, Mr. Paul Cantor's term as a Director was extended for an additional year, and his designation as Chair of the Board was reconfirmed. On March 31, 2011, the Board was composed of the following nine Directors, with two vacant positions in the process of being filled:

- Paul Cantor, Chair of the Board
- Cheryl Barker
- Léon Courville
- Lynn Haight
- Michael P. Mueller
- Bob Baldwin
- Diane Bean
- Anthony R. Gage
- William A. MacKinnon

Canadian securities regulators have defined the concept of "independent director" applicable to publicly-listed issuers as an individual who has no direct or indirect material relationship with the issuer. A "material relationship" has been defined as a relationship which could, in the view of the issuer's board of directors, be reasonably expected to interfere with the exercise of an individual's independent judgment. Those regulations do not apply to PSP Investments, given that it is not a publicly-listed issuer. However, based on the same definitions, all Directors of PSP Investments would be considered independent directors.

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.

In addition to investment management knowledge, the Directors of PSP Investments possess a wide range of professional experience in a variety of fields, including accounting, finance, law, economics and human resources. Brief biographies of each Director, as of March 31, 2011, can be found beginning on page 58.

[1] 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 and will come into force on a date to be fixed by order of the Governor in Council.

ROLES AND RESPONSIBILITIES OF THE BOARD OF DIRECTORS AND BOARD COMMITTEES

BOARD OF DIRECTORS

In order to ensure that PSP Investments' statutory mandate is met, the Board of Directors, in addition to the requirements of the Act, 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") for each Pension Plan Account;
- 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, Employees and Others ("Employee Code"), and a Code of Conduct for Directors ("Director Code");
- Ensuring that effective enterprise, 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 Pension Plan Account and for PSP Investments as a whole.

The Terms of Reference describing the roles and responsibilities of the Board of Directors and its committees and the Chair of the Board may be viewed in their entirety on PSP Investments' website **www.investpsp.ca**.

BOARD COMMITTEES

The Board of Directors has established the following four committees to assist in the fulfillment of its obligations.

- Investment Committee
- Audit Committee
- Human Resources and Compensation Committee
- Governance Committee

INVESTMENT COMMITTEE

The Investment Committee is responsible for overseeing the investment management function of PSP Investments. The Investment Committee's duties assigned to it by the Board or provided for in the Act include the following:

- Approving all investment proposals and related borrowings above thresholds delegated by the Board to management for approval;
- Making annual and other recommendations to the Board of Directors on the SIP&P for each Pension Plan Account;
- Overseeing PSP Investments' investment risks and ensuring that an appropriate control environment is in place to govern the management of investment risks; and
- Approving the engagement of external investment managers having discretionary authority to invest PSP Investments' assets.

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

AUDIT COMMITTEE

The Audit Committee's role is generally to review financial statements and 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. Many of the duties of the Audit Committee are set out in the Act. These duties include:

- Reviewing quarterly and annual financial statements for each Pension Plan Account and for 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 external auditors;
- Meeting separately with PSP Investments' joint external auditors and internal auditors, without management present, to discuss and review specific issues related to the Audit Committee;
- Overseeing PSP Investments' operational risks and ensuring that an appropriate control environment is in place to govern the management of operational risks inherent to PSP Investments' activities;
- Ensuring that internal audits are conducted in respect of PSP Investments and its subsidiaries; and
- Adopting and maintaining an appropriate whistle-blowing mechanism for reporting fraudulent, illegal and inappropriate activities.

On March 31, 2011, the Audit Committee was composed of the following Directors[2]:

- William A. MacKinnon, Chair
- Anthony R. Gage
- Cheryl Barker
- Lynn Haight

All Audit Committee members are required to be financially literate in order to ensure that they can read and understand PSP Investments' financial statements and properly fulfill their role.

HUMAN RESOURCES AND COMPENSATION COMMITTEE

The Board of Directors strongly believes in the importance of human resources 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. The Human Resources and Compensation Committee is therefore 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;

[2] Mr. Jamie Baillie was a member of the Audit Committee up until his resignation from the Board on August 21, 2010. Mr. Anthony R. Gage was appointed to the Audit Committee on October 1, 2010.

- Overseeing PSP Investments' human resources risks and ensuring that an appropriate governance environment is in place to manage human resources risks inherent to PSP Investments' activities; and
- Reviewing and reporting to the Board on PSP Investments' succession planning.

On March 31, 2011, the Human Resources and Compensation Committee was composed of the following Directors[3]:

- Michael P. Mueller, Chair
- Diane Bean
- Bob Baldwin
- Léon Courville

GOVERNANCE COMMITTEE

The Governance Committee's role is generally to assist the Board of Directors in monitoring governance matters at PSP Investments and developing related policies. The Governance Committee has responsibility for the application of the Director Code and the Employee Code. The Governance Committee's duties also include 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 Chair of the Board of PSP Investments, the Terms of Reference for the Board of Directors and the committees of the Board, and recommending to the Board such amendments as may be necessary or advisable;
- Developing and recommending to the Board of Directors for approval new or amended by-laws and governance-related policies, including the Director Code and the Employee Code;
- Developing target recruitment skills sets and other recruiting capabilities to facilitate the identification by the independent Nominating Committee of suitable candidates for appointment as Directors of PSP Investments;
- Overseeing the implementation of procedures for assessing the effectiveness of the Board of Directors as a whole, as well as the performance of individual Directors; and
- Overseeing PSP Investments' governance risks and ensuring that an appropriate governance framework is in place.

On March 31, 2011, the Governance Committee was composed of the following Directors[4]:

- Cheryl Barker, Chair
- Léon Courville
- Bob Baldwin
- Michael P. Mueller

[3] Mr. Jean Lefebvre was a member of the Human Resources and Compensation Committee up until his resignation on July 29, 2010. Ms. Diane Bean was appointed to the Human Resources and Compensation Committee on August 5, 2010. Mr. Anthony R. Gage ceased being a member of the Human Resources and Compensation Committee on October 1, 2010.
[4] Mr. Jamie Baillie was a member of the Governance Committee up until his resignation from the Board on August 21, 2010.

ACCOUNTABILITY

PSP Investments is a Crown corporation with a unique governance and accountability regime which is set out in the Act. The Act provides that PSP Investments operates at arm's length from the Government of Canada and imposes on it reporting obligations to the Government of Canada and the contributors to the Plans.

The Board of Directors is responsible for the selection, appointment, performance evaluation and compensation of the President and CEO, who reports to the Board of Directors. PSP Investments reports to the ministers responsible for the Plans through its quarterly financial statements and annual report. The annual report must also be made available to contributors to the Plans and is tabled in each House of Parliament by the President of the Treasury Board, who is responsible for the Act.

The President and CEO and the Chair of the Board are required to meet once a year with advisory committees appointed to oversee the Plans. PSP Investments is also required to hold an annual public meeting. In addition, PSP Investments communicates on an ongoing basis with the Chief Actuary of Canada, Treasury Board officials and other Government of Canada officials in the execution of its statutory mandate.

Pursuant to the *Financial Administration Act* ("FAA"), Deloitte & Touche LLP and the Auditor General of Canada serve as joint external auditors of PSP Investments, and are also responsible for conducting Special Examinations as stipulated in the FAA at least once every 10 years. PSP Investments' joint auditors conducted 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 the FAA. The report on such Special Examination forms part of this annual report as required by the Act.

ASSESSMENT OF BOARD PERFORMANCE

The Governance Committee implemented a formal process to evaluate the performance of the Chair of the Board, the Chairs of Board committees, individual Directors and the Board as a whole. Every Director, as well as the President and CEO and certain members of senior management, participate in the evaluation process. The Chair of the Governance Committee presents the results of the evaluation to the Board of Directors. Ensuing Board discussions focus on concerns and opportunities for improvement, what is working properly and what has improved since previous assessments, following which any measures deemed necessary are implemented.

GOVERNANCE FRAMEWORK REVIEW

Every three years, an overall governance review is conducted to assess the extent to which PSP Investments' Terms of Reference for the Board, its committees and relevant officers are being fulfilled. Based on the review, a governance report is submitted to the Governance Committee which reports to the Board thereon. The purpose of this report is to assist the Board of Directors in ensuring that the duties and responsibilities set out in the Terms of Reference are carried out. The last governance review was conducted at the end of fiscal year 2010. The report, produced by an independent consultant, concluded that PSP Investments' Terms of Reference were consistent with the requirements of the Act and formed part of an internal framework reflecting best practices for organizations with mandates and structures similar to those of PSP Investments.

As part of the Special Examination conducted in fiscal year 2011, the Examiners reviewed PSP Investments' governance framework and concluded that the Board of Directors has clearly defined its roles and responsibilities and those of its committees in their respective Terms of Reference, and that PSP Investments has a corporate governance framework that performs well and meets industry practice expectations for board stewardship and oversight.

CODE OF CONDUCT FOR DIRECTORS

The Director Code together with the Employee Code have been developed to establish and maintain a culture that guides decision-making throughout the Corporation. The purpose of the Director Code goes beyond complying with minimum statutory requirements; it reflects the expectation that Directors will have the highest level of integrity and ethical standards. The Director Code 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 Director Code 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 Director Code aims to assist Directors in determining appropriate business practices and behaviour.

Among other stipulations, the Director Code:

- 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 where they have a conflict of interest;
- Requires the disclosure of any other business activity in which they participate that directly or indirectly affects PSP Investments' activities or is in competition with PSP Investments' activities; and
- Requires the Directors to pre-clear all securities trades, except exempt trades, and to report quarterly to a PSP Investments auditor on their personal trading activities.

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

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 mandate. The Act also requires 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 2011, each Director was allocated an individual budget, equal to 15% of the retainer and meeting fees he or she earned in fiscal year 2010, 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 compensation adopted by the Board of Directors reflects the 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 mandate. 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 following compensation 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 Chair: $27,500
- Annual retainer for each Chair of a committee of the Board: $8,750
- Attendance fee for each Board meeting: $1,500
- Attendance fee for each committee meeting: $1,250
- 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.

The Chair of the Board is not entitled to any meeting fees. 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 10 times during fiscal year 2011 and its committees held 27 meetings. This translated into total remuneration for Directors of $678,259. The tables on the following two pages illustrate and break down the above-mentioned information.

The Board of Directors met **10** times during fiscal year 2011 and its committees held 27 meetings.

ATTENDANCE OF DIRECTORS BOARD AND COMMITTEE MEETINGS FISCAL YEAR 2011

	Board of Directors		Audit Committee		Governance Committee		Human Resources and Compensation Committee		Investment Committee	
	Regular	Special	Regular	Special	Regular	Special	Regular	Special	Regular	Special
Number of meetings Fiscal Year 2011	8	2[1]	5	1	4	1	5	1	6	4
Jamie Baillie[2]	3/3		2/2		2/2	1/1			2/2	
Bob Baldwin	8/8	2/2			4/4	1/1	5/5	1/1	6/6	4/4
Cheryl Barker	7/8	2/2	4/5	1/1	4/4	1/1			5/6	4/4
Diane Bean[3]	5/6	2/2					4/4		4/5	4/4
Paul Cantor[4]	8/8	1/2							6/6	4/4
Léon Courville	8/8	2/2			4/4	1/1	5/5	1/1	6/6	4/4
Anthony R. Gage[5]	8/8	2/2	3/3	1/1			2/2	1/1	6/6	4/4
Lynn Haight	6/8	1/2	5/5	1/1					5/6	2/4
Jean Lefebvre[6]	2/2						1/1		1/1	–
William A. MacKinnon	8/8	0/2	5/5	1/1					5/6	2/4
Michael P. Mueller	8/8	2/2			4/4	1/1	5/5	1/1	6/6	4/4

[1] The Special Meetings of the Board were held concurrently with the Special Meetings of the Investment Committee.

[2] Mr. Baillie resigned on August 21, 2010.

[3] Ms. Diane Bean was appointed to the Board of Directors on June 18, 2010 and became a member of the Investment Committee on the same date. She was also appointed to the Human Resources and Compensation Committee on August 5, 2010.

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

[5] Mr. Gage was appointed to the Audit Committee on October 1, 2010, and ceased to be a member of the Human Resources and Compensation Committee as of October 1, 2010.

[6] Mr. Lefebvre resigned on July 29, 2010.

REMUNERATION OF DIRECTORS FISCAL YEAR 2011

	Remuneration[1]				
Name	Annual Retainer	Chair of a Committee/ Annual Retainer	Boards/ Committees Meeting Fees	Travel Fees	Total
Jamie Baillie[2]	$10,761	–	$12,500	$4,500	$27,761
Bob Baldwin	$27,500	–	$36,750	–	$64,250
Cheryl Barker	$27,500	$8,750	$32,000	$7,500	$75,750
Diane Bean[3]	$21,531	–	$21,000	–	$42,531
Paul Cantor	$125,000 (Board Chair)	–	–	–	$125,000
Léon Courville	$27,500	–	$36,750	–	$64,250
Anthony R. Gage[4]	$27,500	$8,750	$31,000	$9,000	$76,250
Lynn Haight	$27,500	–	$24,500	–	$52,000
Jean Lefebvre[5]	$8,967	–	$5,500	–	$14,467
William A. MacKinnon	$27,500	$8,750	$26,750	–	$63,000
Michael P. Mueller	$27,500	$8,750	$36,750	–	$73,000

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

2 Mr. Baillie resigned on August 21, 2010.

3 Ms. Diane Bean was appointed to the Board of Directors on June 18, 2010 and became a member of the Investment Committee on the same date. She was also appointed to the Human Resources and Compensation Committee on August 5, 2010.

4 Mr. Gage was appointed to the Audit Committee on October 1, 2010, and ceased to be a member of the Human Resources and Compensation Committee as of October 1, 2010.

5 Mr. Lefebvre resigned on July 29, 2010.

INVESTMENT GOVERNANCE OVERSIGHT

As a long-term investor, PSP Investments believes in the importance of establishing adequate governance oversight of its investments. PSP Investments actively uses its ownership positions to promote good corporate governance practices by exercising its proxy voting rights and actively engaging with companies, individually and through collaborative initiatives with other like-minded institutional investors.

PROXY VOTING

PSP Investments has adopted Proxy Voting Guidelines (the "Guidelines") addressing the areas of corporate governance with respect to which it may be requested to vote on from time to time, as well as the principles on which PSP Investments will rely in determining a response to such requests. 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.

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
- Environmental, social and governance issues.

In fiscal year 2011, PSP Investments reviewed and amended the Guidelines to take into consideration market trends.

As part of the 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**.

PROXY VOTING ACTIVITIES

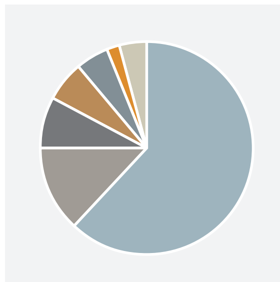
In fiscal year 2011, PSP Investments exercised its voting rights at 2,201 meetings, voting against management's recommendations on proposed resolutions on 8.7% of the resolutions.

The issues on which PSP Investments voted against management's recommendation or abstained on such resolutions are shown below:

ISSUES

As at March 31, 2011 (percent)

Board Independance and Effectiveness	62
Compensation	13
Auditors and Accounting Irregularity	8
Shareholder Proposals	6
Capital Structure	5
Amendment to Articles	2
Other	4



BOARD INDEPENDENCE AND EFFECTIVENESS

PSP Investments believes that a strong independent board of directors is best positioned to successfully direct and control a company in a way that ensures the creation of long-term shareholder value. This category includes resolutions where PSP Investments withheld its votes from nominees seeking election as directors. In the latest fiscal year, PSP Investments withheld its votes from nominees because of non-independence issues, non separation of the role of chair and CEO, poor attendance records and director time-commitment issues.

COMPENSATION

PSP Investments believes that compensation incentives to executives should be suitably structured to enhance shareholder value while rewarding performance that meets or exceeds stated objectives. During the latest fiscal year, PSP Investments voted against several compensation plans that were misaligned with performance or that failed to adequately disclose performance conditions.

AUDITORS AND ACCOUNTING IRREGULARITIES

PSP Investments supports the election of auditors where they meet generally accepted independence standards and the integrity of an audit has not been compromised. On a limited number of occasions during the past fiscal year, PSP Investments voted against auditors who did not live up to these standards.

SHAREHOLDER PROPOSALS

PSP Investments reviews all shareholder proposals on a case-by-case basis. The Corporation generally supports shareholder proposals that increase the board of directors' level of accountability to shareholders and serve the company's short- or long-term financial interest, without putting excessive constraints on the company, its board of directors or its management. In the latest fiscal year, PSP Investments supported shareholder proposals relating to advisory votes on executive compensation, majority voting for the election of directors, and additional disclosure with respect to environmental risks.

CAPITAL STRUCTURE

PSP Investments is generally supportive of changes to a company's capital structure, provided there are sound business reasons for the proposed changes. In the latest fiscal year, PSP Investments voted against certain changes to capital structures because of dilution issues not justified by business considerations.

AMENDMENT TO ARTICLES

From time to time, PSP Investments is asked to consider resolutions regarding amendments to the articles of a company. In the past fiscal year, PSP Investments was asked to vote on amendments to articles that would limit the right to call a special meeting, that called for the adoption or elimination of cumulative voting, that amended or eliminated "supermajority" requirements, or that would change the state or province of incorporation of a company. All resolutions amending articles are reviewed on a case-by-case basis in light of the proposed changes to the company's governance structure. PSP Investments generally votes against amendments to articles that reduce shareholders' rights.

TAKE-OVER PROTECTION

PSP Investments always evaluates takeover-protection policies and proposals as well as shareholder-rights plans on a case-by-case basis. During the past fiscal year, PSP Investments voted against takeover proposals, policies and shareholder-rights plans where it felt they did not provide for an equal treatment of shareholders in the event of a takeover offer or included anti-takeover measures such as the right to issue shares should the company be subject to a bid.

RESPONSIBLE INVESTING

PSP Investments recognizes that a broad range of financial and non-financial considerations can be relevant in terms of making investment decisions. PSP Investments' Responsible Investment Policy embodies PSP Investments' belief that responsible corporate behaviour with respect to environmental, social and governance ("ESG") 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 ESG issues that are, or could become, material to long-term financial performance. ESG risks are considered as part of the due-diligence process of potential investments and assessment of the practices of external managers in this area. The monitoring of these risks is part of an ongoing dialogue with external managers, boards of directors and senior management of the private and public companies in which PSP Investments invests.

With the assistance of a service provider, PSP Investments is actively engaging public companies with a view to improving their ESG practices. Public companies are selected for engagement based on a process that takes into account elements such as a company's ability to create shareholder value, the prospects for successful engagement and the ESG issues at hand. The intensity of PSP Investments' involvement with public companies evolves over time; some engagements involve one or two meetings over a period of months, while others are more complex and entail multiple meetings with board members and senior management over several years.

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

DIRECT ENGAGEMENT ACTIVITIES

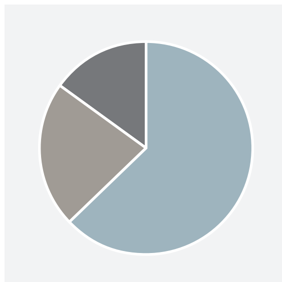
In fiscal year 2011, PSP Investments directly engaged with 144 public companies held in PSP Investments' portfolios on a range of ESG issues.

Below is a breakdown of PSP Investments' engagement activities by issue:

ENGAGEMENTS

As at March 31, 2011 (percent)

Governance	63
Social	22
Environmental	15



GOVERNANCE

Governance can be defined as the framework of rules and practices by which a board of directors ensures accountability and transparency in the company's relationship with its shareholders. PSP Investments engaged with public companies on a number of governance issues during the past fiscal year. Examples of issues raised were director independence, the separation of chair and CEO roles, succession planning, committee structures and risk management.

ENVIRONMENT

PSP Investments also met with a significant number of public companies on environmental-related issues in fiscal year 2011. These engagements focused mainly on climate change, water stress and oil-sands activities.

SOCIAL

PSP Investments engaged public companies on a variety of social issues, including labour, operations in troubled regions and health-and-safety concerns.

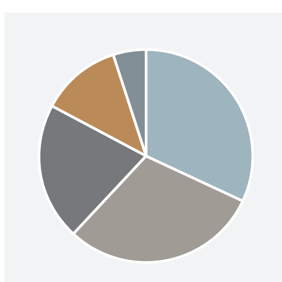
Below is a breakdown of PSP Investments' engagement activities by country or region:

ENGAGEMENT ACTIVITIES BY COUNTRY OR REGION

As at March 31, 2011 (percent)

Europe	32
US and Latin America	30
Asia Pacific [1]	21
Canada	12
Africa and Middle East	5

[1] This region includes Australia and New Zealand.



COLLABORATIVE INITIATIVES

In addition to its direct-engagement efforts with public companies, PSP Investments participates in collaborative governance initiatives with other like-minded institutional investors to strengthen its voice with regard to corporate governance issues. PSP Investments is an active member of the Canadian Coalition for Good Governance, which represents 44 institutional investors managing assets totaling more than $1.5 trillion.

PSP Investments is also a signatory of the Carbon Disclosure Project. The Carbon Disclosure Project acts on behalf of 551 institutional investors representing over $71 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.

PSP Investments is an active member of the Canadian Coalition for Good Governance, which represents 44 institutional investors managing assets totaling more than

$1.5 trillion

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 is also a member of the Pension Investment Association of Canada (PIAC). PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

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

COMPENSATION

The Board of Directors approves PSP Investments' compensation framework as well as total compensation for the President and Chief Executive Officer and other officers upon recommendation by the Human Resources and Compensation Committee (HRCC). Other compensation matters, including the total aggregate compensation for all of the Corporation's employees, are the responsibility of the HRCC.

In a highly competitive market for qualified personnel, PSP Investments' Compensation Policy is designed to attract and retain talented employees, reward performance and reinforce business strategies and priorities. The Board of Directors recognizes the fundamental value of a motivated and committed team and strongly believes that the recruitment and retention of high-performing employees is critical to achieving PSP Investments' objectives.

To that end, 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.

The Corporation's Performance Management and Professional Development process also contributes to improving business performance and employee engagement.

As part of a Special Examination conducted in fiscal year 2011 by the Office of the Auditor General of Canada and Deloitte & Touche LLP, the Examiners reviewed PSP Investments' compensation framework and practices. They concluded that the short-term and long-term incentive programs are comparable to industry practices, are designed to reduce the potential for excessive risk-taking and are aligned with the Corporation's strategic objectives and investment policies. Furthermore, in 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. An independent review of PSP Investments' assessment confirmed PSP Investments' level of compliance with the G20 Recommendations.

In order to ensure that PSP Investments offers competitive compensation to its employees, managers and officers, their compensation levels are benchmarked with those of a select group of peers — Canadian organizations in the pension fund and investment management industry, the financial-services industry and other similar industries appropriate for the positions being benchmarked. The main comparator group in fiscal year 2011 was comprised of the following pension funds: Alberta Investment Management Corporation, British Columbia Investment Management Corporation, *Caisse de dépôt et placement du Québec*, Canada Pension Plan Investment Board, Ontario Municipal Employees Retirement System and Ontario Teachers' Pension Plan. These organizations were selected based on three main criteria: the size of the assets under management, their business sector (pension fund investment) and the commonality of the talent pool.

In addition, 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, such as McLagan's Investment Management Survey, Towers Watson's Investment Management Compensation Survey, Mercer's Canadian Investment Management Compensation Survey, Executive, Management and Professionals Compensation Survey, and Information Technology Compensation Survey.

To remain competitive, PSP Investments strives to offer:

1. base salaries at the median of the comparator group;
2. incentive compensation with potential payouts superior to the median of the comparator group for superior performance; and
3. benefits that compare favourably to the comparator group.

On an annual basis, the Board of Directors ensures that PSP Investments' executive compensation is consistent with PSP Investments' Compensation Policy. In fiscal year 2011, the Board retained the services of an independent compensation consulting firm to recommend appropriate annual base-salary adjustments, as well as appropriate total compensation levels. The consulting firm also assisted in conducting a pay-for-performance review of PSP Investments' incentive compensation plans.

PRINCIPLES OF PSP INVESTMENTS' COMPENSATION FRAMEWORK

PSP Investments believes that its compensation framework should be driven by a pay-for-performance approach that:

- rewards long-term performance (see *Figure A below*);
- discourages short-term decision-making and undue risk-taking;
- establishes incentive compensation as the largest component of target total compensation for executives (see *Figure B* below); and
- ensures that total fund investment performance is a component of incentive compensation at all levels of PSP Investments, in order to encourage and reinforce the benefits of teamwork.

FIGURE A: SEVEN YEARS OF INVESTMENT PERFORMANCE ARE MEASURED BY THE STIP AND THE LTIP

Both the Short-Term Incentive Plan (the "STIP") and Long-Term Incentive Plan (the "LTIP") are built around rolling four-year periods spanning a total seven years of investment performance.

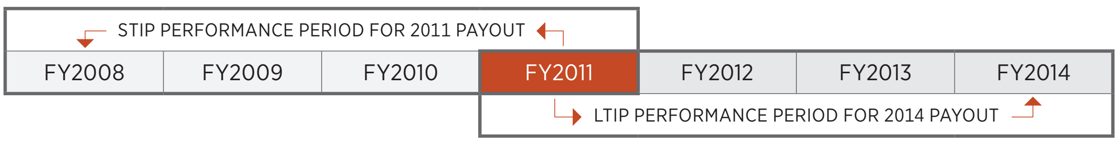


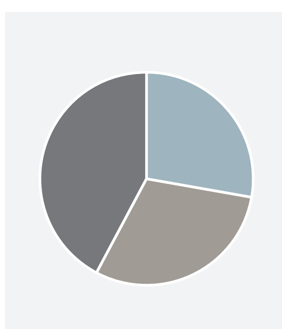
FIGURE B: COMPENSATION MIX OF TOTAL COMPENSATION FOR FISCAL YEAR 2011 (TARGET AWARDS)

Consistent with PSP Investments' pay-for-performance approach, total compensation for the President and Chief Executive Officer and for First Vice President (Investment) positions is constituted primarily of incentive compensation tied to the performance of PSP Investments and, where applicable, to the investment performance of a particular asset class.

PRESIDENT AND CHIEF EXECUTIVE OFFICER

(percent)

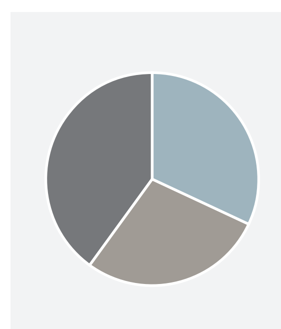
Base Salary	28
Short-term Incentive Compensation	30
Long-term Incentive Compensation	42



FIRST VICE PRESIDENT POSITIONS - INVESTMENT

(percent)

Base Salary	32
Short-term Incentive Compensation	28
Long-term Incentive Compensation	40



BASE SALARY

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

The annual budget for base salary increases in fiscal year 2011 was consistent with PSP Investments' comparator group and in accordance with the Compensation Policy.

INCENTIVE PLANS

In the course of fiscal year 2011, PSP Investments undertook a detailed review of its incentive plans to ensure that total compensation remained competitive with the main 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 independent compensation consulting firm.

The following plans comprise incentive compensation at PSP Investments:

1) A Short-Term Incentive Plan (STIP), to recognize performance results for the current year and the previous three years;
2) 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
3) A Restricted Fund Unit Plan (RFU), designed to help retain key employees.

SHORT-TERM INCENTIVE PLAN

PSP Investments' Short-Term Incentive Plan (the "STIP") became effective on April 1, 2008 and was amended, effective April 1, 2010.

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 with a target incentive award based on a percentage of base salary. At the beginning of each fiscal year, each participant in the STIP is advised of his or her short-term incentive target amount. The target incentive amount, the performance measures and the weighting given to each measure will vary according to the participant's position level. The target incentive amount is measured on the achievement of individual 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. Investment performance is measured against relative or absolute benchmarks (total fund, asset classes, portfolios) and thresholds below which no payments are made.

For the first four years of participation in the STIP, participants will go through a transition period building up to a rolling sequence of four consecutive years of performance. The investment performance measure is calculated on the current year as well as up to the three preceding years of investment performance, depending on the number of years an employee has participated in the STIP.

As of fiscal year 2011, the investment performance for each year is independently weighted. A greater weight is given to performance of the current year in order to more closely link contribution and rewards, while still taking into account the investment performance of the previous three years. Investment performance floors and maximum levels have also been introduced to the STIP calculation methodology, in order to ensure that the results of a single year's investment performance do not unduly impact the overall calculation.

The HRCC reviews the annual incentive compensation payment process to ensure that payments are calculated in accordance with the terms of the STIP. In addition, the Board of Directors approves the annual incentive compensation payable to officers of PSP Investments.

FISCAL YEAR 2011 PERFORMANCE

In fiscal year 2011, 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 to four years of participation.

The one-year investment performance of Real Estate, Private Equity and Public Markets was above incentive thresholds and, therefore, payouts were earned for eligible participants in these asset classes. The one-year asset class performance for Infrastructure was below threshold and generated no incentive payout for eligible participants.

The four-year performance was above threshold for Real Estate, Private Equity and Public markets and generated incentive payouts for eligible participants which was not the case for participants in Infrastructure over the same four-year period with a performance below threshold level.

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

The total incentive amount paid under the STIP was $18.8 million in fiscal year 2011 (317 employees), $8.8 million in fiscal year 2010 (293 employees), and $5.2 million in fiscal year 2009 (277 employees).

LONG-TERM INCENTIVE PLAN

PSP Investments' Long-Term Incentive Plan (the "LTIP") became effective on 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 holding senior positions, solely taking into account the achievement of investment performance on the assets managed by PSP Investments. It requires above-threshold performance over a four-year period before a payout is earned.

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 measured 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) for investment professionals, the investment performance of a particular asset class. The target incentive level, performance measures and the weighting given to each measure 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 (if applicable) the asset class actual value added exceeded the incentive thresholds. In addition, 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 or the asset class return, as the case may be, over the four-year period.

The HRCC reviews the long-term incentive compensation process to ensure 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 generated by the Long-Term Incentive Plan in fiscal year 2011, because the initial four-year cycle has not yet been completed. The first potential payments of LTIP will occur at the end of fiscal year 2012.

DEFERRED INCENTIVE PLAN

Until March 31, 2008, long-term incentive compensation awards were granted under the Deferred Incentive Plan (DIP), which used a three-year payout cycle. In order to compensate for the gap in the incentive opportunity between the DIP's payout cycle and the four-year payout cycle of the LTIP, a transitional DIP, which is ending with this year's payment, has been maintained for fiscal year 2009. Awards paid under the transitional DIP in fiscal year 2011 were calculated at the end of fiscal year 2009 and the payout was deferred for two years, in accordance with the plan provisions.

In addition, the Board of Directors, upon recommendation of the HRCC, has approved a discretionary incentive payment of $1.7 million which was paid to 21 employees. The decision of the Board aims at recognizing the essential contribution of Officers and key senior employees in creating value for the organization while the markets recovered from the recent economic downturn and ensuring an alignment of their four-year total compensation with comparable positions within PSP Investments' comparator group.

Incentive amounts paid under the transitional DIP were of $3.3 million in fiscal 2011, $2.0 million in fiscal year 2010 and of $3.0 million in fiscal year 2009. There will be no future payment made under the DIP or under the transitional DIP.

The HRCC is satisfied that the payouts were calculated in accordance with the terms of the DIP.

RESTRICTED FUND UNIT PLAN

PSP Investments' Restricted Fund Unit Plan (the "RFU") became effective on April 1, 2009.

Under the RFU Plan, grants of restricted fund units can be made to the President and Chief Executive Officer and, upon recommendation of the President and Chief Executive Officer, to other members of the senior management team. Grants may also be made to other key senior employees based on performance or market-related considerations. The HRCC reviews and approves the grants of restricted fund units. In addition, the Board of Directors approves grants to officers of PSP Investments.

The grants made under the RFU vest over a three-year period from the effective date of the grant. Given that it is performance-related, the annual amount paid is adjusted by the total fund rate of return for the period subsequent to the grant. Restricted Fund Units support the objective of retaining key individuals in the organization (see *Figure C* below).

FIGURE C: RESTRICTED FUND UNIT FRAMEWORK

In fiscal year 2011, the Restricted Fund Unit Plan was amended to allow for greater flexibility in allocating RFUs as deemed necessary by the Board of Directors and the HRCC.

The total incentive amount paid under the RFU in fiscal year 2011 was $2.5 million to recognize the contribution of key individuals to the performance of PSP Investments' results. The amount paid in fiscal year 2010 was $0.4 million.

GROUP INSURANCE BENEFITS

The Group Insurance Plan 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 the peer group.

OTHER REMUNERATION

PSP Investments' executives are provided with a perquisites allowance. In addition, PSP Investments offers its executives a health-and-lifestyle assessment.

RETIREMENT PLANS

All PSP Investments' eligible 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 post-retirement pension benefits for each year of participation, calculated using 2% of the participant's average of the best consecutive three years of salary.

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	7.5	$73,400	$191,700	$695,300	$60,800	$165,600	$921,700
John Valentini	6.0	$41,900	$156,100	$344,800	$40,900	$103,100	$488,800
Derek Murphy	7.1	$44,900	$116,100	$433,800	$41,400	$101,100	$576,300
Neil Cunningham	3.4	$18,600	$88,100	$134,400	$72,800	$45,700	$252,900
Bruno Guilmette	5.4	$29,700	$138,600	$196,600	$66,000	$70,000	$332,600

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, 2011.

4 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.

5 Includes employer service cost at the beginning of the year, the impact arising from the difference between actual pensionable earnings and those anticipated at the prior year-end and the impact of amendments to the pension plans if any.

6 Includes employee contributions and benefit payments made in the year, change in assumptions, non-pay-related experience and the interest cost for the year.

7 Accrued obligation using a discount rate of 5.4%. The obligations are calculated as at March 31, 2011 using the assumptions and methods that were used for the accounting disclosures as at December 31, 2010.

SUMMARY COMPENSATION TABLE

Total compensation paid to PSP Investments' five highest-paid officers in fiscal year 2011 totalled $8,809,249, an increase of $2,956,803 from the $5,852,446 reported in the 2010 annual report. The increase is mainly due to the strong performance of the total fund, Public Markets, Real Estate and Private Equity asset classes which triggered payments above target under the STIP.

Compensation paid during fiscal year 2011 to the five highest-paid officers of PSP Investments includes payment of amounts earned over the four-year period ended March 31, 2009, under the Deferred Incentive Plan and deferred for two years as per the terms of this plan.

Name	Fiscal Year	Base Salary	Short-term Incentive Plan	Deferred Incentive Plan	Restricted Fund Units	Benefits and Other Compensation	Pension and SERP Plans	Total Compensation
Gordon J. Fyfe	2011	$485,000	$1,276,763	$484,927	$292,238	$35,681	$60,800	$2,635,409
President and	2010	$485,000	$552,900	$37,280	$0	$35,768	$53,800	$1,164,748
Chief Executive Officer	2009	$485,000	$189,122	$611,100	n/a	$35,876	$98,500	$1,419,598
John Valentini	2011	$355,000	$744,415	$220,234	$189,219	$30,675	$40,900	$1,580,443
Executive Vice	2010	$355,000	$357,840	$0	$25,150	$130,667	$33,700	$902,357
President, Chief Operating Officer and Chief Financial Officer	2009	$342,250	$170,890	$207,653	n/a	$29,235	$85,900	$835,928
Derek Murphy	2011	$314,000	$716,772	$194,339	$243,278	$43,256	$41,400	$1,553,045
First Vice President,	2010	$314,000	$749,178	$400,851	$17,117	$25,619	$36,500	$1,543,265
Private Equity Investments	2009	$314,000	$117,762	$336,105	n/a	$25,668	$66,200	$859,735
Neil Cunningham	2011	$300,000	$605,996	$345,839	$175,465	$34,663	$72,800	$1,534,763
First Vice President,	2010	$260,000	$158,600	$555,153	$9,449	$25,710	$34,100	$1,043,012
Real Estate Investments	2009	$260,000	$180,760	$364,673	n/a	$25,660	$49,200	$880,293
Bruno Guilmette	2011	$300,000	$381,109	$549,448	$167,709	$41,323	$66,000	$1,505,589
First Vice President,	2010	$263,000	$501,151	$0	$14,337	$126,210	$20,200	$928,898
Infrastructure Investments	2009	$263,000	$310,941	$423,542	n/a	$24,748	$40,000	$1,062,231

LONG-TERM INCENTIVE PLAN AWARDS GRANTED FOR FISCAL YEAR 2011

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 Year 2011 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	$842,500	3 years	n/a	$842,500	$842,500
John Valentini	LTIP	$248,500	4 years	$0	$248,500	$621,250
	RFU	$464,250	3 years	n/a	$464,250	$464,250
Derek Murphy	LTIP	$282,600	4 years	$0	$282,600	$1,413,000
	RFU	$651,300	3 years	n/a	$651,300	$651,300
Neil Cunningham	LTIP	$270,000	4 years	$0	$270,000	$1,350,000
	RFU	$475,000	3 years	n/a	$475,000	$475,000
Bruno Guilmette	LTIP	$270,000	4 years	$0	$270,000	$1,350,000
	RFU	$435,000	3 years	n/a	$435,000	$435,000

1 Actual payouts will be adjusted upwards or downwards by PSP Investments' compounded 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 CUMULATIVE VALUE

The total cumulative value[1] as at March 31, 2011 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
		2012	2013	2014	
Gordon J. Fyfe	LTIP	$708,100	$1,193,100	$863,300	$2,764,500
	RFU	$458,905	$542,238	$333,333	$1,334,476
John Valentini	LTIP	$322,204	$611,310	$442,330	$1,375,844
	RFU	$254,844	$269,969	$153,125	$677,938
Derek Murphy	LTIP	$450,747	$649,980	$412,596	$1,513,323
	RFU	$339,278	$367,746	$192,000	$899,024
Neil Cunningham	LTIP	$170,820	$397,800	$502,200	$1,070,820
	RFU	$267,265	$302,383	$183,600	$753,248
Bruno Guilmette	LTIP	$252,086	$397,656	$240,300	$890,042
	RFU	$236,559	$266,099	$160,650	$663,308

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. RFUs' accumulated values reflect PSP Investments' total fund rate of return for fiscal years 2010 and 2011 but no returns for future years.

POST-EMPLOYMENT POLICIES

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 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
Gordon J. Fyfe	7.6 years	$2,363,563	$0
John Valentini	6.0 years	$1,011,750	$0
Derek Murphy	7.1 years	$894,900	$0
Neil Cunningham	6.8 years	$855,000	$0
Bruno Guilmette	5.4 years	$807,500	$0

[1] Assumes a notional termination as at March 31, 2011.

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

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 Chair of the York University Board of Governors, and serves on the Boards of Intact Financial Corporation and of ING Bank of Canada, where he is Chair of the Risk Oversight and Investment Committee. Mr. Cantor previously served as Chair & CEO of National Trust Company; President & CEO of Confederation Life; President, Investment Bank, CIBC; and Managing Partner of Russell Reynolds Associates Canada. Mr. Cantor was the founding Executive Director of the International Leadership Centre for Financial Sector Supervision. Earlier, he worked for the Government of Canada Department of Finance, Polysar Limited and World University Service of Canada.

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).

BOB BALDWIN
Consultant

MEMBER:
Governance Committee /
Human Resources and Compensation Committee /
Investment 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 Actuarial Standards Oversight Council of the Canadian Institute of Actuaries and chairs the Board of Trustees of the Canada Wide Industrial Pension Plan. A Senior Associate with Informetrica Limited, he is also a Policy Associate of the Caledon Institute of Social Policy. Mr. Baldwin holds a Master's Degree in Political Science from the University of Western Ontario.

CHERYL BARKER
Corporate Director

MEMBER:
Audit Committee /
Governance Committee – Chair /
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.

DIANE BEAN
Corporate Director

MEMBER:
Human Resources and Compensation Committee /
Investment Committee

Board member since June 18, 2010

Ms. Bean is a member of the Boards of Directors of Manulife International Limited (Asia), The Insurance Company of the West Indies, Roy Thomson Hall/Massey Hall and the Canada School of Public Service, and was founding Co-Chair of the Toronto Regional Immigration Employment Council. She was Executive Vice-President of Manulife Financial until her retirement in February 2011. For more than 30 years she served in senior management roles for its businesses in Canada, the United States and Asia, most recently as head of global human resources. Ms. Bean has a B.Comm. from the University of Toronto.

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, an associate professor at l'École des Hautes Études Commerciales 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:
Audit Committee /
Investment Committee – Chair

Board member since June 27, 2006

Mr. Gage is Vice Chair of the Board of Governors of the University of Victoria, 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 Committee /
Investment Committee

Board member since January 14, 2010

Ms. Haight recently 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 member of the Board of Directors and Chair of the Audit Committee of World Bank's Consortium of International Agricultural Research Centres and Green Shield Canada. She also sits on the Boards of the Bank of India (Canada) and Somerville College, Oxford University. She has served as a Trustee and Chair of the Audit Committee of the Ontario Arts Council, 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.

DIRECTORS' BIOGRAPHIES

WILLIAM A. MACKINNON
Corporate Director

MEMBER:
Audit Committee – Chair /
Investment Committee

Board member since January 14, 2010

Mr. MacKinnon is a member of the Boards of Directors of Telus, Pioneer Petroleum, Osisko Mining Corporation 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, Chair of the Board of the Canadian Institute of Chartered Accountants, and Chair of The Toronto East General Hospital Board. 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 /
Governance Committee

Board member since December 18, 2006

Mr. Mueller is Chairman of the Boards of The Scarborough Hospital and Annidis Corp., and a member of the Boards of AIM Therapeutics, Biovest Corp., Budco 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.

FINANCIAL STATEMENTS AND NOTES TO THE FINANCIAL STATEMENTS

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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 (SIP&P).

In this regard, investments of PSP Investments held during the year ended March 31, 2011, were in accordance with the Act and the SIP&P.

The Audit Committee ("the 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 "joint" auditors, the Office of the Auditor General of Canada and Deloitte & Touche LLP ("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.

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 Independent Auditors' Report. The External Auditors have full and unrestricted access to management and the 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 12, 2011

John Valentini
Executive Vice President,
Chief Operating Officer and Chief Financial Officer
May 12, 2011

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, 2011, were in accordance with the Act and PSP Investments' Statement of Investment Policies, Standards and Procedures".

Paul Cantor
Chairperson
May 12, 2011

PUBLIC SECTOR PENSION INVESTMENT BOARD

CONSOLIDATED

INDEPENDENT AUDITORS' REPORT

To the President of the Treasury Board

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated financial statements of the Public Sector Pension Investment Board (PSP Investments) and its subsidiaries, which comprise the consolidated balance sheet as at March 31, 2011, and the consolidated statement of net income from operations and comprehensive income and the consolidated statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of PSP Investments and its subsidiaries as at March 31, 2011, and the results of their operations and changes in their net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the *Financial Administration Act,* we report that, in our opinion, Canadian generally accepted accounting 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

May 12, 2011
Montreal, Canada

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

May 12, 2011
Ottawa, Canada

CONSOLIDATED BALANCE SHEET

As at March 31

($ millions)	**2011**	2010
ASSETS		
Investments (Note 3 (a))	**$ 60,872**	$ 48,182
Investment-related assets (Note 3 (a))	**1,475**	804
Cash	**4**	2
Other assets	**52**	47
TOTAL ASSETS	**$ 62,403**	$ 49,035
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 4,307**	$ 2,709
Accounts payable and other liabilities	**83**	56
TOTAL LIABILITIES	**$ 4,390**	$ 2,765
NET ASSETS	**$ 58,013**	$ 46,270
Share capital (Note 5)	**$ –**	$ –
Public Service Pension Plan Account	**42,299**	33,661
Canadian Forces Pension Plan Account	**11,289**	9,107
Royal Canadian Mounted Police Pension Plan Account	**4,102**	3,271
Reserve Force Pension Plan Account	**323**	231
NET ASSETS	**$ 58,013**	$ 46,270

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 Committee

CONSOLIDATED STATEMENT OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

For the years ended March 31

($ millions)	2011	2010
INVESTMENT INCOME (Note 7)	$ 7,043	$ 7,605
OPERATING EXPENSES (Note 8)	$ 114	$ 92
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME (NOTE 9)	$ 6,929	$ 7,513

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

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

For the years ended March 31

($ millions)	2011	2010
NET ASSETS, BEGINNING OF YEAR	$ 46,270	$ 33,777
Fund transfers (Note 6)	4,814	4,980
Net income from operations and comprehensive income	6,929	7,513
Increase in net assets for the year	11,743	12,493
NET ASSETS, END OF YEAR	$ 58,013	$ 46,270

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) is a Crown corporation created under the *Public Sector Pension Investment Board Act* ("the Act") to manage and invest amounts that are transferred to it, under the *Superannuation Acts*, by the funds (as defined in the Act) of the pension plans established under the *Public Service Superannuation Act*, the *Canadian Forces Superannuation Act* (CFSA), the *Royal Canadian Mounted Police Superannuation Act* (collectively "the *Superannuation Acts*"), and certain regulations under the CFSA ("the CFSA Regulations"). The pension plans established under the *Superannuation Acts* consist of the Public Service pension plan, the Canadian Forces pension plan, and the Royal Canadian Mounted Police pension plan, whereas the pension plan established under the CFSA Regulations is the Reserve Force pension plan. They are herein referred to individually as "the Plan" and collectively as "the Plans".

The funds from which amounts are currently transferred to PSP Investments (individually "the Fund" and collectively "the Funds") relate to pension obligations under the Plans for service on or after April 1, 2000 except, in the case of the Reserve Force Plan, they relate to service on or after March 1, 2007. The accounts managed by PSP Investments for the Funds are herein referred to individually as "the Plan Account" and collectively as "the Plan Accounts".

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, having regard to the funding, policies and requirements of the Plans and the ability of the Plans to meet their financial obligations.

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 Funds. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of all the Funds. The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). 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 of the Funds' 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 are 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 carried 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.

At trade date, the best evidence of fair value is the transaction price. At each subsequent reporting period-end, market prices are used to determine fair value where an active market exists (such as a recognized securities exchange), as they reflect actual and regularly occurring market transactions on an arm's length basis. If quoted market prices are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the end of the reporting year that are derived from observable market data.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

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).

VALUATION OF CAPITAL DEBT FINANCING

PSP Investments' short-term capital debt financing is recorded at cost plus accrued interest, which approximate 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 by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment. 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).

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 or payable on securities sold short are reflected as dividend expense. Other income includes securities lending income (net of fees on securities borrowed), and Private Market Investments' distributions from pooled funds, limited partnerships or from direct investments and co-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 period-end date. The resulting realized and unrealized gains (losses) on foreign exchange are included in investment income (loss).

FUND TRANSFERS

Amounts received from the Funds 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 makes certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of Private Market Investments, ABTNs, OTC 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, 2011

2. FUTURE CHANGES IN ACCOUNTING POLICIES

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises would converge with International Financial Reporting Standards (IFRS) effective January 1, 2011.

In April 2010, the AcSB issued an exposure draft that proposed a scope expansion to Section 4600 "Pension Plans" 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 do not themselves have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments and would continue to account for and report its investments at fair value.

Concurrent with the aforementioned standard-setting activities in Canada, the International Accounting Standards Board (IASB) had announced that it intended to propose that investment companies be exempt from consolidation and should account for their controlled investments at fair value.

In light of the announcement from the IASB, the AcSB announced in June 2010 that it had decided not to proceed with the scope expansion of Section 4600, but that it would reconsider this need once the IASB finalizes its standard.

In January 2011, the AcSB decided to defer the adoption of IFRS by investment companies, currently applying AcG-18 to annual periods starting on or after January 1, 2013. This deferral delays PSP Investments' transition to IFRS until the March 31, 2014 annual consolidated financial statements. PSP Investments will finalize its assessment of the impact of its transition to IFRS once the investment company standard is issued.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 was as follows as at March 31:

($ millions)

	2011		2010	
Asset Class	**Fair Value**	**Cost**	Fair Value	Cost
World Equity				
Canadian Equity	**$ 14,135**	**$ 11,603**	$ 10,336	$ 9,099
Foreign Equity:				
US Large Cap Equity	**3,881**	**3,552**	2,134	2,057
EAFE Large Cap Equity	**3,087**	**3,228**	2,065	2,372
Small Cap Developed World Equity	**3,182**	**2,683**	1,953	1,814
Emerging Markets Equity	**2,827**	**2,382**	2,516	2,249
Private Equity	**5,479**	**4,777**	5,220	5,585
Nominal Fixed Income				
Cash, Cash Equivalents & Other [1]	**4,401**	**4,537**	4,615	4,749
World Government & Corporate Bonds	**2,855**	**2,959**	1,084	1,157
Canadian Fixed Income	**6,786**	**6,478**	7,033	6,846
Real Return Assets				
World Inflation-Linked Bonds	**2,981**	**3,066**	334	350
Real Estate	**6,635**	**6,434**	6,120	6,159
Infrastructure	**2,706**	**2,934**	2,358	2,420
Absolute Return	**1,917**	**1,369**	2,414	2,243
INVESTMENTS	**$ 60,872**	**$ 56,002**	$ 48,182	$ 47,100
Investment-Related Assets				
Amounts receivable from pending trades	**$ 697**	**$ 697**	$ 164	$ 164
Interest receivable	**140**	**140**	105	105
Dividends receivable	**50**	**50**	57	57
Derivative-related receivables	**588**	**28**	478	6
Total Investment-Related Assets	**$ 1,475**	**$ 915**	$ 804	$ 332
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (1,084)**	**$ (1,084)**	$ (458)	$ (458)
Interest payable	**(21)**	**(21)**	(14)	(14)
Securities sold short	**(43)**	**(37)**	(114)	(131)
Securities sold under repurchase agreements	**(511)**	**(511)**	–	–
Derivative-related payables	**(198)**	**(24)**	(415)	(3)
Capital debt financing:				
Short-term	**(702)**	**(702)**	(649)	(649)
Long-term	**(1,748)**	**(1,709)**	(1,059)	(1,010)
Total Investment-Related Liabilities	**$ (4,307)**	**$ (4,088)**	$ (2,709)	$ (2,265)
NET INVESTMENTS	**$ 58,040**	**$ 52,829**	$ 46,277	$ 45,167

[1] Includes floating rate notes with maturities greater than one year with a fair value of $1,255 million (2010 – $1,396 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 and co-investments in companies as well as fund investments. They include investments in various private entities as well as mezzanine debt and distressed debt.

The Real Estate asset class is comprised of direct investments in various private entities, properties and third-party debts, as well as 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, partnerships and companies operating in the office, retail, industrial, hospitality and residential sectors, as well as private funds 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, other structured finance products as well as real estate debt funds (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, 2011, the total amount of third-party financing included in the Real Estate asset class contracted by direct investments controlled by PSP Investments was $2,113 million (2010 – $2,130 million).

The Infrastructure asset class is comprised of direct investments and co-investments in various private entities and fund investments. They include investments in companies engaged in the management, ownership or operation of assets in power, transportation and other regulated businesses. The Infrastructure asset class is accounted for net of all third-party financings. As at March 31, 2011, the total amount of third-party financing included in the Infrastructure asset class contracted by direct investments controlled by PSP Investments was $51 million (2010 – $79 million).

Valuation Techniques

The fair value of Private Market Investments is determined at least annually, using acceptable industry valuation methods. During the year, the fair value is reviewed and adjusted, as appropriate, to reflect the impact of any significant market or investment-specific events or circumstances. For each investment, the relevant methodology is applied consistently over time as appropriate in the prevailing circumstances.

In cases where the services of third-party appraisers are used, 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 direct investments and co-investments in Infrastructure, valuation methods used include discounted cash flows, 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

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, prices of recent comparable transactions and the direct capitalization approach. 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, Infrastructure fund investments as well as Private Equity co-investments, the annual 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 & Other, World Government & Corporate Bonds and Canadian Fixed Income. Cash Equivalents include short-term instruments having a maximum term to maturity of one year. Floating rate notes are included in Cash, Cash Equivalents & Other, provided the final maturity date does not exceed three years and the coupons reset more than once per year. World Government & Corporate Bonds and Canadian Fixed Income include government bonds, provincial and territorial bonds, municipal bonds and corporate 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.

PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs. As at March 31, 2011, the margin funding facilities have not been drawn upon since inception. The agreement to exchange the non-bank ABCP for ABTNs included a moratorium preventing collateral calls for an 18-month period that ended on July 16, 2010.

Management's best estimate of the fair value of PSP Investments' ABTNs as at March 31, 2011 was equal to $1,242 million (2010 – $1,185 million). This amount was net of principal repayments and corresponding gains, together amounting to $57 million for the year ended March 31, 2011 (for the year ended March 31, 2010 – $146 million). PSP Investments recorded an increase of $74 million in the fair value of the ABTNs during the year ended March 31, 2011 (increase of $198 million during the year ended March 31, 2010). The ABTNs' fair value was reduced by the impact of the funding facilities amounting to $57 million as at March 31, 2011 (2010 – $65 million).

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, expected returns, an average maturity of six years as well as liquidity estimates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 that consist of externally managed investments. Such investments take advantage of specific opportunities aimed to perform positively irrespective of market performance. Such opportunities include investments in equity, fixed income and derivative instruments.

Valuation Techniques

The fair value of these investments is obtained from the investment's external manager and reflects the fair value of the underlying equity, fixed income or derivative instruments.

(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 year.

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 year.

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) Interest & Dividends Receivable

Interest and dividends are recorded at the amounts expected to be received as at the reporting date.

(vii) Interest Payable

Interest accrued is recorded at the amount expected to be paid as at the reporting date.

(viii) 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.

(ix) Securities Sold under Repurchase Agreements

PSP Investments is party to agreements which involve the sale of securities with a simultaneous agreement to repurchase such securities at a specified price and specified future date.

Securities sold under the repurchase agreements are not derecognized as PSP Investments retains all related risks and rewards of ownership. As such, all related income (loss) continues to be reported in Investment Income (Loss).

Obligations to repurchase the securities sold are accounted for as Investment-Related Liabilities. Interest expense related to such obligations is reported in Investment Income (Loss).

Valuation Techniques

Obligations to repurchase the securities sold under repurchase agreements are recorded at cost plus accrued interest, which approximate fair value.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date, the value of which is derived from changes in underlying assets, interest or exchange rates. Derivative financial instruments do not, typically, require an initial net investment. In certain cases, they require an initial net investment that is less than what would be required to hold the underlying position directly. PSP Investments uses derivative financial instruments to enhance 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:

(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 CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 is 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 to purchase 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. 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. Although pricing models used are widely accepted and used by other market participants, in the case of collaterized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

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. Except for credit derivatives[1], notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions disclosed below. 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)

	2011				2010			
		Fair Value				Fair Value		
INVESTMENTS	Notional Value	Assets	Liabilities	Net	Notional Value	Assets	Liabilities	Net
Equity and Commodity Derivatives								
Futures	$ 430	$ –	$ –	$ –	$ 113	$ –	$ –	$ –
Total Return Swaps	5,541	191	–	191	3,524	116	(1)	115
Warrants and Rights	2	2	–	2	1	1	–	1
Options: Listed-purchased	442	12	–	12	–	–	–	–
Listed-written	395	–	(19)	(19)	5	–	–	–
Currency Derivatives								
Forwards	17,101	316	(121)	195	10,183	310	(28)	282
Swaps	1,673	24	(11)	13	–	–	–	–
Options: OTC-purchased	1,010	6	–	6	654	4	–	4
OTC-written	183	–	(2)	(2)	171	–	(1)	(1)
Interest Rate Derivatives								
Bond Forwards	993	5	(3)	2	206	–	(2)	(2)
Futures	1,770	–	–	–	522	–	–	–
Interest Rate Swaps	17,546	14	(17)	(3)	3,904	24	(38)	(14)
Total Return Swaps	646	–	–	–	2,811	19	(14)	5
Swaptions	3,522	6	(3)	3	–	–	–	–
Options: Listed-purchased	5,347	7	–	7	425	–	–	–
Listed-written	7,512	–	(7)	(7)	1,165	–	–	–
Credit Derivatives[1]:								
Purchased	418	3	(4)	(1)	28	1	–	1
Sold	409	2	(11)	(9)	744	3	(331)	(328)
Total	$ 64,940	$ 588	$ (198)	$ 390	$ 24,456	$ 478	$ (415)	$ 63

[1] Credit derivatives include credit default swaps and collateralized debt obligations. 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, 2011

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives was as follows as at March 31, 2011:

($ millions)

Less than 3 months	$ 24,155
3 to 12 months	37,197
Over 1 year	3,588
Total	**$ 64,940**

(C) FAIR VALUE MEASUREMENT

Investments, investment-related assets and investment-related liabilities 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 assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities 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 assets or liabilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2011:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 24,974	$ 2,138	$ –	$ –	$ 27,112
Private Equity	–	–	5,479	–	5,479
Nominal Fixed Income	583	12,058	1,401	–	14,042
Real Return Assets					
World Inflation-Linked Bonds	–	2,981	–	–	2,981
Real Estate	–	–	6,635	–	6,635
Infrastructure	–	–	2,706	–	2,706
Absolute Return	–	1,114	803	–	1,917
INVESTMENTS	$ 25,557	$ 18,291	$ 17,024	$ –	$ 60,872
Investment-Related Assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 697	$ 697
Interest receivable[1]	–	–	–	140	140
Dividends receivable[1]	–	–	–	50	50
Derivative-related receivables	20	566	2	–	588
Total Investment-Related Assets	$ 20	$ 566	$ 2	$ 887	$ 1,475
Investment-Related Liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (1,084)	$ (1,084)
Interest payable[1]	–	–	–	(21)	(21)
Securities sold short	(43)	–	–	–	(43)
Securities sold under repurchase agreements	–	(511)	–	–	(511)
Derivative-related payables	(27)	(161)	(10)	–	(198)
Capital debt financing:					
Short-term	–	(702)	–	–	(702)
Long-term	–	(1,748)	–	–	(1,748)
Total Investment-Related Liabilities	$ (70)	$ (3,122)	$ (10)	$ (1,105)	$ (4,307)
NET INVESTMENTS	$ 25,507	$ 15,735	$ 17,016	$ (218)	$ 58,040

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2010:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 17,597	$ 1,407	$ –	$ –	$ 19,004
Private Equity	–	–	5,220	–	5,220
Nominal Fixed Income	121	11,326	1,285	–	12,732
Real Return Assets					
World Inflation-Linked Bonds	–	334	–	–	334
Real Estate	–	–	6,120	–	6,120
Infrastructure	–	–	2,358	–	2,358
Absolute Return	–	1,239	1,175	–	2,414
INVESTMENTS	$ 17,718	$ 14,306	$ 16,158	$ –	$ 48,182
Investment-Related Assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 164	$ 164
Interest receivable[1]	–	–	–	105	105
Dividends receivable[1]	–	–	–	57	57
Derivative-related receivables	–	473	5	–	478
Total Investment-Related Assets	$ –	$ 473	$ 5	$ 326	$ 804
Investment-Related Liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (458)	$ (458)
Interest payable[1]	–	–	–	(14)	(14)
Securities sold short	(114)	–	–	–	(114)
Derivative-related payables	–	(84)	(331)	–	(415)
Capital debt financing:					
Short-term	–	(649)	–	–	(649)
Long-term	–	(1,059)	–	–	(1,059)
Total Investment-Related Liabilities	$ (114)	$ (1,792)	$ (331)	$ (472)	$ (2,709)
NET INVESTMENTS	$ 17,604	$ 12,987	$ 15,832	$ (146)	$ 46,277

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The classification within the levels of the hierarchy is established at the time of the initial valuation of the asset or liability and reviewed on each subsequent reporting period-end.

There were no significant transfers between Level 1 and Level 2 during the year ended March 31, 2011 (no significant transfers during the year ended March 31, 2010).

Level 3 Reconciliation

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2011:

($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/payables (net)	Total
Opening Balance	$ 5,220	$ 1,285	$ 8,478	$ 1,175	$ (326)	$ 15,832
Purchases	1,043	72	1,967	59	251	3,392
Sales/Settlements	(1,577)	(28)	(1,272)	(575)	(4)	(3,456)
Total gains	809	72	168	144	71	1,264
Transfer out of Level 3	(16)	–	–	–	–	(16)
Closing Balance	$ 5,479	$ 1,401	$ 9,341	$ 803	$ (8)	$ 17,016

Total gains, for the year ended March 31, 2011, included in investment income and categorized within Level 3, are presented as follows:

($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/payables (net)	Total
Total realized gains (losses)	$ (217)	$ 1	$ 113	$ (41)	$ (247)	$ (391)
Total unrealized gains	$ 1,026	$ 71	$ 55	$ 185	$ 318	$ 1,655
Total gains	$ 809	$ 72	$ 168	$ 144	$ 71	$ 1,264

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation (continued)

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities 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	$ 4,241	$ 1,127	$ 9,800	$ 682	$ (1,223)	$ 14,627
Purchases	989	–	824	269	1	2,083
Sales/Settlements	(418)	(67)	(996)	(8)	–	(1,489)
Total gains (losses)	408	225	(1,150)	232	896	611
Transfers into or out of Level 3	–	–	–	–	–	–
Closing Balance	$ 5,220	$ 1,285	$ 8,478	$ 1,175	$ (326)	$ 15,832

Total gains (losses), for the year ended March 31, 2010, included in investment income and categorized within Level 3, are presented as follows:

($ millions)	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)	$ 365	$ 209	$ (1,178)	$ 232	$ 897	$ 525
Total gains (losses)	$ 408	$ 225	$ (1,150)	$ 232	$ 896	$ 611

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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 2% increase/decrease (2010 – 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).

(D) INVESTMENT ASSET MIX

The SIP&P sets out the long-term target weights of the assets that will 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 were as follows as at March 31:

	2011			2010		
($ millions)	Fair Value		Policy Portfolio Long-Term Target	Fair Value		Policy Portfolio Long-Term Target
World Equity						
Canadian Equity	$ 18,665	32.2%	30.0%	$ 13,547	29.2%	30.0%
Foreign Equity:						
US Large Cap Equity	3,829	6.6	5.0	2,111	4.6	5.0
EAFE Large Cap Equity	3,052	5.2	5.0	2,043	4.4	5.0
Small Cap Developed World Equity	3,221	5.5	5.0	1,977	4.3	5.0
Emerging Markets Equity	4,062	7.0	7.0	2,987	6.5	7.0
Private Equity	5,582	9.6	10.0	5,426	11.7	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	1,254	2.2	2.0	1,892	4.1	2.0
World Government Bonds	2,298	4.0	5.0	2,128	4.6	5.0
Canadian Fixed Income	5,387	9.3	8.0	4,830	10.4	8.0
Real Return Assets						
World Inflation-Linked Bonds	3,022	5.2	5.0	2,145	4.6	5.0
Real Estate	5,312	9.1	10.0	5,118	11.1	10.0
Infrastructure	2,356	4.1	8.0	2,073	4.5	8.0
NET INVESTMENTS	$ 58,040	100.0%	100.0%	$ 46,277	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, 2011

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. Lending and borrowing transactions under such programs do not transfer the risks or rewards of ownership of the securities to the counterparty. Consequently, PSP Investments does not derecognize securities lent or recognize securities borrowed.

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. PSP Investments and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at March 31, 2011, PSP Investments has re-invested $1,498 million of collateral held (2010 – $1,770 million).

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)	2011	2010
Securities Lending		
Securities lent	$ 5,775	$ 4,005
Collateral contractually receivable[1]	6,041	4,179
Securities Borrowing		
Securities borrowed	43	114
Collateral contractually payable[2]	46	119

[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.

(F) SECURITIES SOLD & COLLATERAL PLEDGED UNDER REPURCHASE AGREEMENTS

Securities sold under repurchase agreements are described in Note 3 (a) (ix) and involve pledging collateral consisting of cash or securities deemed acceptable by the counterparties. Collateral transactions are conducted under terms that are usual and customary in standard repurchase arrangements. Such terms require the respective counterparty to pledge additional collateral based on the changes in the fair value of the existing collateral pledged. The counterparties are authorized to sell, repledge or otherwise use collateral held. The securities pledged as collateral must be returned to the respective counterparty at the end of the contract, unless an event of default occurs. PSP Investments does not sell, repledge or otherwise use collateral held.

PSP Investments pledged collateral under the repurchase agreements with a fair value of $511 million at March 31, 2011 (2010 – nil).

4. INVESTMENT RISK MANAGEMENT

Risk Management is a central part of PSP Investments' operations. Included in the overall risk management framework is a continuous process whereby PSP Investments systematically addresses the investment risks related to its various investment activities with the goal of achieving a maximum rate of return without undue risk of loss.

A risk governance framework that includes required reporting on risk to all levels of the organization ensures that appropriate investment objectives are pursued and achieved in line with the fulfillment of PSP Investments' legislated mandate. The Board of Directors and its committees oversee all risk matters and receive assurances from senior management, including the Chief Risk Officer, as well as PSP Investments' independent internal auditor reporting directly to the Audit Committee.

PSP Investments has adopted an Investment Risk Management Policy which is an integral part of its risk control system and supplements the SIP&P. The objective of this policy is to provide a framework to manage the risks that PSP Investments is exposed to, namely market, credit and liquidity risks.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(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.

Market risk management focuses on the following two key components:

– Policy Portfolio

The Policy Portfolio (long-term asset mix), as defined in the SIP&P, determines a diversification strategy to mitigate risk whereby PSP Investments invests in a diversified portfolio expected to achieve a return at least equal to the Actuarial Rate of Return (ARR); defined as the rate of return assumption used by the Chief Actuary of Canada in the latest actuarial valuation reports of the Plans. In the absence of other factors affecting the funding of the Plans or changes to pension benefits under the Plans, the ARR is the rate of return required to maintain funding requirements and pension benefits at their current levels.

– Active Management

Active management is defined as the sum of investment strategies that deviate from the approved Policy Portfolio. It is designed to supplement the returns of the Policy Portfolio within an active risk budget.

The risks associated with these components are the Policy Portfolio market risk and the active risk. The Policy Portfolio market risk represents the investment risk arising from the exposure to approved asset classes in the approved weightings. In establishing its Policy Portfolio, PSP Investments also takes into consideration the impact of the Policy Portfolio market risk on the funding risk. The funding risk is the risk that the assets under management will be insufficient to meet the relevant pension liabilities of the Plans. The Policy Portfolio is reviewed at least annually as part of the review of the SIP&P, and this review includes changes, if any, to PSP Investments' long-term expectations of market conditions and other factors that may affect the funding levels of the Plans.

Active risk refers to all market risk arising from active management activities. It is managed in accordance with the Investment Risk Management Policy.

Measurement of Market Risk

The Value-at-Risk (VaR) is one of the methods used to measure market risk and is reported on a quarterly basis. It is not the maximum potential loss, but rather the maximum loss not exceeded with a given confidence level, over a given period of time. PSP Investments uses a Historical VaR model incorporating ten years' worth of market returns scaled to a twelve-month holding period at a 95% confidence level. In measuring Policy Portfolio risk, VaR represents the absolute loss expected from the Policy Portfolio (Policy Portfolio VaR). Whereas in terms of measuring the active risk, VaR reflects the loss relative to the Policy Portfolio benchmark (Active VaR).

VaR is statistically valid under normal market conditions and does not specifically consider losses from severe market events. It also assumes that the future will behave in a pattern similar to the past. Consequently, if future market conditions differ significantly from those of the past, potential losses may differ from those originally estimated.

The following table shows the Total VaR consisting of the Policy Portfolio VaR, the Active VaR and the diversification effect, calculated as a percentage of net investments, as at March 31. The diversification effect captures the impact of holding different types of assets which may react differently in various types of situations and thus reduces the Total VaR.

	2011	2010
Policy Portfolio VaR	**22.4%**	21.2%
Active VaR	**2.2**	1.8
Total VaR (Undiversified)	**24.6**	23.0
Diversification Effect	**(2.9)**	(2.0)
Total VaR	**21.7%**	21.0%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Stress Testing

Although VaR is a widely accepted risk measure, it is complemented by other risk measurement methodologies that provide greater insight on market risk. PSP Investments 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 reacts under such circumstances. Stress testing and scenario analysis are also deployed to assess new product performance.

(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 were as follows as at March 31, 2011:

	Terms to Maturity				
($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Total
Government of Canada bonds	$ 25	$ 1,149	$ 58	$ 472	$ 1,704
Provincial and Territorial bonds	116	453	709	414	1,692
Municipal bonds	11	41	42	6	100
Corporate bonds	131	907	661	349	2,048
ABTNs	–	48	1,194	–	1,242
Total Canadian Fixed Income	**$ 283**	**$ 2,598**	**$ 2,664**	**$ 1,241**	**$ 6,786**
Total World Government & Corporate Bonds	**$ 795**	**$ 1,035**	**$ 468**	**$ 557**	**$ 2,855**
Total World Inflation-Linked Bonds	**$ –**	**$ 797**	**$ 831**	**$ 1,353**	**$ 2,981**
Real Estate Debt [1]	**$ 222**	**$ 72**	**$ –**	**$ –**	**$ 294**
Grand Total	**$ 1,300**	**$ 4,502**	**$ 3,963**	**$ 3,151**	**$ 12,916**

[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 is not significant due to their short-term nature.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 or cross currency swaps, positions in foreign currencies. PSP Investments' policy is to hedge a target of 50% of its foreign currency investments. Additional factors are considered when implementing the hedging target for investments in emerging countries, namely, total relative exposure and cost effectiveness.

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 were as follows as at March 31:

Currency (in millions of Canadian $)	2011 Fair Value	2011 % of Total	2010 Fair Value	2010 % of Total
US Dollar	**$ 9,493**	**54.0%**	$ 6,276	51.2%
Euro	**2,385**	**13.6**	1,815	14.8
British Pound	**1,331**	**7.6**	778	6.4
Brazilian Real	**881**	**5.0**	669	5.5
Japanese Yen	**708**	**4.0**	429	3.5
Hong Kong Dollar	**664**	**3.8**	506	4.1
Korean Won	**470**	**2.7**	351	2.9
Australian Dollar	**306**	**1.7**	151	1.2
New Taiwan Dollar	**281**	**1.6**	200	1.6
South African Rand	**168**	**1.0**	157	1.3
Others	**874**	**5.0**	917	7.5
Total	**$ 17,561**	**100.0%**	$ 12,249	100.0%

PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $3,983 million ($3,534 million US, €370 million and R243 million South African Rands) which were not included in the foreign currency exposure table.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 that the counterparty to a derivative contract, to a securities lending and borrowing transaction or to securities sold under repurchase agreements, 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 and counterparty that transacts with PSP Investments. 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. Except for ABTNs, 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 was as follows as at March 31:

	2011	2010
Investment grade (AAA to BBB–)	**98.0%**	98.1%
Below investment grade (BB+ and below)	**0.4**	0.2
Not rated:		
Rated by a single credit rating agency	**–**	0.2
Not rated by credit rating agencies	**1.6**	1.5
Total	**100.0%**	100.0%

The breakdown of credit concentration risk for PSP Investments did not include investments in distressed debt included in pooled funds in the amount of approximately $2 billion as at March 31, 2011 (2010 – approximately $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, 2011, PSP Investments also had a net notional exposure of $261 million (2010 – $614 million) to various tranches of collateralized debt obligations, of which approximately 44% (2010 – approximately 64%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities of a maximum amount of $969 million (2010 – $969 million) to support potential margin calls on the ABTNs (Note 3 (a) (iii)).

As at March 31, 2011, PSP Investments' maximum exposure to credit risk, excluding collateral held and the investments in distressed debt and collateralized debt obligations described above, amounted to approximately $16 billion (2010 – approximately $13 billion). This amount also excludes the impact of guarantees and indemnities disclosed in Note 12.

(i) Counterparty Risk

Counterparty risk represents the credit risk from current and potential exposure related to transactions involving derivative contracts, securities lending and borrowing as well as securities sold under repurchase agreements. In order to minimize 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. With respect to derivative contracts, PSP Investments has the ability to terminate all trades with most counterparties who have their credit rating downgraded below "A–" subsequent to the trade date.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSP Investments to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. PSP Investments did not deposit nor did it pledge any securities as collateral with respect to derivative contracts at March 31, 2011 (2010 – $208 million). All collateral deposited or pledged was held, in the prior fiscal year, with counterparties having a minimum credit rating of "A–". Securities with a fair value of $137 million were received from counterparties as collateral at March 31, 2011 (2010 – $177 million). PSP Investments does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

With respect to transactions involving securities lending and borrowing as well as securities sold under repurchase agreements, collateral requirements are in place to mitigate counterparty risk. Notes 3 (e) and 3 (f) describe collateral requirements in securities lending and borrowing programs as well as securities sold under repurchase agreements, respectively.

In the case of the securities lending program, PSP Investments' exposure to counterparty risk is further mitigated as the custodian of the securities lent assumes the risk that a counterparty will be unable to meet its obligations associated with the collateral requirements.

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 and Treasury utilize 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 are disclosed in Note 3 (b).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

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, 2011:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities [1]				
Amounts payable from pending trades	$ (1,084)	$ –	$ –	$ (1,084)
Interest payable	–	(21)	–	(21)
Securities sold short	(43)	–	–	(43)
Securities sold under repurchase agreements	(511)	–	–	(511)
Capital debt financing	(573)	(129)	(1,748)	(2,450)
Accounts payable and other liabilities	(61)	(4)	(18)	(83)
Total	$ (2,272)	$ (154)	$ (1,766)	$ (4,192)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial assets and liabilities				
Derivative-related assets	$ 239	$ 339	$ 10	$ 588
Derivative-related liabilities [1]	(129)	(47)	(22)	(198)
Total	$ 110	$ 292	$ (12)	$ 390

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

5. SHARE CAPITAL

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

6. FUND TRANSFERS

PSP Investments received fund transfers of $4,814 million for the year ended March 31, 2011 (2010 – $4,980 million) from the Funds.

The breakdown of the fund transfers, for the years ended March 31, was as follows:

($ millions)	2011	2010
Public Service Pension Fund	$ 3,591	$ 3,707
Canadian Forces Pension Fund	828	866
Royal Canadian Mounted Police Pension Fund	341	323
Reserve Force Pension Fund	54	84
Total	**$ 4,814**	$ 4,980

7. INVESTMENT INCOME

(A) INVESTMENT INCOME

Investment income, for the years ended March 31, was as follows:

($ millions)	2011	2010
Interest income	$ 513	$ 409
Dividend income	601	408
Other income	182	214
Dividend expense	(19)	(22)
Interest expense (Note 10)	(61)	(53)
Transaction costs	(57)	(21)
External investment management fees [1]	(39)	(33)
	1,120	902
Net realized gains [2]	1,822	1,526
Net unrealized gains	4,101	5,177
Investment Income	**$ 7,043**	$ 7,605

[1] Includes amounts incurred for public market investments that are paid directly by PSP Investments (Note 1). This excludes certain public market pooled fund investment fees, primarily related to performance, in the amount of $84 million for the year ended March 31, 2011 (2010 – $11 million) as well as Private Market Investments' management fees that are not paid directly by PSP Investments.

Private Market Investments' management fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, amounted to $140 million for the year ended March 31, 2011 (2010 – $152 million).

[2] Includes foreign currency gains of $114 million for the year ended March 31, 2011 (2010 – $621 million).

(B) INVESTMENT INCOME BY ASSET MIX

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

($ millions)	2011	2010
World Equity		
Canadian Equity	$ 3,031	$ 3,690
Foreign Equity:		
US Large Cap Equity	299	247
EAFE Large Cap Equity	172	251
Small Cap Developed World Equity	486	282
Emerging Markets Equity	451	1,013
Private Equity	1,041	1,211
Nominal Fixed Income		
Cash & Cash Equivalents	21	45
World Government Bonds	45	(345)
Canadian Fixed Income	243	195
Real Return Assets		
World Inflation-Linked Bonds	86	(253)
Real Estate	641	28
Infrastructure	(46)	158
Absolute Return [1]	573	1,083
Investment Income	**$ 7,043**	$ 7,605

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

8. OPERATING EXPENSES

Operating expenses consisted of the following for the years ended March 31:

($ thousands)	2011	2010
Salaries and benefits	$ 70,134	$ 53,434
Professional and consulting fees	8,066	9,289
Office supplies and equipment	12,593	11,215
Other operating expenses	4,893	4,201
Depreciation of fixed assets	9,841	7,093
Occupancy costs	4,804	4,323
Custodial fees	2,365	1,556
Remuneration earned by Directors	763	794
Travel and related expenses for Directors	189	316
Communication expenses	197	175
Total	$ 113,845	$ 92,396

Professional and consulting fees paid or accrued to the external auditors include audit fees of $461 thousand (2010 – $470 thousand), audit-related fees of $681 thousand (2010 – $145 thousand) and non-audit fees of $498 thousand (2010 – $258 thousand). PSP Investments employed externally contracted internal auditors in 2010 and paid audit fees of $470 thousand and non-audit fees of $157 thousand. In 2011, the internal audit function was repatriated and, as a result, no such amounts were incurred.

9. ALLOCATION OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

The net income from operations and comprehensive income of PSP Investments is allocated to each Plan Account as follows:

(A) INVESTMENT INCOME

The investment income 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 Plan Accounts 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 was 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 years ended March 31, were allocated in proportion to the annual amount of net assets in each Plan Account as follows:

	2011	2010
Public Service Pension Plan Account	72.7%	72.5%
Canadian Forces Pension Plan Account	19.7	20.0
Royal Canadian Mounted Police Pension Plan Account	7.1	7.2
Reserve Force Pension Plan Account	0.5	0.3
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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

10. CAPITAL DEBT FINANCING

PSP Investments' Capital Debt Financing program consists of the private placement of short-term promissory notes as well as medium-term notes issued by PSP Capital Inc., a wholly-owned subsidiary of PSP Investments. The capital raised is primarily used to finance investments in the Real Estate and Infrastructure asset classes. It is unconditionally and irrevocably guaranteed by PSP Investments in accordance with its corporate leverage policy.

During the year ended March 31, 2011, the Board of Directors amended the maximum amount authorized for the Capital Debt Financing program. Pursuant to such amendment, as at March 31, 2011, the maximum amount authorized was 7.5% of the net investments plus all recourse debt outstanding of PSP Investments. Within such amount, the short-term promissory note component cannot exceed $3 billion. As at March 31, 2010, the maximum amount authorized by the Board of Directors for the short-term promissory notes and medium-term notes was $2 billion and $2 billion, respectively.

The following outlines the terms as well as the fair value of the notes issued under the Capital Debt Financing program as at March 31:

($ millions)	2011	2010
Short-term promissory notes, bearing interest between 1% and 1.39% and maturing within 29 and 363 days of issuance (March 31, 2010 – 14 and 120 days)	**$ 702**	$ 649
Medium-term notes Series 1, bearing interest of 4.57% per annum and maturing on December 9, 2013	**$ 1,056**	$ 1,059
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**$ 692**	$ –
Total	**$ 2,450**	$ 1,708

The capital amounts to be paid at maturity are $0.7 billion for the short-term promissory notes, and $1 billion and $0.7 billion for the Series 1 and Series 2 medium-term notes, respectively.

Interest expense, for the years ended March 31, was as follows:

($ thousands)	2011	2010
Short-term promissory notes	**$ 8,933**	$ 7,424
Medium-term notes	**52,353**	45,700
Total	**$ 61,286**	$ 53,124

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

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, having regard to the funding, policies and requirements of the pension plans established under the *Superannuation Acts* and the ability of the Plans to meet their financial obligations. 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.

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 CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2011

12. GUARANTEES AND INDEMNITIES

PSP Investments provides indemnification to its Directors, its Officers, its vice-presidents 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 or made any payment for such indemnity.

In certain cases, PSP Investments also provides indemnification to third parties in the normal course of business. As a result, PSP Investments may be required to indemnify such third parties in connection with the performance of their contractual obligations. To date, PSP Investments has not received any claims nor made any payments for such indemnities.

As at March 31, 2011, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, PSP Investments could assume the obligation up to $403 million (2010 – $403 million) plus interest and other related costs.

As part of an investment transaction entered into during the year ended March 31, 2011, a wholly-owned subsidiary of PSP Investments has agreed to provide indemnification with respect to the contractual obligations and commitments of a third-party. In the event of a default by such third-party, the subsidiary may be required to assume an obligation of up to $195 million as estimated at the time of the completion of the investment transaction. The subsidiary would also have direct recourse against the defaulting third party in all circumstances. The guarantee expires in April 2012.

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. The commitments were as follows as at March 31, 2011:

($ millions)

Private Equity	$ 2,540
Real Estate	938
Infrastructure	781
Public markets	258
Total	**$ 4,517**

MANAGEMENT TEAM AND OFFICERS

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

MARC LACOURCIÈRE
First Vice President and Chief Legal Officer

STÉPHANIE LACHANCE
Corporate Secretary

CONSOLIDATED TEN YEAR FINANCIAL REVIEW

As at March 31

Unaudited

($ millions)	**2011**	2010	2009	2008	2007	2006	2005	2004	2003	2002
CHANGE IN NET ASSETS										
Investment income (loss)	**$ 7,043**	$ 7,605	$ (9,493)	$ (197)	$ 3,414	$ 4,097	$ 1,334	$ 2,453	$ (924)	$ 146
Operating expenses	**114**	92	86	77	52	39	21	12	9	7
Net income (loss) from operations and comprehensive income	**6,929**	7,513	(9,579)	(274)	3,362	4,058	1,313	2,441	(933)	139
Fund transfers	**4,814**	4,980	4,431	4,237	3,990	4,197	3,816	3,696	3,382	2,996
Increase/(decrease) in net assets	**$ 11,743**	$ 12,493	$ (5,148)	$ 3,963	$ 7,352	$ 8,255	$ 5,129	$ 6,137	$ 2,449	$ 3,135
NET INVESTMENT ASSETS										
Investments										
World Equity										
Canadian Equity	**$ 18,665**	$ 13,547	$ 8,815	$ 11,538	$ 10,328	$ 9,346	$ 7,758	$ 5,332	$ 3,162	$ 1,979
Foreign Equity:										
US Large Cap Equity	**3,829**	2,111	926	1,763	2,498	2,618	2,314	2,125	1,225	971
EAFE Large Cap Equity	**3,052**	2,043	1,043	1,831	1,720	3,217	2,506	1,738	855	720
Small Cap Developed World Equity	**3,221**	1,977	781	1,930	2,936	2,006	105	65	–	–
Emerging Markets Equity	**4,062**	2,987	2,122	2,726	2,501	1,943	354	–	–	–
Private Equity	**5,582**	5,426	4,191	3,972	1,669	301	3	–	–	–
Nominal Fixed Income										
Cash & Cash Equivalents[1]	**1,254**	1,892	73	533	468	967	537	109	245	168
World Government Bonds	**2,298**	2,128	2,105	2,248	1,663	–	–	–	–	–
Canadian Fixed Income	**5,387**	4,830	4,253	4,849	5,426	5,243	5,143	4,790	2,615	1,786
Real Return Assets										
World Inflation-Linked Bonds	**3,022**	2,145	2,389	2,211	1,714	421	219	–	–	–
Real Estate	**5,312**	5,118	4,653	4,029	3,596	1,584	429	74	–	–
Infrastructure	**2,356**	2,073	2,446	1,343	479	–	–	–	–	–
Net investments	**$ 58,040**	**$ 46,277**	**$ 33,797**	**$ 38,973**	**$ 34,998**	**$ 27,646**	**$ 19,368**	**$ 14,233**	**$ 8,102**	**$ 5,624**
PERFORMANCE (%)										
Annual rate of return	**14.5**	21.5	(22.7)	(0.3)	11.3	19.1	7.9	26.1	(13.5)	2.7
Benchmark	**12.7**	19.8	(17.6)	1.2	10.1	18.0	7.2	25.4	(12.9)	2.8

PSP Investments' total rate of return since inception (April 2000) is 4.7%.

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

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.

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.

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 the global association for investment professionals. CFA Institute has more than 100,000 members, who include the world's 90,000 CFA charter holders in 135 countries and territories. The investment performance standards of the CFA Institute detail methodology and guidelines that promote uniformity in reporting investment performance.

CO-INVESTMENT

A co-investment is an investment made through an external manager with whom an investor already has committed and delegated funds, in order to obtain an additional participation in a specific investment in partnership with other investors. The external manager oversees the management of the investment and makes most decisions on behalf of the investor, although in certain cases the investor may have specific rights associated with the additional participation.

GLOSSARY

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.

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 require little or no initial investment and are typically 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 for service after the relevant date.

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.

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) adopted IFRS for 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.

GLOSSARY

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 euro zone countries.

N

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

Fund accounts created by the Government of Canada to receive the employer and employee net contributions in respect of service under the Plans after 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 for service under the Reserve Force Pension Plan after March 1, 2007.

PENSION PLAN ACCOUNT (OR PLAN ACCOUNT)

Separate accounts established by PSP Investments for each of the pension fund accounts to receive from the Government of Canada 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 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.

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.

SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

Sale and repurchase agreements involve the sale of securities for cash with a simultaneous agreement to repurchase them at a specified date and price. Such agreements typically require collateral and generally do not constitute sales transactions and therefore are, in substance, collateralized financing transactions.

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 COMPOSITE INDEX

Comprises the majority of market capitalization for Canadian-based, Toronto Stock Exchange listed companies. It is the leading benchmark used to measure the price performance of the broad Canadian senior equities market.

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.

GLOSSARY

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.

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.

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.

Public Sector Pension Investment Board

Special Examination Report—2011

Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

Deloitte.

Ce document est également publié en français.

Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

Deloitte.

To the Board of Directors of the Public Sector Pension Investment Board:

We have completed the special examination of the Public Sector Pension Investment Board in accordance with the plan presented to the Audit Committee of the Board of Directors on 5 August 2010. As required by section 139 of the *Financial Administration Act* (FAA), we are pleased to provide the attached final special examination report to the Board of Directors.

We will be pleased to respond to any comments or questions you may have concerning our report at your meeting on 12 May 2011.

I would like to take this opportunity to express my appreciation to the Board members, management, and the Corporation's staff for the excellent co-operation and assistance offered to us during the examination.

Yours sincerely,

Lissa Lamarche, CA
Principal, Office of the Auditor General

OTTAWA, 12 May 2011

Normand Favreau, CA
Partner, Deloitte & Touche LLP

MONTREAL, 12 May 2011

Attach.

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Public Sector Pension Investment Board

Special Examination Report—2011

Main Points

What we examined

The Public Sector Pension Investment Board (PSP Investments or the Corporation) is a Crown corporation created to invest the pension contributions (net of benefit payments made) of the Public Service, Canadian Forces, Royal Canadian Mounted Police, and Reserve Force pension plans (the Plans). Its mandate is to manage and invest these funds in the best interests of the contributors and beneficiaries, 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 pension plans.

We examined whether PSP Investments' systems and practices provide the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. We focused on the areas of governance, risk management, strategic planning, performance measurement, investment management, human resource management, and information technology management. Our examination covered the systems and practices that were in place between June 2010 and November 2010.

Why it's important

Net contributions from the plan members and sponsors which are transferred to PSP Investments represent an important portion of the assets which will serve to pay benefits of plan members upon their retirement. Ineffective systems and practices could lead to diminished returns and erosion of capital, potentially compromising the plans' ability to meet their financial obligations.

What we found

We found no significant deficiencies in the Corporation's systems and practices. This means that the Corporation maintains systems and practices that provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. A significant deficiency is reported when there is a major weakness in the Corporation's key systems and practices that could prevent it from having that reasonable assurance. We noted good practices in most areas, as well as some areas where PSP Investments would benefit from certain improvements.

- The Corporation has the key elements of a strong governance framework, and its governance practices are consistent with industry practices for stewardship and oversight by boards of directors. However, the lack of the staggering of appointments to the Board of Directors, which is not under the control of PSP Investments, may potentially lead to significant turnover in the Board membership in 2014 and 2015.
- The Corporation's risk management practices, particularly in the area of investment risk, provide for identification, monitoring, management, and reporting of risks to protect its assets from undue risk of loss. The Corporation continues to develop its risk measurement and risk management capabilities, in line with industry practice.
- The Corporation's compensation framework and practices are comparable with those of the industry. Incentives for investment staff are designed to balance the need to attract and retain talented performers with the need to align behaviours with the Corporation's investment strategies, policies, and risk tolerances. Staff engaged in risk and compliance functions are compensated in a manner that maintains their independence from the areas they oversee. The Board plays an active oversight role in the design and operation of compensation practices, and reviews and monitors them independently of management.
- The Corporation regularly benchmarks its practices against those of comparable organizations in the industry. Its practices in most areas are consistent with those of the industry. However, improvements can be made in public reporting of its Responsible Investment activities in order to better align with industry practices in this area.

The Corporation has responded. *The Corporation agrees with all the recommendations. Its responses follow the recommendations throughout the report.*

Special Examination Opinion

To the Board of Directors of the Public Sector Pension Investment Board

1. Under section 131 of the *Financial Administration Act* (FAA), the Public Sector Pension Investment Board is required to maintain financial and management control and information systems and management practices that provide reasonable assurance that its assets are safeguarded and controlled; its financial, human, and physical resources are managed economically and efficiently; and its operations are carried out effectively.

2. Section 138 of the FAA also requires the Corporation to have a special examination of these systems and practices carried out at least once every 10 years.

3. Our responsibility is to express an opinion on whether there is reasonable assurance that during the period covered by the examination—from June 2010 to November 2010—there were no significant deficiencies in the Corporation's systems and practices.

4. We based our examination plan on our survey of the Corporation's systems and practices and a risk analysis.
On 5 August 2010, we submitted the plan to the Audit and Conflicts Committee of the Board of Directors. The plan identified the systems and practices that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. Those are the systems and practices that we selected for examination.

5. The examination plan also included the criteria that we used to examine the Corporation's systems and practices. These criteria were selected for this examination in consultation with the Corporation. The criteria were based on our experience with performance auditing and our knowledge of the subject matter. The criteria and the systems and practices we examined are listed in About the Special Examination at the end of this report.

6. We conducted our examination in accordance with our plan and with the standards for assurance engagements established by The Canadian Institute of Chartered Accountants. Accordingly, it included the tests and other procedures we considered necessary in the circumstances. In carrying out the special examination, we relied on the following internal audit reports: Annual Report on Internal

Controls, Internal Audit of Information Technology General Controls, the IT Project Management Audit, and the Internal Audit report on the Control Environment and Corporate Controls.

7. In our opinion, based on the criteria established for the examination, there is reasonable assurance that during the period covered by the examination there were no significant deficiencies in the Corporation's systems and practices.

8. The rest of this report provides an overview of the Corporation and more detailed information on our examination observations and recommendations.

Sheila Fraser	Deloitte & Touche LLP[1]
Sheila Fraser, FCA Auditor General of Canada	[1]Chartered accountant auditor permit No. 18527
Ottawa, Canada 10 December 2010	Montreal, Canada 10 December 2010

Overview of the Public Sector Pension Investment Board

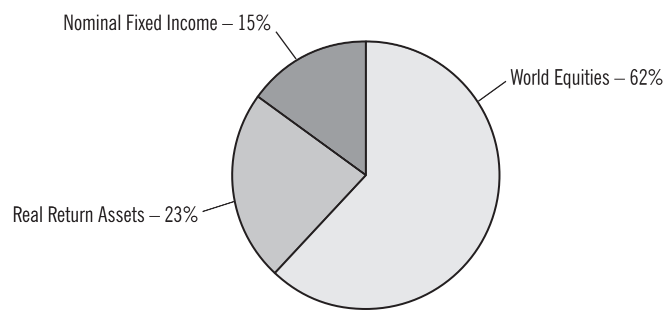
9. The Public Sector Pension Investment Board (PSP Investments or the Corporation) is a Crown corporation established by Parliament under the *Public Sector Pension Investment Board Act* in September 1999. Its mandate is to manage and invest amounts transferred to it under the superannuation acts for the Public Service, Canadian Forces, and Royal Canadian Mounted Police pension plans by the plan sponsors (Treasury Board, National Defence, and Public Safety Canada respectively). In February 2007, its mandate was expanded to include the investment of Reserve Force Pension Plan contributions. PSP Investments was created at arm's length from the plan sponsors and provides for the independent investment of the plan assets in a manner that generates a return based on market performance.

10. Specifically, section 4 of the *Public Sector Pension Investment Board Act* (the PSPIB Act) states that the objects of the Corporation are

- to manage the amounts that are transferred to it under the *Canadian Forces Superannuation Act,* the *Public Service Superannuation Act,* and the *Royal Canadian Mounted Police Superannuation Act*, in the best interests of the contributors and beneficiaries under those Acts; and
- to invest its assets 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 pension plans established under the Acts referred to in paragraph (a) and the ability of those plans to meet their financial obligations.

11. To achieve its mandate, PSP Investments targets a minimum long-term real rate of return of 4.3 percent on the plan assets it manages, which corresponds to the long-term actuarial rate of return used by the Chief Actuary of Canada in the most recent actuarial reports of the plans. To achieve this minimum rate of return, PSP Investments has allocated, in its Statement of Investment Policies, Standards and Procedures (SIP&P), the plan assets to various asset classes (Exhibit 1). This is PSP Investments' Policy Portfolio, which it believes, based on its expectations of long-term market conditions, should achieve this target return. These asset classes include public and private investments such as Canadian and foreign equities, real estate, bonds, and debt securities. One of PSP Investments' competitive advantages is the fact that it expects to receive positive net inflows over the next 19 years. This flexibility enables it to take advantage of long-term opportunities in less liquid asset classes, such as private market investments, which allows it to further diversify the fund.

Exhibit 1 The Corporation's Policy Portfolio includes different investment asset classes



Source: Public Sector Pension Investment Board 2010 Annual Report

12. In addition to the returns expected from the Policy Portfolio, PSP Investments employs investment management strategies, referred to as active investment management strategies, designed to increase returns, within approved risk limits. These active investment management strategies seek to outperform the Policy Portfolio benchmarks.

13. The Corporation's strategic plan also sets out corporate objectives that support the achievement of the statutory mandate. For the 2010–12 planning period, PSP Investments' strategic plan articulates strategic objectives that include

- further alignment of the Corporation's SIP&P to the plan sponsors' objectives and risk tolerances,
- the continued implementation of its active investment management strategies,
- the achievement of optimal organizational effectiveness and enhanced risk management capabilities, and
- the further enhancement of employee engagement.

14. To achieve its mandate and investment objectives, PSP Investments has a team of investment professionals and support personnel who design investment strategies that are in line with the Corporation's investment objectives and SIP&P, and who identify, manage, and monitor risk and investment performance. PSP

Investments acknowledges that the achievement of its statutory mandate and investment objectives is highly dependent on the quality of its human resources, and that it operates in a very competitive human resource environment, given the high demand in the industry for experienced and competent investment professionals. Thus, its compensation practices aim to attract and retain competent employees, while also ensuring alignment of investment decision making with the Corporation's business strategies, priorities, and risk tolerances.

15. Since the last special examination, which was carried out by Deloitte & Touche and reported on in November 2005, PSP Investments has grown considerably, from an organization of 75 employees and assets under management of $19.4 billion to an organization of 311 employees and assets under management totalling $46.3 billion as at 31 March 2010 (Exhibit 2). This growth has led to changes in the organization, such as the development of a diversified investment strategy, the implementation of increasingly complex management information systems, and the need for more sophisticated human resource management systems and practices, particularly in the areas of recruitment and development.

16. PSP Investments' activities are overseen by its Board of Directors, which comprises 11 members, including the Chair. The Board of Directors reports to the President of the Treasury Board, who is responsible for PSP Investments' legislation, as well as to the ministers of National Defence and Public Safety Canada. The Corporation's President and Chief Executive Officer and senior management team oversee its day-to-day activities.

Exhibit 2 The Corporation has grown over the last five years

	2005	2006	2007	2008	2009	2010
Assets under management	$ 19.4B	$ 27.6B	$ 35.0B	$ 39.0B	$ 33.8B	$ 46.3B
Overall increase (decrease)	5.2B	8.2B	7.4B	4.0B	(5.2B)	12.5B
Contributions	3.8B	4.2B	4.0B	4.2B	4.4B	5.0B
Net income (loss)	1.4B	4.0B	3.4B	(0.2B)	(9.6B)	7.5B
Employees	75	133	182	229	297	311
Increase		58	49	47	68	14

Source: Public Sector Pension Investment Board annual reports and information provided by management

Focus of the special examination

17. Our objective is to determine whether PSP Investments' systems and practices provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively during the period covered by the examination. We focused on the areas of governance, risk management, strategic planning, performance measurement and reporting, investment management, human resources management, and information technology.

18. Further details on the audit objectives, systems and practices, and criteria are provided in **About the Special Examination** at the end of the report.

Observations and Recommendations

Corporate governance

19. Sound corporate governance practices are essential to enable a corporation to meet its mandate and objectives. The division of powers and responsibilities among Parliament, ministers, the board of directors, and management establishes key oversight and accountability mechanisms. In particular, the board of directors oversees the affairs of the corporation to ensure it achieves its mandate and objectives, as set out in the corporation's legislation. We examined whether the Public Sector Pension Investment Board (PSP Investments or the Corporation) has a well-performing corporate governance framework that meets industry practices in board stewardship, oversight, and stakeholder relations.

20. In examining corporate governance, we looked at the following elements:

- the roles and responsibilities of the Board of Directors and its committees, including independence policies and membership of the Board;
- orientation and ongoing training practices offered to the directors; and
- information provided to the directors, as well as ongoing communications among senior management, the directors, and stakeholders.

21. Overall, we found that PSP Investments has a corporate governance framework that performs well and meets industry practice expectations for Board stewardship and oversight, and relations and communications with stakeholders (namely the plan sponsors and beneficiaries). However, we noted that the Corporation may need to further engage with the parties responsible for the appointments process to encourage further staggering of appointments to the Board of Directors to avoid potential significant turnover in Board membership in 2014 and 2015. The following sections present our detailed findings on corporate governance.

The Board of Directors has what it needs to provide stewardship and oversight

22. The *Public Sector Pension Investment Board Act* defines the legislative mandate of PSP Investments as well as the roles and responsibilities of its Board of Directors. To assist it in discharging these roles and responsibilities, the Board has established four committees:

- the Investment Committee,
- the Audit and Conflicts Committee,
- the Human Resource and Compensation Committee, and
- the Governance Committee.

23. The Board has clearly defined its roles and responsibilities and those of its committees in their respective terms of reference. The terms of reference of the Board and its committees are reviewed and updated, at least every two years. They are implemented via annual work plans that encompass roles and responsibilities, as well as annual objectives. We found that the Board structure, as well as its Terms of Reference, were comparable to those of the Corporation's peers and aligned with the responsibilities assigned to the Board and the Board committees in the PSPIB Act.

24. The Terms of Reference of the Board's Audit and Conflicts Committee include guidance on oversight of financial reporting, internal controls, and audits, as well as monitoring compliance with the Code of Conduct for officers and employees. The Audit and Conflicts Committee is supported by PSP Investments' Internal Audit function, which provides audit reports on PSP Investments' activities, conducted according to the risk-based internal audit plan.

25. Based on our discussions with directors and a review of information submitted to Board committees, we found that management provides the Board with the information it needs to interpret the Corporation's legislative mandate, provide management with strategic direction, and exercise its oversight responsibilities.

Information on the Corporation's management and results that directors receive on an ongoing basis is timely, comprehensive, and relevant to their oversight responsibilities.

26. Annually, the Corporation holds strategic sessions with its Board of Directors, whereby the Board is directly involved in determining the Corporation's strategic direction and its performance indicators and measures. In addition, the Board discusses and reviews specific aspects of the strategic direction and goals, including implementation progress, throughout the year.

The Corporation manages the skills and independence of its Board, but it should examine how the staggering of the appointments could be improved

27. At the time of the examination, the Board of Directors comprised nine members (out of eleven positions), whose profiles include experience in banking and investment management, insurance, pension management, as well as general corporate management. To ensure the Board collectively possesses required skills and competencies, a Board Competency Profile outlining the required competencies, skills, and experience sought on PSP Investments' Board of Directors has been developed. The Governance Committee regularly assesses the Board's collective skills and competencies against this Board Competency Profile, specifically when terms are expected to expire or when vacancies arise. Any gaps or desired skills or competencies are identified. The competency profile was last updated in June 2010, in order to prepare the candidate profile for the upcoming appointments to fill vacancies and expiring terms. We found that the Board of Directors has consistently used this process to ensure that it collectively has the skills and competencies it believes necessary to discharge its roles and responsibilities.

28. When new directors are appointed, PSP Investments offers them a timely and comprehensive director orientation program. The Corporation also offers an ongoing directors' training program, which provides tailored learning opportunities, including courses, conferences, technical literature, and subscriptions to help directors deepen their understanding of PSP Investments' business and activities.

29. Independence of the Board of Directors is managed through different mechanisms. The PSPIB Act prohibits 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 under the Plans from being appointed as directors of the Corporation. PSP Investments' Code of Conduct for Directors is communicated to directors. Directors disclose all potential conflicts of interest and declare their compliance with the Code of Conduct, upon appointment and annually thereafter, to the Corporate Secretary. Exceptions or instances of non-compliance with the Code of Conduct are reported to the Governance Committee and the Chair of the Board. We found that the Corporation complies with the PSPIB Act and its policies regarding independence of its Board of Directors.

30. The President of the Treasury Board recommends candidates for appointment to PSP Investments' Board of Directors to the Governor in Council, who is responsible for these appointments. As per the PSPIB Act, the Treasury Board President's recommendation is made from a list of qualified candidates established by an independent third party Nominating Committee based on the Board Competency Profile provided by PSP Investments' Governance Committee. The Nominating Committee is composed of eight members, seven of which are representatives of the plans. The eighth member is the Committee Chair, who is independent and appointed by the President of the Treasury Board, after consultation with the Minister of National Defence and the Minister of Public Safety.

31. Assuming that members of the Board of Directors continue to be appointed for four-year terms, we noted that 10 terms out of 11 could potentially expire in 2014 and 2015. Such significant turnover in a two-year period could challenge the Board's ability to maintain sufficient corporate knowledge and continuity, and thus compromise its effectiveness. Though this risk can be mitigated through the re-appointment of existing directors and ensuring that sufficient knowledge transfer takes place through the Board orientation process, the Corporation does not control the appointment process, and thus cannot rely on this strategy. It may also need to consider increased communication with, and perhaps recommendations to, the Nominating Committee.

32. **Recommendation.** To assist in providing an orderly transition of appointments of members to the Board of Directors, the Public Sector Pension Investment Board (PSP Investments) should examine whether a more optimal staggering of Board appointments could be implemented and consider whether it should make recommendations to this effect to the Nominating Committee and the President of the Treasury Board.

The Corporation's response. *Agreed. The Board of Directors of PSP Investments is aware of this issue. Recent appointments have been made in* *groups, which has led to the limited staggering of the terms of our current directors. Through the Chair of the Board of Directors and the Chair of the Governance Committee, PSP Investments will continue to have dialogue with the President of the Treasury Board and the Nominating Committee to attempt to improve the board appointment process.*

The Corporation will be proposing two changes in the appointment process to address this issue. The first change will be to restructure the recommendation process of the Nominating Committee. The Corporation will propose to hold an annual meeting with the Nominating Committee to establish the candidate selection criteria, followed by one further meeting with the Nominating Committee in which the preferred candidates and alternates, based on the agreed criteria, are presented to it for recommendation to the President of the Treasury Board. The second change will be to recommend to the Nominating Committee and the President of the Treasury Board that when appointments are to be made in groups, that they be made for different term lengths to achieve a better staggering of the terms.

The Corporation communicates in a timely manner with stakeholders

33. Based on our review of presentations made to the plan sponsors and correspondence between PSP Investments and the plan sponsors, as well as our discussions with PSP Investments' directors and senior management, dialogue with the key stakeholders is ongoing and open and includes discussions around, for example, investment performance and activities, as well as the sponsors' risk tolerances and the plans' funding principles. For example, in its annual report, the Corporation describes the results for the year and performance relative to its strategic goals. As well, it holds an annual public meeting to present its results for the past fiscal year. Finally, the President and CEO as well as the Chair of the Board of Directors meet at least annually with the advisory committees to the pension plans to report on the Corporation's activities.

Risk management

34. The activities of the Public Sector Pension Investment Board (PSP Investments or the Corporation) involve assuming risk, principally investment risk. The Corporation recognizes that its exposure to risk goes beyond investment risk, and that it needs to consider a full spectrum of risks on an enterprise-wide basis. The Corporation must manage these risks in ways that allow it to meet its statutory mandate and its targeted long-term rate of return, without exposing its assets to undue risk of loss.

35. We examined whether the Corporation has established an enterprise-wide risk management framework supported by a risk culture that promotes the achievement of its mandate, business goals, and objectives, and that it has systems and practices in place to identify, measure, mitigate, monitor, and report on key risks associated with the achievement of its business objectives.

36. We looked at the following elements:

- the Corporation's enterprise risk management framework and policies;
- implementation of these policies around risk measurement, mitigation, and monitoring; and
- risk management reporting throughout the organization.

37. The special examination report issued in 2005 included recommendations aimed mainly at helping the Corporation evolve its risk management capabilities to catch up with the growth of its assets. Since the 2005 special examination, the Corporation's risk management practices have evolved considerably with the creation of the Chief Risk Officer (CRO) position, the implementation of an enterprise risk management framework and program, the enhancement of risk measurement practices, and the monitoring and reporting of key risk indicators.

38. Overall, we found that the Corporation has a well-defined enterprise-wide risk management framework that is supported by a risk culture and processes that promote the achievement of its mandate and business objectives. This framework also provides for identification, measurement, mitigation, monitoring, and reporting on the Corporation's key risks. The following section presents our detailed findings on risk management.

There is a corporate-wide approach to risk management

39. The Corporation has established an enterprise-wide risk management framework that has been approved by the Board of Directors. The framework is designed to ensure independence, accountability, and appropriate segregation of duties in the oversight and management of corporate-wide risks through different levels of responsibilities, including

- the oversight role of the Board of Directors and Board committees;
- involvement of management committees; and

- independent support and control functions such as the CRO, a Risk Management Group, and an independent Compliance Group.

Roles and responsibilities for risk management have been established, approved, and communicated through employee job descriptions and various policies and procedures. The Enterprise Risk Management (ERM), Investment Risk Management (IRM), and Operational Risk Management (ORM) policies and their supporting procedures provide the framework necessary for identifying, measuring, mitigating, and monitoring significant risks.

40. The Corporation has articulated its investment risk tolerance, approved by the Board, as an investment risk budget measured as a **Value at Risk (VaR)** upper limit. It uses this measure to manage and monitor the risk inherent in its investment strategies for the entire portfolio and for different asset classes. The Risk Management Group measures the Corporation's investment risk exposure against established risk limits and reports the results to relevant members of senior management, management committees, and Board committees.

Value at Risk (VaR)—A measure of the risk of loss on a portfolio, expressed in basis points (units equal to 1/100th of a percentage point), for a given probability and time horizon.

41. Every three years, the Corporation undertakes its Risk and Control Self-Assessment, which is a corporate-wide assessment of the risks that threaten the achievement of corporate objectives and the controls in place to mitigate them. This self-assessment enables the Corporation to identify new and emerging risks as well as to update its current risk profile. The Risk and Control Self-Assessment serves as an important input to PSP Investments' three-year strategic planning process. The 2011 Risk and Control Self-Assessment is currently under way.

42. We found that the Corporation provides a comprehensive set of reports to management, the Board of Directors and Board committees, which include investment risk as well as operational risk measures. Key investment risk indicators and limits are reported weekly to the Management Investment Committee in a risk limit report. Key operational risk indicators, such as employee turnover and information technology system availability, are reported to the Management Investment Committee and to the Investment Committee of the Board in the ERM quarterly report.

43. We found that, while the Corporation has articulated its risk tolerance for investment risk, it has not defined its risk tolerance for non-financial risks, such as operational risk and reputational risk. We encourage management to continue the dialogue with Board members to further define the Corporation's risk tolerance for each significant risk and to establish a risk tolerance framework to ensure that management decisions are aligned with the Board-approved risk tolerance.

44. While risk is discussed in various committees under their respective mandates and the Enterprise Risk Management Policy, PSP Investments does not have a formal executive-level forum where all significant risks are systematically discussed and considered. As PSP Investments continues to grow and its risk management practices evolve, we encourage senior management to assess the benefits of formally establishing an executive-level forum within its existing committee structure to discuss enterprise-wide risks at a strategic level.

Strategic planning, performance measurement and reporting

45. Strategic planning is important in ensuring that a corporation as a whole can meet its long-term objectives and that its strategies, objectives, tactics, and the allocation of its resources are aligned with the achievement of its statutory mandate, which includes assessing and adjusting an organization's direction in response to a changing environment. Measuring and reporting on performance are important steps in making sound decisions, holding management accountable, and demonstrating the extent to which a corporation has achieved expected results in accordance with its strategic plan. Such information supports accountability and should help drive behaviour toward achievement of the corporation's mandate and objectives.

46. We examined whether the Public Sector Pension Investment Board (PSP Investments or the Corporation) has a clearly defined strategic direction and specific and measurable goals, objectives, and performance indicators to achieve its mandate and statutory objectives. The Corporation's strategic direction and goals need to take into account identified risks, and the need to control and protect its assets and manage its resources economically and effectively. We also examined whether the Corporation's performance reporting provides complete, accurate, timely, and balanced information for decision making and accountability reporting.

47. In examining strategic planning, performance measurement and reporting, we looked at the following elements:

- the Corporation's 2010–2012 Strategic Plan and the process to develop it;
- its assessment of its internal and external environments, as well as of its strengths, weaknesses, opportunities, and threats;

- communication of the strategic direction throughout the organization;
- performance indicators, and the process to select investment performance measures;
- the monitoring and reporting of performance information, including a review of internal performance reports and the annual report; and
- public reporting of performance information.

48. The 2005 special examination report included recommendations around formalizing and documenting PSP Investments' strategic planning process and performance reporting framework, as well as establishing a longer term strategic direction. Since 2005, PSP Investments has responded to these recommendations by developing its planning policy, which formalizes the planning process and performance reporting framework, and provides for the development of a three-year strategic plan.

49. Overall, we found that the Corporation has clearly defined and communicated its strategic direction in its 2010–2012 Strategic Plan. The Plan considers the operating environment; risks threatening the achievement of the statutory mandate; the Corporation's strengths, weaknesses, opportunities, and threats; and the need to control and protect its assets and manage its resources economically and efficiently. In addition, we found that the Corporation produces performance information that enables the Board of Directors and stakeholders to assess its performance, as well as its progress toward the achievement of its mandate, statutory objectives, and key strategic objectives. However, we found that, while the Corporation measures its performance related to its strategic goals and objectives, the measures are focused on tasks rather than outcomes. The following section presents our detailed findings on strategic planning and performance measurement and reporting.

Strategic direction is the result of a comprehensive planning process, but measures of strategic outcomes should be determined

50. PSP Investments' planning policy provides for a systematic and comprehensive approach to the development of a three-year Strategic Plan. The Board of Directors approves the strategic direction and is involved throughout the planning process. PSP Investments' last Strategic Plan was developed and approved in the 2008–09 fiscal year for the 2010–12 planning period. In developing its 2010–2012

Strategic Plan, PSP Investments considered its most recent risk assessment; its external and internal operating environment; and an assessment of its strengths, weaknesses, opportunities, and threats, by investment area. The Board was engaged and provided input at strategic planning sessions.

51. PSP Investments has clearly defined its vision statement, operating and investment principles, and strategic goals and linked them to clear and measurable objectives and tasks, which are specifically assigned to groups and/or individuals. We found that the 2010–2012 Strategic Plan was aligned with and supported the execution of the Corporation's mandate, as set out in the *Public Sector Pension Investment Board Act*, including the control and protection of its assets by not assuming undue risk of loss.

52. The various groups or individuals to whom the strategic goals are assigned establish more detailed plans, resource requirements, and financial budgets for the three-year planning period, as well as for each year included in the plan. Senior management and the Audit and Conflicts Committee roll up and monitor the various financial budgets and resource requirements, and benchmark this information against industry comparators to ensure that the Corporation's plans reflect an economic and efficient use of its resources.

53. The Corporation communicates its Strategic Plan in a timely manner throughout the organization using various means, including corporate or group meetings, presentations of business plans by the various groups, and communications through the Corporation's intranet site or distinct publications. In addition, strategic objectives are incorporated in individual performance objectives and translated into specific tasks, which are monitored as part of the performance management and assessment process at the end of the year, to ensure behaviours throughout the organization align with the Strategic Plan.

54. However, while the Corporation uses measures to assess its performance in areas related to its strategic objectives and goals, the process does not fully enable it to assess its success in the achievement of its strategic goals, as it focuses on execution of tasks, rather than on measures of success related to goals (that is, outcomes). Monitoring and measuring outcomes, in addition to currently tracking the achievement of underlying tasks, is necessary in order to measure success against strategic goals.

55. **Recommendation.** The Public Sector Pension Investment Board (PSP Investments) should develop and assign measurable outcomes for its strategic goals, to enable measurement of success for each strategic goal.

The Corporation's response. *Agreed. In its next Strategic Plan, PSP Investments will endeavour to develop additional measurable outcomes that are designed to measure the overall achievement of the strategic goals.*

The Corporation has established suitable investment performance benchmarks

56. While the Corporation's strategic goals and performance indicators encompass many objectives, central to PSP Investments' mandate is the performance of its investments. To monitor its investment performance, PSP Investments compares its actual investment returns against its Policy Portfolio and specific asset class **benchmark returns**. For its public market asset classes, PSP Investments uses representative publicly available market indices as its asset class benchmarks. For all of its private asset classes, the Corporation has recently decided to move to **cost of capital benchmarks**. Implementation of these new measures is currently under way.

Benchmark return—A rate of return against which the performance of individual asset classes and investment managers is measured.

Cost of capital benchmarks—Target return benchmark based on the long-term market expected return of the asset class.

57. PSP Investments has established a process for selecting these performance benchmarks that includes Board oversight and consultations with internal stakeholders (operations and investment units) and with external advisers. A process is also in place to ensure that portfolio and benchmark performance returns reported are calculated according to the Chartered Financial Analyst Institute Performance Reporting Standards. We found that the Corporation has established practices to ensure that selected performance benchmarks are suitable and relevant for its investment portfolios.

The Corporation monitors and reports its performance

58. PSP Investments' planning policy provides for

- a review of progress made in implementing the three-year Strategic Plan, which becomes an input to the following Strategic Plan;
- a detailed mid-cycle review of the Corporation's progress against Strategic Plan objectives;
- a quarterly review of the divisional results against its objectives; and

- annual performance assessments of management, based on the achievement of the objectives and initiatives set out in the planning documents.

59. In the 2010–11 fiscal year, PSP Investments, with the Board of Directors, undertook its mid-cycle review of progress against the 2010–2012 Strategic Plan. This review included reporting its progress on strategic objectives and tasks, as well as evaluating whether it was on track to meet its strategic goals and objectives. This review also included a survey of the current business environment, changes within PSP Investments, and the results on key performance indicators, to assess whether the Corporation's strategic objectives were still appropriate and to update strategic objectives and/or underlying tasks based on the current environment. For example, new objectives were included to address some of the observations emerging from the 2009 employee engagement survey. This exercise enabled the Corporation to confirm that its strategic objectives were still appropriate and that it was on track to achieve these objectives.

60. The Finance and Operations group assesses investment performance against the benchmark returns and reports these to the Management Investment Committee on a weekly basis and to the Investment Committee of the Board of Directors quarterly. Long-term performance is measured and assessed annually, during the review of the Corporation's Statement of Investment Policies, Standards and Procedures (SIP&P), to ensure the Policy Portfolio remains aligned with PSP Investments' target long-term real rate of return of 4.3 percent. Other performance information, such as progress against various initiatives, is assessed and reported quarterly to the Management Operations Committee and at least annually to the Board of Directors.

61. PSP Investments reports its performance against its strategic objectives and performance targets to its stakeholders via a number of different mechanisms, including its annual report, presentations at the meetings of the pension plan advisory committees, and its annual public meeting. Information provided to stakeholders includes investment performance overall and by asset class, performance of material investments and significant investment activities carried out during the year, and progress on other key strategic goals and objectives. To ensure it continues to provide its stakeholders with relevant and complete information comparable to industry practices in performance reporting, PSP Investments regularly compares its external performance reporting to that of its peers. Such a benchmarking exercise is currently under way and may impact the information contained in its 2011 Annual Report.

Investment management

62. Investment management is central to achieving the statutory mandate of the Public Sector Pension Investment Board (PSP Investments or the Corporation). The nature of the Corporation's activities exposes it to significant investment risks, such as fluctuations in interest rates, foreign currency exchange rates, and market values for investments. As a result, to meet its statutory mandate, the Corporation needs to have investment management systems and practices that enable it to invest its assets to achieve the targeted return while managing the related investment risk.

63. We examined whether investment decision making and monitoring practices are in place to support the development of investment strategies, the conduct of due diligence, and the monitoring of investment performance. We also examined whether risk arising from investment activities is identified, measured, mitigated, monitored, and reported.

64. In examining investment management, we looked at the following elements:

- investment management policies and procedures;
- investment strategies and decision making, including due diligence activities and consideration of environmental, social, and governance (ESG) imperatives; and
- management, monitoring, and reporting of investment activities and performance.

65. The 2005 special examination report included a number of recommendations in the area of investment management regarding refinements in investment policies, particularly in the area of evaluating, monitoring, and mitigating investment risk. Since 2005, the Corporation has reviewed its systems and practices to address the report's recommendations.

66. Overall, we found that the Corporation has implemented investment management processes and procedures that are aligned with the Corporation's objectives and risk tolerances and support the development of investment strategies; the conduct of due diligence; and the identification, measurement, mitigation, monitoring, and reporting of investment risk activities and performance. However, opportunities for improvement exist in the approval process for new investment activities and public reporting of responsible investing activities. The following sections present our detailed findings on investment management.

Investment policies and procedures support investment management activities, but opportunities for improvement exist

67. PSP Investments' Statement of Investment Policies, Standards and Procedures (SIP&P) sets out how the Corporation is to carry out its investment activities. The Corporation has a process to ensure that it establishes and implements investment strategies that are compliant with its SIP&P. Namely, the Management Investment Committee reviews and approves the business plans of asset classes, investment strategies, new investment products, and other investment-related activities. For new investment products, the Committee receives a recommendation from the New Product Committee, which assesses the financial and non-financial risks as well as operational impacts of these new investment products. Policies, guidelines, and procedures related to investment activities have been developed and effectively communicated to investment personnel, following senior management and Board approval. The Corporation reviews and updates the SIP&P and its related policies and procedures at least annually.

68. The Corporation's internal compliance function also carries out independent compliance activities to assess whether investments and investment activities comply with the SIP&P and the PSPIB Act and regulations. PSP Investments identifies, reports, and escalates investment compliance issues when they occur and undertakes remediation measures, if required. The Corporation is in the process of acquiring a pre-trade compliance software to improve its existing compliance processes. It will benefit from a more automated compliance review process, particularly as the volume of its transactions increases.

69. PSP Investments appropriately documents, reviews, and executes arrangements with external managers and business partners. It performs due diligence procedures when dealing with potential business partners and external managers to ensure that their investment activities (both fund investments and direct investments) are properly approved and in line with PSP Investments' SIP&P.

70. However, we noted that the New Product Committee will review new investment activities that use approved investment products only when the Management Investment Committee decides it is appropriate. As a result, the process to introduce new investment activities does not systematically assess whether these activities introduce new or additional risk exposures that were not originally contemplated. As such, these new investment activities are not necessarily subject to the review and approval process, specifically the input of the New Product Committee.

71. **Recommendation.** The Public Sector Pension Investment Board's (PSP Investments) New Product Committee should systematically review new investment activities using approved investment products to assess whether they introduce new risk exposures. These activities should be subject to the same review and approval process as all new investment products.

The Corporation's response. *Agreed. The above concern is implicitly addressed by the Terms of Reference of the Management Investment Committee, which includes the review and approval of the business plans of asset classes, investment activities, new investment products, and other investment-related activities. PSP Investments will amend the New Product Committee's Terms of Reference and its related procedures to expand its scope to include new investment activities using approved products.*

Investment risk management activities are managed, monitored, and reported

72. The Corporation's investment activities involve a significant number of transactions each year, as well as significant funds being invested in individual investments, asset classes, investment strategies, or other investment related activities. As a result, in order to ensure its investments activities remain within approved risk tolerances, PSP Investments has developed and implemented policies, procedures, and guidelines to ensure measurement, management, monitoring, mitigation and reporting of investment activities. These policies, procedures, and guidelines outline the review, approval, and monitoring processes to manage investment activities within the Board-approved risk tolerance; they also include pricing and market risk measurement methodologies and guidelines for establishing new valuation models and risk measurement techniques.

73. We found that the Corporation monitors its investment risk according to its risk management policies. It sets investment risk limits as part of the annual risk budgeting process and monitors these on an ongoing basis to ensure they are not exceeded. It establishes asset class ranges and limits to ensure diversification of investment risk according to its SIP&P. It has also established various parameters to monitor and manage other risks, such as risks related to concentrations in various geographical areas or industries.

74. PSP Investments uses various risk mitigation strategies to reduce its exposure to specific risks, where possible, such as certain exposures to foreign currency risks and to the credit risk of counterparties with whom it undertakes transactions. We found that PSP Investments mitigates its exposure to the credit risk of these counterparties through collateral arrangements, where counterparties provide assets to secure the performance of their obligations, and through regular counterparty credit risk monitoring. This includes dealing only with approved counterparties and setting transaction limits with these counterparties. Through the implementation of a new system, PSP Investments is further enhancing the process for measurement and monitoring this risk.

75. Investment risk information, including VaR measures, stress testing, exceptions to risk limits, and the performance of external managers and business partners, are reported to senior management and the Board on a timely basis. Oversight processes are in place for risk management methodologies, assumptions, models, and systems, independent of the investment units. A formal review of **private market proxies** is undertaken at least annually to confirm whether the assumptions remain valid. The results of the review are reported to the Risk Steering Committee and the Management Investment Committee.

Private market proxies—Substitute measures used to represent the broad market or a segment of the market where data limitations exist.

76. In order to validate the continued effectiveness and applicability of its risk measurement methodologies and the assumptions included in its risk measurement models, PSP Investments back-tests its models. Back-testing compares actual portfolio returns to estimates from the risk measurement models to ensure that changes in market values and risk are consistent with market movements and portfolio transactions. Annual reporting to the Board of Directors on the results of back-testing for both public and private markets is in place.

Responsible investment practices are evolving, but more public reporting is necessary

77. Responsible investing (RI) is important for an organization such as PSP Investments, because failure to consider environmental, social, and governance (ESG) risks can compromise value and return on investment and could expose the organization to reputational risks, given the heightened public interest in this area and PSP Investments' status as a federal Crown Corporation. In 2009, PSP Investments updated its RI policy, which requires that it identify, assess, and mitigate ESG issues that are, or could become, material to longer term financial performance. The policy also provides for direct engagement in public and private market investments and for collaborative engagement with other like-minded organizations. An RI procedure, issued in August 2010, supplements the policy to guide investment managers in their consideration of ESG factors during their due diligence reviews of potential investments, external managers, and fund managers.

78. As the RI policy aims first and foremost to protect portfolio values and investment returns, investment managers are accountable for ESG risks. Investment managers consider ESG risks through their due diligence procedures of potential investments and assessment of the practices of external managers and fund managers in this area. The monitoring of ESG risks in private markets is undertaken through ongoing dialogue with partner investors and senior management of private market investments. For its public market investments, PSP Investments monitors ESG risks with external service providers, who assist the Corporation with casting its voting rights (proxy voting) for its investments and by engaging with companies on ESG factors. PSP Investments also requires external managers it engages to confirm, on a quarterly basis, their compliance with the Corporation's SIP&P, which includes the RI policy.

79. As the development of the RI policy and procedure is a recent initiative, investment managers have received limited training in the consideration of ESG matters in investment decisions and limited detailed guidance and checklists. In addition, the Corporation currently does not employ an expert in responsible investing. The Corporate Secretariat and Legal Affairs provide support to the investment groups in this area. With limited internal expertise or detailed guidance and checklists to support the implementation of the RI policy and procedure, there is a risk that ESG risks will not be identified or properly assessed. As PSP Investments continues to grow, we encourage it to consider enhancing its in-house capacity and training in this area.

80. PSP Investments reports quarterly to the Governance Committee of the Board of Directors on its engagement activities in public markets as well as on its proxy voting activities. For its private market investments, PSP Investments reports on ESG issues as they emerge and are identified. PSP Investments' RI policy and Proxy Voting Guidelines are publicly available on its website and briefly discussed in its Annual Report. However, the Corporation does not report publicly on its responsible investment activities, including its proxy voting activities. Industry practices include reporting on responsible investment activities in an annual RI report or in the

Annual Report, and making detailed proxy voting activities publicly available, which promotes transparency and accountability in this area of heightened public interest.

81. **Recommendation.** The Public Sector Pension Investment Board should review its public reporting of its responsible investment activities to ensure that they reflect industry practices in this area.

The Corporation's response. *Agreed. The Corporation will review its public disclosure practices in the area of responsible investing and proxy voting, and will expand its annual disclosure to better align its practices in these areas with those of its peers.*

Human resource management

82. The success of the Public Sector Pension Investment Board (PSP Investments or the Corporation) in achieving its statutory mandate depends largely on the quality of its human resources and its ability to attract, retain, and develop skilled and experienced employees. The Corporation has undergone significant growth since the last special examination; its staff complement has increased from 75 to 311 over the last six years.

83. We examined whether human resource management systems and practices provide the Corporation with the human resource capacity and work environment it needs to achieve its goals and objectives. We also examined whether the Corporation has aligned its compensation practices with prudent risk-taking and relevant industry practices.

84. When examining human resource management, we looked at the following elements:

- human resource policies and procedures in planning, recruiting, and allocating staff;
- performance management;
- learning and development;
- succession planning; and
- compensation.

85. The 2005 special examination report included a number of observations in the area of human resource management systems and practices, aimed at managing the Corporation's growth in this area. Since then, the Corporation has implemented numerous systems and practices to address these observations, including the implementation of a recruitment and talent management methodology called the

Topgrading© Talent Management Strategy, as well as the implementation of an internal communication plan in response to the Corporation's most recent employee engagement survey.

86. Overall, we found that PSP Investments has a human resource management framework in place that provides the Corporation with assurance that it has the human resource capacity and work environment it needs to achieve its goals and objectives, and that its compensation framework rewards behaviours that are aligned with prudent risk taking and relevant industry practices. The following sections present our detailed findings on human resource management.

The Corporation has implemented rigorous hiring practices

87. PSP Investments has a Human Resource Strategic Plan as well as a human resource management policy that are aligned with the Corporation's strategic plan. They ensure that the Corporation identifies and addresses human resource needs resulting from the implementation of the Strategic Plan. The objectives of the Human Resource Strategic Plan are incorporated in the Human Resource First Vice President's annual objectives.

88. In the past five years, PSP Investments has implemented the Topgrading© methodology for recruitment, performance management, and talent development. The Topgrading© methodology includes rigorous processes for recruiting staff, including a detailed definition of the position and skills required, as well as for their subsequent performance measurement and talent development. In addition, the Corporation assesses and classifies its employees according to their performance and potential, as per the methodology, which helps it design tailored development plans and provides inputs to its succession plan.

89. Using this methodology, PSP Investments has established rigorous hiring and performance management practices in order to obtain the human resource capacity it needs. The Corporation tracks its hiring success by assessing hired candidates three months after their hire. It also reassesses, measures, and reports performance levels as well as the potential of its employees as part of the annual performance management process.

Compensation practices align behaviours while maintaining competitiveness

90. PSP Investments recognizes that, while compensation is important to attract and retain competent staff, it also plays an important role in aligning behaviours with the Corporation's strategic objectives and risk tolerances. PSP Investments' total compensation framework thus provides for base salary, short-term and long-term incentives, and benefits. As they are based on the Corporation's performance metrics, the short-term and long-term incentives enable PSP Investments to reward behaviours that are aligned with the Corporation's strategic objectives and investment policies.

91. The short-term incentive plan recognizes performance for the current and the previous three years. The long-term incentive plan is based on four-year performance periods with payouts after four years. The Corporation also offers a discretionary Restricted Fund Unit plan to its senior management, for which the annual amount paid is adjusted by the fund's performance over three years. This long-term compensation horizon, combined with capping of potential payouts, reduces the potential for excessive risk-taking by limiting the opportunities for investment managers to benefit from significant short-term gains that could expose the Corporation to longer term risks.

92. The Corporation compensates its risk, compliance, financial reporting, and audit functions in a manner that preserves their independence from specific investment managers. Their incentive compensation is not driven by specific asset class performances.

93. To maintain its competitiveness, PSP Investments' compensation policy provides that annual base compensation be within the industry median; however, incentive compensation provides for superior potential payouts for superior performance. PSP Investments uses external service providers to benchmark its base and incentive compensation to those of its peers on an annual basis.

94. We found that the Corporation's current compensation framework is comparable to industry practices. The Corporation describes its compensation practices in its Annual Report and discloses the base and incentive compensation of its five highest earners each year, as well as their potential payouts upon termination. In addition, the Board of Directors plays an active role in the review and oversight of the Corporation's compensation practices, through, among other things, the commissioning of an independent review and comparison to industry practices.

Talent is managed and developed

95. PSP Investments' talent management and development policy provides for the development of a "scorecard" for each employee. We found that scorecards include skills, competencies, roles, and responsibilities, as well as the employee's objectives for the year, including development objectives. Annual performance objectives assigned to staff originate from the Strategic Plan and are aligned with the strategic objectives. Performance against these annual objectives is measured as part of the employee's annual performance assessment. PSP Investments has tailored its approach to employee development to the individual's needs and objectives in the context of his or her role in the organization.

96. PSP Investments' performance management system, which establishes who its top performers and high potential individuals are, contributes to the Corporation's succession plan. For each key senior management position, the Corporation identifies potential internal successors and assesses their level of readiness. These individuals' development plans are designed to help them acquire the skills and competencies required for the position for which they are being prepared. Where immediate candidates are not available, the Corporation identifies alternative plans (for example, external hiring, internal reorganization, and so on).

The Corporation monitors and reports on human resource engagement

97. The Human Resources First Vice President reports annually and semi-annually to the Board's Human Resources and Compensation Committee on the Corporation's human resource activities, including specifically the succession plan, and its performance against key performance indicators such as turnover, employee development, hiring metrics, Topgrading© assessment of employees, and so on.

98. In addition, every two years, the Corporation contracts an external firm to conduct an employee engagement survey. The results of this survey are reported corporate-wide and to the Board of Directors. While the last engagement survey, conducted in 2009, indicated opportunities for improvement in areas such as leadership and work processes, PSP Investments had strong results in such areas as the physical work environment, benefits, and employee health and well-being. The Human Resources Group developed and implemented an action plan to address observations from this employee engagement survey, and regularly monitors its implementation.

Information technology

99. The Public Sector Pension Investment Board (PSP Investments or the Corporation) operates in an automated environment where technology is essential to its effective operations, and thus its ability to meet its objectives. Over the last couple of years, the Corporation has redesigned its information technology infrastructure, and it is currently implementing new core applications to increase workflow automation. System and data integrity and availability are crucial to ensuring the Corporation's continued operational effectiveness.

100. We examined whether the planning, development, implementation, and management of information technology and information management systems support the organization's strategic and operational objectives, ensure business continuity, and satisfy informational needs at an acceptable cost and on a timely basis.

101. In examining information technology management, we looked at the following elements:

- the Corporation's alignment of its information technology activities with its Strategic Plan,
- policies and procedures around security and access controls,
- business continuity planning, and
- project management.

102. Overall, we found that the Corporation's information technology management supports its strategic and operational objectives, ensures business continuity, and satisfies information needs at an acceptable cost and on a timely basis. The following sections present our detailed findings on information technology.

Information technology is aligned with the Corporation's needs

103. We found that the Corporation has aligned its information technology strategic and operational plans with its Strategic Plan and operational and information needs. Within the plans, PSP Investments' information technology group has described the Corporation's operational and information needs, its risk tolerance regarding its information technology systems, new developments in information technology, and the Corporation's ability to take advantage of these new opportunities to enhance the effectiveness of its operations and management information.

104. The Corporation's users and stakeholders are appropriately identified in implementation business cases for information technology systems, and their needs are clearly understood. In order to ensure that user needs are well integrated into system development, the information technology group surveys and reports on user satisfaction.

105. The Corporation's information technology access and change controls (such as security protocols, passwords, and authorizations for system changes) ensure appropriate access to systems and data, data and processing accuracy, and the processing of only authorized transactions and system changes. In addition, the Corporation has business continuity plans in place that are regularly tested to ensure they remain effective.

106. The Corporation has identified a number of performance metrics that are aligned with its strategic objectives and needs, including system availability, client satisfaction, data accuracy, system security, and system malfunction. The Information Technology group measures and reports these performance metrics on a quarterly basis to the Management Operations Committee and semi-annually to the Audit and Conflicts Committee of the Board of Directors.

The Corporation has implemented information technology project management practices

107. PSP Investments has implemented a standard project development methodology that provides clear accountabilities and a systematic approach to identifying user needs, evaluating technology options, and contributing to risk-based decision making. We found that the Corporation consistently applies its project development methodology. Appropriate testing takes place before implementing new systems or making changes to systems. To ensure that it undertakes information technology activities at an acceptable cost and on a timely basis, the Corporation establishes an annual budget for information technology activities and projects during its overall budgeting process. It also monitors its information technology activities and projects against the related timelines and budgets. The Corporation reports monthly on these activities and projects at Management Operations Committee meetings and semi-annually to the Audit and Conflicts Committee of the Board of Directors.

Conclusion

108. Based on the work performed in the Special Examination of the Public Sector Pension Investment Board's systems and practices, we conclude that there is reasonable assurance that the Corporation has maintained systems and practices to provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

About the Special Examination

All of the audit work in this report was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While we adopted these standards as the minimum requirement for our examination, we also drew upon the standards and practices of other disciplines.

Objective

Under section 138 of the *Financial Administration Act* (FAA), federal Crown corporations are subject to a special examination once every 10 years. Special examinations of Crown corporations are a form of performance audit where the scope is set by the FAA to include the entire corporation. In special examinations, the examiner provides an opinion on the management of the corporation as a whole. The opinion for this special examination is found on page 3 of this report.

Special examinations answer the question: Do the Corporation's systems and practices provide reasonable assurance that assets are safeguarded and controlled, resources are managed economically and efficiently, and operations are carried out effectively? A significant deficiency is reported when there is a major weakness in the Corporation's key systems and practices that could prevent it from having reasonable assurance that its assets are safeguarded and controlled, its resources are managed efficiently and economically, and its operations are carried out effectively.

Key systems and practices examined and criteria

At the start of this special examination, we presented the Corporation's Audit and Conflicts Committee with an audit plan that identified the systems and practices, and related criteria, that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. These are the systems and practices and criteria that we used for our special examination.

These criteria were selected for this examination in consultation with the Corporation. They were based on our experience with performance auditing—in particular with our special examinations of Crown corporations—and on our knowledge of the subject matter. Management reviewed and accepted the suitability of the criteria used in the special examination.

Key system and practice examined	Criteria
1. Corporate governance	To maximize the Corporation's effectiveness and its ability to meet its objectives, the Corporation should have a well-performing corporate governance framework that meets industry practices in Board oversight, stewardship, and stakeholder relationships.
2. Risk management	• The Corporation has established an enterprise-wide risk management framework supported by a risk culture that promotes the achievement of its mandate, business goals, and objectives. • The Corporation has systems and practices in place to identify, measure, mitigate, monitor, and report on key risks associated with the achievement of its business objectives.
3. Strategic planning, performance measurement and reporting	The Corporation has a clearly defined strategic direction and specific and measurable goals and objectives to achieve its mandate. Its strategic direction and goals take into account identified risks, and the need to control and protect its assets and manage its resources economically and efficiently. The Corporation has identified performance indicators to measure the performance of its investments and achievement of its mandate and statutory objectives. It also has reports that provide complete, accurate, timely, and balanced information for decision making and accountability reporting.
4. Investment management	• The Corporation has investment decision-making and monitoring processes and procedures in place to support the development of investment strategies, conduct of due diligence, and monitoring of investment performance. • The Corporation has systems and practices that support the identification, measurement, mitigation, management, and reporting of risks inherent to investment activities, including environment, social, and governance risks.
5. Human resource management	• Human resources are managed in a manner that provides the Corporation with the human resource capacity and the work environment it needs to achieve its goals and objectives. • The Corporation has established compensation practices that are aligned with prudent risk-taking and relevant industry practices.
6. Information technology	The planning, development, implementation, and management of information technology and information management systems support the Corporation's strategic and operational objectives, ensure business continuity, and satisfy information needs at an acceptable cost and on a timely basis.

Period covered by the special examination

Audit work for this special examination was substantially completed on 10 December 2010. It covered the systems and practices that were in place between June 2010 and November 2010.

Audit team

Office of the Auditor General

Assistant Auditor General: Clyde MacLellan
Principal: Lissa Lamarche
Directors: Riowen Abgrall and Tony Brigandi

Deloitte

Lead Client Service and Advisory Partner: Don Wilkinson
Lead Engagement Partner: Normand Favreau
Enterprise Risk Associate Partner: Rita Sciannamblo
Senior Manager: Victoria Loutsiv
Senior Manager: Céline Pillet

For information, please contact Communications at 613-995-3708 or 1-888-761-5953 (toll-free).

Appendix List of recommendations

The following is a list of recommendations found in the Special Examination Report. The number in front of the recommendation indicates the paragraph where it appears in the report. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Corporate governance	
32. To assist in providing an orderly transition of appointments of members to the Board of Directors, the Public Sector Pension Investment Board (PSP Investments) should examine whether a more optimal staggering of Board appointments could be implemented and consider whether it should make recommendations to this effect to the Nominating Committee and the President of the Treasury Board. **(19–31)**	Agreed. The Board of Directors of PSP Investments is aware of this issue. Recent appointments have been made in groups, which has led to the limited staggering of the terms of our current directors. Through the Chair of the Board of Directors and the Chair of the Governance Committee, PSP Investments will continue to have dialogue with the President of the Treasury Board and the Nominating Committee to attempt to improve the board appointment process. The Corporation will be proposing two changes in the appointment process to address this issue. The first change will be to restructure the recommendation process of the Nominating Committee. The Corporation will propose to hold an annual meeting with the Nominating Committee to establish the candidate selection criteria, followed by one further meeting with the Nominating Committee in which the preferred candidates and alternates, based on the agreed criteria, are presented to it for recommendation to the President of the Treasury Board. The second change will be to recommend to the Nominating Committee and the President of the Treasury Board that when appointments are to be made in groups, that they be made for different term lengths to achieve a better staggering of the terms.
Strategic planning, performance measurement and reporting	
55. The Public Sector Pension Investment Board (PSP Investments) should develop and assign measurable outcomes for its strategic goals, to enable measurement of success for each strategic goal. **(45–54)**	Agreed. In its next Strategic Plan, PSP Investments will endeavour to develop additional measurable outcomes that are designed to measure the overall achievement of the strategic goals.

Recommendation	Response
Investment management	
71. The Public Sector Pension Investment Board's (PSP Investments) New Product Committee should systematically review new investment activities using approved investment products to assess whether they introduce new risk exposures. These activities should be subject to the same review and approval process as all new investment products. **(62–70)**	Agreed. The above concern is implicitly addressed by the Terms of Reference of the Management Investment Committee, which includes the review and approval of the business plans of asset classes, investment activities, new investment products, and other investment-related activities. PSP Investments will amend the New Product Committee's Terms of Reference and its related procedures to expand its scope to include new investment activities using approved products.
81. The Public Sector Pension Investment Board should review its public reporting of its responsible investment activities to ensure that they reflect industry practices in this area. **(77–80)**	Agreed. The Corporation will review its public disclosure practices in the area of responsible investing and proxy voting, and will expand its annual disclosure to better align its practices in these areas with those of its peers.

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PUBLIC SECTOR PENSION INVESTMENT BOARD

2011 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
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PSP INVESTMENTS

11

FINANCIAL STATEMENTS AND NOTES TO THE FINANCIAL STATEMENTS

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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 (SIP&P).

In this regard, investments of PSP Investments held during the year ended March 31, 2011, were in accordance with the Act and the SIP&P.

The Audit Committee ("the 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 "joint" auditors, the Office of the Auditor General of Canada and Deloitte & Touche LLP ("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.

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 Independent Auditors' Report. The External Auditors have full and unrestricted access to management and the 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 12, 2011

John Valentini
Executive Vice President,
Chief Operating Officer and Chief Financial Officer
May 12, 2011

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, 2011, were in accordance with the Act and PSP Investments' Statement of Investment Policies, Standards and Procedures".

Paul Cantor
Chairperson
May 12, 2011

PUBLIC SERVICE PENSION PLAN ACCOUNT

INDEPENDENT AUDITORS' REPORT

To the President of the Treasury Board

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Public Sector Pension Investment Board – Public Service Pension Plan Account (the Public Service Pension Plan Account), which comprise the balance sheet as at March 31, 2011, and the statement of net income from operations and comprehensive income and the statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Public Service Pension Plan Account as at March 31, 2011, 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the *Financial Administration Act,* we report that, in our opinion, Canadian generally accepted accounting 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

May 12, 2011
Montreal, Canada

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

May 12, 2011
Ottawa, Canada

BALANCE SHEET

As at March 31

($ millions)	2011	2010
ASSETS		
Investments (Note 3 (a))	**$ 44,375**	$ 35,045
Investment-related assets (Note 3 (a))	**1,075**	584
Other assets	**36**	32
Due from the Canadian Forces Pension Plan Account	**9**	6
Due from the Royal Canadian Mounted Police Pension Plan Account	**3**	2
TOTAL ASSETS	**$ 45,498**	$ 35,669
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 3,140**	$ 1,970
Accounts payable and other liabilities	**59**	38
TOTAL LIABILITIES	**$ 3,199**	$ 2,008
NET ASSETS	**$ 42,299**	$ 33,661
Accumulated net income from operations and comprehensive income	**$ 10,689**	$ 5,642
Accumulated fund transfers	**31,610**	28,019
NET ASSETS	**$ 42,299**	$ 33,661

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 Committee

STATEMENT OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

For the years ended March 31

($ millions)	2011	2010
INVESTMENT INCOME (Note 6)	$ 5,130	$ 5,525
OPERATING EXPENSES (Note 7)	$ 83	$ 67
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	$ 5,047	$ 5,458

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

STATEMENT OF CHANGES IN NET ASSETS

For the years ended March 31

($ millions)	2011	2010
NET ASSETS, BEGINNING OF YEAR	$ 33,661	$ 24,496
Fund transfers (Note 5)	3,591	3,707
Net income from operations and comprehensive income	5,047	5,458
Increase in net assets for the year	8,638	9,165
NET ASSETS, END OF YEAR	$ 42,299	$ 33,661

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) is a Crown corporation created under the *Public Sector Pension Investment Board Act* ("the Act") to manage and invest amounts that are transferred to it, under the *Superannuation Acts*, by the funds (as defined in the Act) of the pension plans established under the *Public Service Superannuation Act*, the *Canadian Forces Superannuation Act* (CFSA), the *Royal Canadian Mounted Police Superannuation Act* (collectively "the *Superannuation Acts*"), and certain regulations under the CFSA ("the CFSA Regulations"). The pension plans established under the *Superannuation Acts* consist of the Public Service pension plan, the Canadian Forces pension plan, and the Royal Canadian Mounted Police pension plan, whereas the pension plan established under the CFSA Regulations is the Reserve Force pension plan. They are herein referred to individually as "the Plan" and collectively as "the Plans".

The fund from which amounts are currently transferred to PSP Investments ("the Fund") relates to pension obligations under the Public Service pension plan for service on or after April 1, 2000. The account managed by PSP Investments for the Fund is herein referred to as "the Plan Account". PSP Investments maintains records of the 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 from the Fund 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, having regard to the funding, policies and requirements of the *Public Service Superannuation Act* and the Public Service pension plan's ability to meet its financial obligations.

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 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 Fund. The financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). 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 carried 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.

At trade date, the best evidence of fair value is the transaction price. At each subsequent reporting period-end, market prices are used to determine fair value where an active market exists (such as a recognized securities exchange), as they reflect actual and regularly occurring market transactions on an arm's length basis. If quoted market prices are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the end of the reporting year that are derived from observable market data.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

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).

VALUATION OF CAPITAL DEBT FINANCING

PSP Investments' short-term capital debt financing is recorded at cost plus accrued interest, which approximate 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 by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment. 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).

INCOME RECOGNITION

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

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 or payable on securities sold short are reflected as dividend expense. Other income includes securities lending income (net of fees on securities borrowed), and Private Market Investments' distributions from pooled funds, limited partnerships or from direct investments and co-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 period-end date. The resulting realized and unrealized gains (losses) on foreign exchange are included in investment income (loss).

FUND TRANSFERS

Amounts received from the Fund are recorded in the 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 makes certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of Private Market Investments, ABTNs, OTC 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, 2011

2. FUTURE CHANGES IN ACCOUNTING POLICIES

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises would converge with International Financial Reporting Standards (IFRS) effective January 1, 2011.

In April 2010, the AcSB issued an exposure draft that proposed a scope expansion to Section 4600 “Pension Plans” 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 do not themselves have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments and would continue to account for and report its investments at fair value.

Concurrent with the aforementioned standard-setting activities in Canada, the International Accounting Standards Board (IASB) had announced that it intended to propose that investment companies be exempt from consolidation and should account for their controlled investments at fair value.

In light of the announcement from the IASB, the AcSB announced in June 2010 that it had decided not to proceed with the scope expansion of Section 4600, but that it would reconsider this need once the IASB finalizes its standard.

In January 2011, the AcSB decided to defer the adoption of IFRS by investment companies, currently applying AcG-18 to annual periods starting on or after January 1, 2013. This deferral delays PSP Investments’ transition to IFRS until the March 31, 2014 annual consolidated financial statements. PSP Investments will finalize its assessment of the impact of its transition to IFRS once the investment company standard is issued.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 was as follows as at March 31:

($ millions)

	2011		2010	
Asset Class	**Fair Value**	**Cost**	Fair Value	Cost
World Equity				
Canadian Equity	$ 10,304	$ 8,466	$ 7,518	$ 6,623
Foreign Equity:				
US Large Cap Equity	2,829	2,590	1,552	1,497
EAFE Large Cap Equity	2,251	2,353	1,502	1,725
Small Cap Developed World Equity	2,319	1,957	1,420	1,320
Emerging Markets Equity	2,061	1,737	1,830	1,636
Private Equity	3,994	3,480	3,797	4,059
Nominal Fixed Income				
Cash, Cash Equivalents & Other [1]	3,208	3,307	3,357	3,455
World Government & Corporate Bonds	2,082	2,156	788	841
Canadian Fixed Income	4,947	4,723	5,116	4,980
Real Return Assets				
World Inflation-Linked Bonds	2,173	2,236	243	255
Real Estate	4,837	4,690	4,451	4,479
Infrastructure	1,973	2,139	1,715	1,761
Absolute Return	1,397	998	1,756	1,630
INVESTMENTS	$ 44,375	$ 40,832	$ 35,045	$ 34,261
Investment-Related Assets				
Amounts receivable from pending trades	$ 508	$ 508	$ 119	$ 119
Interest receivable	102	102	76	76
Dividends receivable	36	36	42	42
Derivative-related receivables	429	21	347	4
Total Investment-Related Assets	$ 1,075	$ 667	$ 584	$ 241
Investment-Related Liabilities				
Amounts payable from pending trades	$ (790)	$ (790)	$ (333)	$ (333)
Interest payable	(16)	(16)	(10)	(10)
Securities sold short	(32)	(27)	(82)	(95)
Securities sold under repurchase agreements	(372)	(372)	–	–
Derivative-related payables	(144)	(17)	(302)	(3)
Capital debt financing:				
Short-term	(512)	(512)	(472)	(472)
Long-term	(1,274)	(1,246)	(771)	(734)
Total Investment-Related Liabilities	$ (3,140)	$ (2,980)	$ (1,970)	$ (1,647)
NET INVESTMENTS	$ 42,310	$ 38,519	$ 33,659	$ 32,855

[1] Includes floating rate notes with maturities greater than one year with a fair value of $915 million for the Plan Account (2010 – $1,015 million).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 and co-investments in companies as well as fund investments. They include investments in various private entities as well as mezzanine debt and distressed debt.

The Real Estate asset class is comprised of direct investments in various private entities, properties and third-party debts, as well as 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, partnerships and companies operating in the office, retail, industrial, hospitality and residential sectors, as well as private funds 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, other structured finance products as well as real estate debt funds (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, 2011, 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 Account was $1,540 million (2010 – $1,549 million).

The Infrastructure asset class is comprised of direct investments and co-investments in various private entities and fund investments. They include investments in companies engaged in the management, ownership or operation of assets in power, transportation and other regulated businesses. The Infrastructure asset class is accounted for net of all third-party financings. As at March 31, 2011, the total amount of third-party financing included in the Infrastructure asset class contracted by direct investments controlled by PSP Investments for the Plan Account was $37 million (2010 – $57 million).

Valuation Techniques

The fair value of Private Market Investments is determined at least annually, using acceptable industry valuation methods. During the year, the fair value is reviewed and adjusted, as appropriate, to reflect the impact of any significant market or investment-specific events or circumstances. For each investment, the relevant methodology is applied consistently over time as appropriate in the prevailing circumstances.

In cases where the services of third-party appraisers are used, 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 direct investments and co-investments in Infrastructure, valuation methods used include discounted cash flows, 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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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, prices of recent comparable transactions and the direct capitalization approach. 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, Infrastructure fund investments as well as Private Equity co-investments, the annual 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 & Other, World Government & Corporate Bonds and Canadian Fixed Income. Cash Equivalents include short-term instruments having a maximum term to maturity of one year. Floating rate notes are included in Cash, Cash Equivalents & Other, provided the final maturity date does not exceed three years and the coupons reset more than once per year. World Government & Corporate Bonds and Canadian Fixed Income include government bonds, provincial and territorial bonds, municipal bonds and corporate 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 Account.

PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, 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 Account. As at March 31, 2011, the margin funding facilities have not been drawn upon since inception. The agreement to exchange the non-bank ABCP for ABTNs included a moratorium preventing collateral calls for an 18-month period that ended on July 16, 2010.

Management's best estimate of the fair value of PSP Investments' ABTNs allocated to the Plan Account as at March 31, 2011 was equal to $906 million (2010 – $862 million). This amount was net of principal repayments and corresponding gains, together amounting to $44 million for the year ended March 31, 2011 (for the year ended March 31, 2010 – $107 million). PSP Investments recorded an increase of $57 million in the fair value of the ABTNs allocated to the Plan Account during the year ended March 31, 2011 (increase of $145 million during the year ended March 31, 2010). The fair value of the ABTNs allocated to the Plan Account was reduced by the impact of the funding facilities amounting to $42 million as at March 31, 2011 (2010 – $47 million).

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, expected returns, an average maturity of six years as well as liquidity estimates.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 that consist of externally managed investments. Such investments take advantage of specific opportunities aimed to perform positively irrespective of market performance. Such opportunities include investments in equity, fixed income and derivative instruments.

Valuation Techniques

The fair value of these investments is obtained from the investment's external manager and reflects the fair value of the underlying equity, fixed income or derivative instruments.

(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 year.

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 year.

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) Interest & Dividends Receivable

Interest and dividends are recorded at the amounts expected to be received as at the reporting date.

(vii) Interest Payable

Interest accrued is recorded at the amount expected to be paid as at the reporting date.

(viii) 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.

(ix) Securities Sold under Repurchase Agreements

PSP Investments is party to agreements which involve the sale of securities with a simultaneous agreement to repurchase such securities at a specified price and specified future date.

Securities sold under the repurchase agreements are not derecognized as PSP Investments retains all related risks and rewards of ownership. As such, all related income (loss) continues to be reported in Investment Income (Loss).

Obligations to repurchase the securities sold are accounted for as Investment-Related Liabilities. Interest expense related to such obligations is reported in Investment Income (Loss).

Valuation Techniques

Obligations to repurchase the securities sold under repurchase agreements are recorded at cost plus accrued interest, which approximate fair value.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date, the value of which is derived from changes in underlying assets, interest or exchange rates. Derivative financial instruments do not, typically, require an initial net investment. In certain cases, they require an initial net investment that is less than what would be required to hold the underlying position directly. PSP Investments uses derivative financial instruments to enhance 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:

(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, 2011

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 is 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 to purchase 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. 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. Although pricing models used are widely accepted and used by other market participants, in the case of collaterized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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. Except for credit derivatives [1], notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions disclosed below. 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)	2011				2010			
		Fair Value				Fair Value		
INVESTMENTS	Notional Value	Assets	Liabilities	Net	Notional Value	Assets	Liabilities	Net
Equity and Commodity Derivatives								
Futures	$ 314	$ –	$ –	$ –	$ 82	$ –	$ –	$ –
Total Return Swaps	4,039	139	–	139	2,563	84	(1)	83
Warrants and Rights	2	2	–	2	1	1	–	1
Options: Listed-purchased	322	9	–	9	–	–	–	–
Listed-written	288	–	(14)	(14)	4	–	–	–
Currency Derivatives								
Forwards	12,466	230	(88)	142	7,407	225	(20)	205
Swaps	1,219	18	(8)	10	–	–	–	–
Options: OTC-purchased	736	4	–	4	476	3	–	3
OTC-written	133	–	(2)	(2)	124	–	(1)	(1)
Interest Rate Derivatives								
Bond Forwards	724	4	(2)	2	149	–	(1)	(1)
Futures	1,290	–	–	–	379	–	–	–
Interest Rate Swaps	12,791	10	(12)	(2)	2,840	17	(28)	(11)
Total Return Swaps	471	–	–	–	2,045	14	(10)	4
Swaptions	2,568	5	(2)	3	–	–	–	–
Options: Listed-purchased	3,898	5	–	5	309	–	–	–
Listed-written	5,476	–	(5)	(5)	847	–	–	–
Credit Derivatives [1]:								
Purchased	305	2	(3)	(1)	20	1	–	1
Sold	298	1	(8)	(7)	541	2	(241)	(239)
Total	$ 47,340	$ 429	$ (144)	$ 285	$ 17,787	$ 347	$ (302)	$ 45

[1] Credit derivatives include credit default swaps and collateralized debt obligations. 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, 2011

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives was as follows as at March 31, 2011:

($ millions)

Less than 3 months	$ 17,608
3 to 12 months	27,117
Over 1 year	2,615
Total	**$ 47,340**

(C) FAIR VALUE MEASUREMENT

Investments, investment-related assets and investment-related liabilities 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 assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities 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 assets or liabilities.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2011:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 18,205	$ 1,559	$ –	$ –	$ 19,764
Private Equity	–	–	3,994	–	3,994
Nominal Fixed Income	425	8,791	1,021	–	10,237
Real Return Assets					
World Inflation-Linked Bonds	–	2,173	–	–	2,173
Real Estate	–	–	4,837	–	4,837
Infrastructure	–	–	1,973	–	1,973
Absolute Return	–	812	585	–	1,397
INVESTMENTS	$ 18,630	$ 13,335	$ 12,410	$ –	$ 44,375
Investment-Related Assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 508	$ 508
Interest receivable[1]	–	–	–	102	102
Dividends receivable[1]	–	–	–	36	36
Derivative-related receivables	15	412	2	–	429
Total Investment-Related Assets	$ 15	$ 412	$ 2	$ 646	$ 1,075
Investment-Related Liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (790)	$ (790)
Interest payable[1]	–	–	–	(16)	(16)
Securities sold short	(32)	–	–	–	(32)
Securities sold under repurchase agreements	–	(372)	–	–	(372)
Derivative-related payables	(19)	(118)	(7)	–	(144)
Capital debt financing:					
Short-term	–	(512)	–	–	(512)
Long-term	–	(1,274)	–	–	(1,274)
Total Investment-Related Liabilities	$ (51)	$ (2,276)	$ (7)	$ (806)	$ (3,140)
NET INVESTMENTS	$ 18,594	$ 11,471	$ 12,405	$ (160)	$ 42,310

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2010:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 12,799	$ 1,023	$ –	$ –	$ 13,822
Private Equity	–	–	3,797	–	3,797
Nominal Fixed Income	88	8,238	935	–	9,261
Real Return Assets					
World Inflation-Linked Bonds	–	243	–	–	243
Real Estate	–	–	4,451	–	4,451
Infrastructure	–	–	1,715	–	1,715
Absolute Return	–	901	855	–	1,756
INVESTMENTS	$ 12,887	$ 10,405	$ 11,753	$ –	$ 35,045
Investment-Related Assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 119	$ 119
Interest receivable[1]	–	–	–	76	76
Dividends receivable[1]	–	–	–	42	42
Derivative-related receivables	–	343	4	–	347
Total Investment-Related Assets	$ –	$ 343	$ 4	$ 237	$ 584
Investment-Related Liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (333)	$ (333)
Interest payable[1]	–	–	–	(10)	(10)
Securities sold short	(82)	–	–	–	(82)
Derivative-related payables	–	(61)	(241)	–	(302)
Capital debt financing:					
Short-term	–	(472)	–	–	(472)
Long-term	–	(771)	–	–	(771)
Total Investment-Related Liabilities	$ (82)	$ (1,304)	$ (241)	$ (343)	$ (1,970)
NET INVESTMENTS	$ 12,805	$ 9,444	$ 11,516	$ (106)	$ 33,659

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The classification within the levels of the hierarchy is established at the time of the initial valuation of the asset or liability and reviewed on each subsequent reporting period-end.

There were no significant transfers between Level 1 and Level 2 during the year ended March 31, 2011 (no significant transfers during the year ended March 31, 2010).

Level 3 Reconciliation

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2011:

($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative–related receivables/ payables (net)	Total
Opening Balance	$ 3,797	$ 935	$ 6,166	$ 855	$ (237)	$ 11,516
Purchases	769	53	1,476	45	193	2,536
Sales/Settlements	(1,170)	(21)	(938)	(418)	(3)	(2,550)
Total gains (losses)	610	54	106	103	42	915
Transfer out of Level 3	(12)	–	–	–	–	(12)
Closing Balance	$ 3,994	$ 1,021	$ 6,810	$ 585	$ (5)	$ 12,405

Total gains, for the year ended March 31, 2011, included in investment income and categorized within Level 3, are presented as follows:

($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative–related receivables/ payables (net)	Total
Total realized gains (losses)	$ (158)	$ 1	$ 83	$ (30)	$ (180)	$ (284)
Total unrealized gains	$ 768	$ 53	$ 23	$ 133	$ 222	$ 1,199
Total gains	$ 610	$ 54	$ 106	$ 103	$ 42	$ 915

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation (continued)

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities 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	$ 3,075	$ 817	$ 7,105	$ 495	$ (886)	$ 10,606
Purchases	734	–	612	203	1	1,550
Sales/Settlements	(311)	(49)	(744)	(6)	–	(1,110)
Total gains (losses)	299	167	(807)	163	648	470
Transfers into or out of Level 3	–	–	–	–	–	–
Closing Balance	$ 3,797	$ 935	$ 6,166	$ 855	$ (237)	$ 11,516

Total gains (losses), for the year ended March 31, 2010, included in investment income and categorized within Level 3, are presented as follows:

($ 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)	$ 266	$ 156	$ (828)	$ 163	$ 649	$ 406
Total gains (losses)	$ 299	$ 167	$ (807)	$ 163	$ 648	$ 470

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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 2% increase/decrease (2010 – 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).

(D) INVESTMENT ASSET MIX

The SIP&P sets out the long-term target weights of the assets that will be invested for the Plan Account. 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 were as follows as at March 31:

	2011			2010		
($ millions)	**Fair Value**		**Policy Portfolio Long–Term Target**	Fair Value		Policy Portfolio Long–Term Target
World Equity						
Canadian Equity	**$ 13,607**	**32.2%**	**30.0%**	$ 9,853	29.2%	30.0%
Foreign Equity:						
US Large Cap Equity	**2,791**	**6.6**	**5.0**	1,536	4.6	5.0
EAFE Large Cap Equity	**2,225**	**5.2**	**5.0**	1,486	4.4	5.0
Small Cap Developed World Equity	**2,348**	**5.5**	**5.0**	1,438	4.3	5.0
Emerging Markets Equity	**2,961**	**7.0**	**7.0**	2,173	6.5	7.0
Private Equity	**4,069**	**9.6**	**10.0**	3,946	11.7	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	**914**	**2.2**	**2.0**	1,376	4.1	2.0
World Government Bonds	**1,675**	**4.0**	**5.0**	1,548	4.6	5.0
Canadian Fixed Income	**3,927**	**9.3**	**8.0**	3,513	10.4	8.0
Real Return Assets						
World Inflation-Linked Bonds	**2,203**	**5.2**	**5.0**	1,560	4.6	5.0
Real Estate	**3,872**	**9.1**	**10.0**	3,722	11.1	10.0
Infrastructure	**1,718**	**4.1**	**8.0**	1,508	4.5	8.0
NET INVESTMENTS	**$ 42,310**	**100.0%**	**100.0%**	$ 33,659	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, 2011

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. Lending and borrowing transactions under such programs do not transfer the risks or rewards of ownership of the securities to the counterparty. Consequently, PSP Investments does not derecognize securities lent or recognize securities borrowed.

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. PSP Investments and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at March 31, 2011, PSP Investments, on behalf of the Plan Account, has re-invested $1,092 million of collateral held (2010 – $1,287 million).

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

($ millions)	2011	2010
Securities Lending		
Securities lent	$ 4,210	$ 2,913
Collateral contractually receivable[1]	4,404	3,039
Securities Borrowing		
Securities borrowed	32	82
Collateral contractually payable[2]	34	87

[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.

(F) SECURITIES SOLD & COLLATERAL PLEDGED UNDER REPURCHASE AGREEMENTS

Securities sold under repurchase agreements are described in Note 3 (a) (ix) and involve pledging collateral consisting of cash or securities deemed acceptable by the counterparties. Collateral transactions are conducted under terms that are usual and customary in standard repurchase arrangements. Such terms require the respective counterparty to pledge additional collateral based on the changes in the fair value of the existing collateral pledged. The counterparties are authorized to sell, repledge or otherwise use collateral held. The securities pledged as collateral must be returned to the respective counterparty at the end of the contract, unless an event of default occurs. PSP Investments does not sell, repledge or otherwise use collateral held.

On behalf of the Plan Account, PSP Investments pledged collateral under the repurchase agreements with a fair value of $372 million at March 31, 2011 (2010 – nil).

4. INVESTMENT RISK MANAGEMENT

Risk Management is a central part of PSP Investments' operations. Included in the overall risk management framework is a continuous process whereby PSP Investments systematically addresses the investment risks related to its various investment activities with the goal of achieving a maximum rate of return without undue risk of loss.

A risk governance framework that includes required reporting on risk to all levels of the organization ensures that appropriate investment objectives are pursued and achieved in line with the fulfillment of PSP Investments' legislated mandate. The Board of Directors and its committees oversee all risk matters and receive assurances from senior management, including the Chief Risk Officer, as well as PSP Investments' independent internal auditor reporting directly to the Audit Committee.

PSP Investments has adopted an Investment Risk Management Policy which is an integral part of its risk control system and supplements the SIP&P. The objective of this policy is to provide a framework to manage the risks that PSP Investments is exposed to, namely market, credit and liquidity risks.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(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.

Market risk management focuses on the following two key components:

– Policy Portfolio

The Policy Portfolio (long-term asset mix), as defined in the SIP&P, determines a diversification strategy to mitigate risk whereby PSP Investments invests in a diversified portfolio expected to achieve a return at least equal to the Actuarial Rate of Return (ARR); defined as the rate of return assumption used by the Chief Actuary of Canada in the latest actuarial valuation reports of the Plans. In the absence of other factors affecting the funding of the Plans or changes to pension benefits under the Plans, the ARR is the rate of return required to maintain funding requirements and pension benefits at their current levels.

– Active Management

Active management is defined as the sum of investment strategies that deviate from the approved Policy Portfolio. It is designed to supplement the returns of the Policy Portfolio within an active risk budget.

The risks associated with these components are the Policy Portfolio market risk and the active risk. The Policy Portfolio market risk represents the investment risk arising from the exposure to approved asset classes in the approved weightings. In establishing its Policy Portfolio, PSP Investments also takes into consideration the impact of the Policy Portfolio market risk on the funding risk. The funding risk is the risk that the assets under management will be insufficient to meet the relevant pension liabilities of the Plans. The Policy Portfolio is reviewed at least annually as part of the review of the SIP&P, and this review includes changes, if any, to PSP Investments' long-term expectations of market conditions and other factors that may affect the funding levels of the Plans.

Active risk refers to all market risk arising from active management activities. It is managed in accordance with the Investment Risk Management Policy.

Measurement of Market Risk

The Value-at-Risk (VaR) is one of the methods used to measure market risk and is reported on a quarterly basis. It is not the maximum potential loss, but rather the maximum loss not exceeded with a given confidence level, over a given period of time. PSP Investments uses a Historical VaR model incorporating ten years' worth of market returns scaled to a twelve-month holding period at a 95% confidence level. In measuring Policy Portfolio risk, VaR represents the absolute loss expected from the Policy Portfolio (Policy Portfolio VaR). Whereas in terms of measuring the active risk, VaR reflects the loss relative to the Policy Portfolio benchmark (Active VaR).

VaR is statistically valid under normal market conditions and does not specifically consider losses from severe market events. It also assumes that the future will behave in a pattern similar to the past. Consequently, if future market conditions differ significantly from those of the past, potential losses may differ from those originally estimated.

The following table shows the Total VaR consisting of the Policy Portfolio VaR, the Active VaR and the diversification effect, calculated as a percentage of net investments, as at March 31. The diversification effect captures the impact of holding different types of assets which may react differently in various types of situations and thus reduces the Total VaR.

	2011	2010
Policy Portfolio VaR	**22.4%**	21.2%
Active VaR	**2.2**	1.8
Total VaR (Undiversified)	**24.6**	23.0
Diversification Effect	**(2.9)**	(2.0)
Total VaR	**21.7%**	21.0%

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Stress Testing

Although VaR is a widely accepted risk measure, it is complemented by other risk measurement methodologies that provide greater insight on market risk. PSP Investments 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 reacts under such circumstances. Stress testing and scenario analysis are also deployed to assess new product performance.

(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 Account'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 were as follows as at March 31, 2011:

	Terms to Maturity				
($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Total
Government of Canada bonds	$ 18	$ 838	$ 42	$ 344	$ 1,242
Provincial and Territorial bonds	84	330	517	302	1,233
Municipal bonds	8	30	31	4	73
Corporate bonds	96	661	481	255	1,493
ABTNs	–	35	871	–	906
Total Canadian Fixed Income	$ 206	$ 1,894	$ 1,942	$ 905	$ 4,947
Total World Government & Corporate Bonds	$ 580	$ 755	$ 341	$ 406	$ 2,082
Total World Inflation-Linked Bonds	$ –	$ 581	$ 606	$ 986	$ 2,173
Real Estate Debt [1]	$ 162	$ 53	$ –	$ –	$ 215
Grand Total	$ 948	$ 3,283	$ 2,889	$ 2,297	$ 9,417

[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 is not significant due to their short-term nature.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 or cross currency swaps, positions in foreign currencies. PSP Investments' policy is to hedge a target of 50% of its foreign currency investments. Additional factors are considered when implementing the hedging target for investments in emerging countries, namely, total relative exposure and cost effectiveness.

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

	2011		2010	
Currency (in millions of Canadian $)	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 6,920**	**54.0%**	$ 4,565	51.2%
Euro	**1,739**	**13.6**	1,321	14.8
British Pound	**971**	**7.6**	566	6.4
Brazilian Real	**642**	**5.0**	487	5.5
Japanese Yen	**516**	**4.0**	312	3.5
Hong Kong Dollar	**484**	**3.8**	368	4.1
Korean Won	**342**	**2.7**	255	2.9
Australian Dollar	**223**	**1.7**	110	1.2
New Taiwan Dollar	**205**	**1.6**	145	1.6
South African Rand	**123**	**1.0**	114	1.3
Others	**637**	**5.0**	666	7.5
Total	**$ 12,802**	**100.0%**	$ 8,909	100.0%

PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $2,904 million ($2,576 million US, €270 million and R177 million South African Rands) for the Plan Account which were not included in the foreign currency exposure table.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 that the counterparty to a derivative contract, to a securities lending and borrowing transaction or to securities sold under repurchase agreements, 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 and counterparty that transacts with PSP Investments. 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. Except for ABTNs, 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 Account was as follows as at March 31:

	2011	2010
Investment grade (AAA to BBB–)	**98.0%**	98.1%
Below investment grade (BB+ and below)	**0.4**	0.2
Not rated:		
Rated by a single credit rating agency	**–**	0.2
Not rated by credit rating agencies	**1.6**	1.5
Total	**100.0%**	100.0%

The breakdown of credit concentration risk for the Plan Account did not include investments in distressed debt included in pooled funds in the amount of approximately $1.5 billion as at March 31, 2011 (2010 – approximately $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, 2011, the Plan Account also had a net notional exposure of $190 million (2010 – $447 million) to various tranches of collateralized debt obligations, of which approximately 44% (2010 – approximately 64%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities of a maximum amount of $705 million (2010 – $705 million) to support potential margin calls on the ABTNs (Note 3 (a) (iii)).

As at March 31, 2011, the Plan Account's maximum exposure to credit risk, excluding collateral held and the investments in distressed debt and collateralized debt obligations described above, amounted to approximately $12 billion (2010 – approximately $9 billion). This amount also excludes the impact of guarantees and indemnities disclosed in Note 10.

(i) Counterparty Risk

Counterparty risk represents the credit risk from current and potential exposure related to transactions involving derivative contracts, securities lending and borrowing as well as securities sold under repurchase agreements. In order to minimize 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. With respect to derivative contracts, PSP Investments has the ability to terminate all trades with most counterparties who have their credit rating downgraded below "A–" subsequent to the trade date.

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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSP Investments to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments did not deposit nor did it pledge any securities as collateral with respect to derivative contracts at March 31, 2011 (2010 – $151 million). All collateral deposited or pledged was held, in the prior fiscal year, with counterparties having a minimum credit rating of “A–”. Securities with a fair value of $100 million were received from counterparties as collateral at March 31, 2011 (2010 – $129 million). PSP Investments does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

With respect to transactions involving securities lending and borrowing as well as securities sold under repurchase agreements, collateral requirements are in place to mitigate counterparty risk. Notes 3 (e) and 3 (f) describe collateral requirements in securities lending and borrowing programs as well as securities sold under repurchase agreements, respectively.

In the case of the securities lending program, PSP Investments’ exposure to counterparty risk is further mitigated as the custodian of the securities lent assumes the risk that a counterparty will be unable to meet its obligations associated with the collateral requirements.

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 and Treasury utilize 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 are disclosed in Note 3 (b).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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, 2011:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities[1]				
Amounts payable from pending trades	$ (790)	$ –	$ –	$ (790)
Interest payable	–	(16)	–	(16)
Securities sold short	(32)	–	–	(32)
Securities sold under repurchase agreements	(372)	–	–	(372)
Capital debt financing	(418)	(94)	(1,274)	(1,786)
Accounts payable and other liabilities	(46)	(3)	(10)	(59)
Total	$ (1,658)	$ (113)	$ (1,284)	$ (3,055)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial assets and liabilities				
Derivative-related assets	$ 175	$ 247	$ 7	$ 429
Derivative-related liabilities[1]	(94)	(35)	(15)	(144)
Total	$ 81	$ 212	$ (8)	$ 285

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

5. FUND TRANSFERS

On behalf of the Plan Account, PSP Investments received fund transfers of $3,591 million for the year ended March 31, 2011 (2010 – $3,707 million) from the Fund.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

6. INVESTMENT INCOME

(A) INVESTMENT INCOME

Investment income, for the years ended March 31, was as follows:

($ millions)	2011	2010
Interest income	$ 374	$ 297
Dividend income	438	296
Other income	132	155
Dividend expense	(14)	(16)
Interest expense (Note 8)	(45)	(39)
Transaction costs	(41)	(15)
External investment management fees[1]	(28)	(24)
	816	654
Net realized gains[2]	1,328	1,110
Net unrealized gains	2,986	3,761
Investment Income	**$ 5,130**	$ 5,525

[1] Includes amounts incurred for public market investments that are paid directly by PSP Investments (Note 1). This excludes certain public market pooled fund investment fees, primarily related to performance, in the amount of $62 million for the year ended March 31, 2011 (2010 – $8 million) as well as Private Market Investments' management fees that are not paid directly by PSP Investments.

Private Market Investments' management fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, amounted to $102 million for the year ended March 31, 2011 (2010 –$111 million).

[2] Includes foreign currency gains of $83 million for the year ended March 31, 2011 (2010 – $451 million).

(B) INVESTMENT INCOME BY ASSET MIX

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

($ millions)	2011	2010
World Equity		
Canadian Equity	$ 2,208	$ 2,680
Foreign Equity:		
US Large Cap Equity	218	179
EAFE Large Cap Equity	125	183
Small Cap Developed World Equity	354	205
Emerging Markets Equity	329	736
Private Equity	758	880
Nominal Fixed Income		
Cash & Cash Equivalents	15	33
World Government Bonds	33	(250)
Canadian Fixed Income	177	142
Real Return Assets		
World Inflation-Linked Bonds	63	(184)
Real Estate	467	20
Infrastructure	(34)	115
Absolute Return[1]	417	786
Investment Income	**$ 5,130**	$ 5,525

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

7. EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the Plan Accounts 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 was 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 years ended March 31, were allocated in proportion to the annual amount of net assets in each Plan Account as follows:

	2011	2010
Public Service Pension Plan Account	**72.7%**	72.5%
Canadian Forces Pension Plan Account	**19.7**	20.0
Royal Canadian Mounted Police Pension Plan Account	**7.1**	7.2
Reserve Force Pension Plan Account	**0.5**	0.3
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 years ended March 31, consisted of the following:

($ thousands)	**2011**	2010
Salaries and benefits	**$ 51,015**	$ 38,745
Professional and consulting fees	**5,867**	6,735
Office supplies and equipment	**9,160**	8,135
Other operating expenses	**3,559**	3,046
Depreciation of fixed assets	**7,158**	5,143
Occupancy costs	**3,495**	3,135
Custodial fees	**1,720**	1,129
Remuneration earned by Directors	**556**	575
Travel and related expenses for Directors	**138**	127
Communication expenses	**144**	229
Total	**$ 82,812**	$ 66,999

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

8. CAPITAL DEBT FINANCING

PSP Investments' Capital Debt Financing program consists of the private placement of short-term promissory notes as well as medium-term notes issued by PSP Capital Inc., a wholly-owned subsidiary of PSP Investments. The capital raised is primarily used to finance investments in the Real Estate and Infrastructure asset classes. It is unconditionally and irrevocably guaranteed by PSP Investments in accordance with its corporate leverage policy.

During the year ended March 31, 2011, the Board of Directors amended the maximum amount authorized for the Capital Debt Financing program. Pursuant to such amendment, as at March 31, 2011, the maximum amount authorized was 7.5% of the net investments plus all recourse debt outstanding of PSP Investments. Within such amount, the short-term promissory note component cannot exceed $3 billion. As at March 31, 2010, the maximum amount authorized by the Board of Directors for the short-term promissory notes and medium-term notes was $2 billion and $2 billion, respectively.

The following outlines the terms as well as the fair value of the notes issued under the Capital Debt Financing program allocated to the Plan Account as at March 31:

($ millions)	2011	2010
Short-term promissory notes, bearing interest between 1% and 1.39% and maturing within 29 and 363 days of issuance (March 31, 2010 – 14 and 120 days)	**$ 512**	$ 472
Medium-term notes Series 1, bearing interest of 4.57% per annum and maturing on December 9, 2013	**$ 770**	$ 771
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**$ 504**	$ –
Total	**$ 1,786**	$ 1,243

The capital amounts allocated to the Plan Account to be paid at maturity are $513 million for the short-term promissory notes, and $729 million and $511 million for the Series 1 and Series 2 medium-term notes, respectively.

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

Interest expense, for the years ended March 31, was as follows:

($ thousands)	2011	2010
Short-term promissory notes	**$ 6,508**	$ 5,393
Medium-term notes	**38,133**	33,214
Total	**$ 44,641**	$ 38,607

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, having regard to the funding, policies and requirements of the pension plans established under the *Superannuation Acts* and the ability of the Plans to meet their financial obligations. 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.

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, 2011

10. GUARANTEES AND INDEMNITIES

PSP Investments provides indemnification to its Directors, its Officers, its vice-presidents 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 or made any payment for such indemnity.

In certain cases, PSP Investments also provides indemnification to third parties in the normal course of business. As a result, PSP Investments may be required to indemnify such third parties in connection with the performance of their contractual obligations. To date, PSP Investments has not received any claims nor made any payments for such indemnities.

As at March 31, 2011, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan Account could assume the obligation up to $292 million (2010 – $292 million) plus interest and other related costs.

As part of an investment transaction entered into during the year ended March 31, 2011, a wholly-owned subsidiary of PSP Investments has agreed to provide indemnification with respect to the contractual obligations and commitments of a third-party. In the event of a default by such third-party, the subsidiary may be required to assume an obligation of up to $195 million, of which $142 million may be allocated to the Plan Account, as estimated at the time of the completion of the investment transaction. The subsidiary would also have direct recourse against the defaulting third party in all circumstances. The guarantee expires in April 2012.

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. The portion of PSP Investments' commitments that would be assumed by the Plan Account was as follows as at March 31, 2011:

($ millions)

Private Equity	$ 1,852
Real Estate	684
Infrastructure	569
Public markets	188
Total	**$ 3,293**

CANADIAN FORCES PENSION PLAN ACCOUNT

INDEPENDENT AUDITORS' REPORT

To the Minister of National Defence

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Public Sector Pension Investment Board – Canadian Forces Pension Plan Account (the Canadian Forces Pension Plan Account), which comprise the balance sheet as at March 31, 2011, and the statement of net income from operations and comprehensive income and the statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Canadian Forces Pension Plan Account as at March 31, 2011, 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the *Financial Administration Act,* we report that, in our opinion, Canadian generally accepted accounting 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

May 12, 2011
Montreal, Canada

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

May 12, 2011
Ottawa, Canada

BALANCE SHEET

As at March 31

($ millions)	2011	2010
ASSETS		
Investments (Note 3 (a))	$ 11,852	$ 9,488
Investment-related assets (Note 3 (a))	287	158
Other assets	10	9
TOTAL ASSETS	$ 12,149	$ 9,655
LIABILITIES		
Investment-related liabilities (Note 3 (a))	$ 839	$ 533
Accounts payable and other liabilities	12	9
Due to the Public Service Pension Plan Account	9	6
TOTAL LIABILITIES	$ 860	$ 548
NET ASSETS	$ 11,289	$ 9,107
Accumulated net income from operations and comprehensive income	$ 2,941	$ 1,587
Accumulated fund transfers	8,348	7,520
NET ASSETS	$ 11,289	$ 9,107

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 Committee

STATEMENT OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

For the years ended March 31

($ millions)	2011	2010
INVESTMENT INCOME (Note 6)	$ 1,376	$ 1,509
OPERATING EXPENSES (Note 7)	$ 22	$ 18
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	$ 1,354	$ 1, 491

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

STATEMENT OF CHANGES IN NET ASSETS

For the years ended March 31

($ millions)	2011	2010
NET ASSETS, BEGINNING OF YEAR	$ 9,107	$ 6,750
Fund transfers (Note 5)	828	866
Net income from operations and comprehensive income	1,354	1,491
Increase in net assets for the year	2,182	2,357
NET ASSETS, END OF YEAR	$ 11,289	$ 9,107

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) is a Crown corporation created under the *Public Sector Pension Investment Board Act* ("the Act") to manage and invest amounts that are transferred to it, under the *Superannuation Acts*, by the funds (as defined in the Act) of the pension plans established under the *Public Service Superannuation Act*, the *Canadian Forces Superannuation Act* (CFSA), the *Royal Canadian Mounted Police Superannuation Act* (collectively "the *Superannuation Acts*"), and certain regulations under the CFSA ("the CFSA Regulations"). The pension plans established under the *Superannuation Acts* consist of the Public Service pension plan, the Canadian Forces pension plan, and the Royal Canadian Mounted Police pension plan, whereas the pension plan established under the CFSA Regulations is the Reserve Force pension plan. They are herein referred to individually as "the Plan" and collectively as "the Plans".

The fund from which amounts are currently transferred to PSP Investments ("the Fund") relates to pension obligations under the Canadian Forces pension plan for service on or after April 1, 2000. The account managed by PSP Investments for the Fund is herein referred to as "the Plan Account". PSP Investments maintains records of the 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 from the Fund 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, having regard to the funding, policies and requirements of the *Canadian Forces Superannuation Act* and the Canadian Forces pension plan's ability to meet its financial obligations.

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 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 Fund. The financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). 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 carried 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.

At trade date, the best evidence of fair value is the transaction price. At each subsequent reporting period-end, market prices are used to determine fair value where an active market exists (such as a recognized securities exchange), as they reflect actual and regularly occurring market transactions on an arm's length basis. If quoted market prices are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the end of the reporting year that are derived from observable market data.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

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).

VALUATION OF CAPITAL DEBT FINANCING

PSP Investments' short-term capital debt financing is recorded at cost plus accrued interest, which approximate 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 by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment. 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).

INCOME RECOGNITION

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

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 or payable on securities sold short are reflected as dividend expense. Other income includes securities lending income (net of fees on securities borrowed), and Private Market Investments' distributions from pooled funds, limited partnerships or from direct investments and co-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 period-end date. The resulting realized and unrealized gains (losses) on foreign exchange are included in investment income (loss).

FUND TRANSFERS

Amounts received from the Fund are recorded in the 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 makes certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of Private Market Investments, ABTNs, OTC 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, 2011

2. FUTURE CHANGES IN ACCOUNTING POLICIES

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises would converge with International Financial Reporting Standards (IFRS) effective January 1, 2011.

In April 2010, the AcSB issued an exposure draft that proposed a scope expansion to Section 4600 "Pension Plans" 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 do not themselves have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments and would continue to account for and report its investments at fair value.

Concurrent with the aforementioned standard-setting activities in Canada, the International Accounting Standards Board (IASB) had announced that it intended to propose that investment companies be exempt from consolidation and should account for their controlled investments at fair value.

In light of the announcement from the IASB, the AcSB announced in June 2010 that it had decided not to proceed with the scope expansion of Section 4600, but that it would reconsider this need once the IASB finalizes its standard.

In January 2011, the AcSB decided to defer the adoption of IFRS by investment companies, currently applying AcG-18 to annual periods starting on or after January 1, 2013. This deferral delays PSP Investments' transition to IFRS until the March 31, 2014 annual consolidated financial statements. PSP Investments will finalize its assessment of the impact of its transition to IFRS once the investment company standard is issued.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 was as follows as at March 31:

($ millions)	2011		2010	
Asset Class	**Fair Value**	**Cost**	Fair Value	Cost
World Equity				
Canadian Equity	**$ 2,752**	**$ 2,255**	$ 2,035	$ 1,791
Foreign Equity:				
US Large Cap Equity	**756**	**691**	420	405
EAFE Large Cap Equity	**601**	**630**	407	468
Small Cap Developed World Equity	**620**	**522**	385	358
Emerging Markets Equity	**550**	**463**	495	443
Private Equity	**1,067**	**932**	1,028	1,102
Nominal Fixed Income				
Cash, Cash Equivalents & Other [1]	**857**	**883**	909	935
World Government & Corporate Bonds	**556**	**576**	214	227
Canadian Fixed Income	**1,321**	**1,261**	1,385	1,348
Real Return Assets				
World Inflation-Linked Bonds	**580**	**596**	66	68
Real Estate	**1,292**	**1,250**	1,205	1,210
Infrastructure	**527**	**571**	464	476
Absolute Return	**373**	**272**	475	448
INVESTMENTS	**$ 11,852**	**$ 10,902**	$ 9,488	$ 9,279
Investment-Related Assets				
Amounts receivable from pending trades	**$ 136**	**$ 136**	$ 32	$ 32
Interest receivable	**27**	**27**	21	21
Dividends receivable	**10**	**10**	11	11
Derivative-related receivables	**114**	**5**	94	2
Total Investment-Related Assets	**$ 287**	**$ 178**	$ 158	$ 66
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (211)**	**$ (211)**	$ (90)	$ (90)
Interest payable	**(4)**	**(4)**	(3)	(3)
Securities sold short	**(8)**	**(7)**	(22)	(26)
Securities sold under repurchase agreements	**(100)**	**(100)**	–	–
Derivative-related payables	**(39)**	**(5)**	(82)	–
Capital debt financing:				
Short-term	**(137)**	**(137)**	(128)	(128)
Long-term	**(340)**	**(332)**	(208)	(199)
Total Investment-Related Liabilities	**$ (839)**	**$ (796)**	$ (533)	$ (446)
NET INVESTMENTS	**$ 11,300**	**$ 10,284**	$ 9,113	$ 8,899

[1] Includes floating rate notes with maturities greater than one year with a fair value of $244 million for the Plan Account (2010 – $275 million).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 and co-investments in companies as well as fund investments. They include investments in various private entities as well as mezzanine debt and distressed debt.

The Real Estate asset class is comprised of direct investments in various private entities, properties and third-party debts, as well as 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, partnerships and companies operating in the office, retail, industrial, hospitality and residential sectors, as well as private funds 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, other structured finance products as well as real estate debt funds (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, 2011, 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 Account was $411 million (2010 – $419 million).

The Infrastructure asset class is comprised of direct investments and co-investments in various private entities and fund investments. They include investments in companies engaged in the management, ownership or operation of assets in power, transportation and other regulated businesses. The Infrastructure asset class is accounted for net of all third-party financings. As at March 31, 2011, the total amount of third-party financing included in the Infrastructure asset class contracted by direct investments controlled by PSP Investments for the Plan Account was $10 million (2010 – $16 million).

Valuation Techniques

The fair value of Private Market Investments is determined at least annually, using acceptable industry valuation methods. During the year, the fair value is reviewed and adjusted, as appropriate, to reflect the impact of any significant market or investment-specific events or circumstances. For each investment, the relevant methodology is applied consistently over time as appropriate in the prevailing circumstances.

In cases where the services of third-party appraisers are used, 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 direct investments and co-investments in Infrastructure, valuation methods used include discounted cash flows, 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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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, prices of recent comparable transactions and the direct capitalization approach. 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, Infrastructure fund investments as well as Private Equity co-investments, the annual 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 & Other, World Government & Corporate Bonds and Canadian Fixed Income. Cash Equivalents include short-term instruments having a maximum term to maturity of one year. Floating rate notes are included in Cash, Cash Equivalents & Other, provided the final maturity date does not exceed three years and the coupons reset more than once per year. World Government & Corporate Bonds and Canadian Fixed Income include government bonds, provincial and territorial bonds, municipal bonds and corporate 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 Account.

PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $190 million was allocated to the Plan Account. As at March 31, 2011, the margin funding facilities have not been drawn upon since inception. The agreement to exchange the non-bank ABCP for ABTNs included a moratorium preventing collateral calls for an 18-month period that ended on July 16, 2010.

Management's best estimate of the fair value of PSP Investments' ABTNs allocated to the Plan Account as at March 31, 2011 was equal to $242 million (2010 – $233 million). This amount was net of principal repayments and corresponding gains, together amounting to $9 million for the year ended March 31, 2011 (for the year ended March 31, 2010 – $26 million). PSP Investments recorded an increase of $12 million in the fair value of the ABTNs allocated to the Plan Account during the year ended March 31, 2011 (increase of $36 million during the year ended March 31, 2010). The fair value of the ABTNs allocated to the Plan Account was reduced by the impact of the funding facilities amounting to $11 million as at March 31, 2011 (2010 – $13 million).

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, expected returns, an average maturity of six years as well as liquidity estimates.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 that consist of externally managed investments. Such investments take advantage of specific opportunities aimed to perform positively irrespective of market performance. Such opportunities include investments in equity, fixed income and derivative instruments.

Valuation Techniques

The fair value of these investments is obtained from the investment's external manager and reflects the fair value of the underlying equity, fixed income or derivative instruments.

(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 year.

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 year.

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) Interest & Dividends Receivable

Interest and dividends are recorded at the amounts expected to be received as at the reporting date.

(vii) Interest Payable

Interest accrued is recorded at the amount expected to be paid as at the reporting date.

(viii) 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.

(ix) Securities Sold under Repurchase Agreements

PSP Investments is party to agreements which involve the sale of securities with a simultaneous agreement to repurchase such securities at a specified price and specified future date.

Securities sold under the repurchase agreements are not derecognized as PSP Investments retains all related risks and rewards of ownership. As such, all related income (loss) continues to be reported in Investment Income (Loss).

Obligations to repurchase the securities sold are accounted for as Investment-Related Liabilities. Interest expense related to such obligations is reported in Investment Income (Loss).

Valuation Techniques

Obligations to repurchase the securities sold under repurchase agreements are recorded at cost plus accrued interest, which approximate fair value.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date, the value of which is derived from changes in underlying assets, interest or exchange rates. Derivative financial instruments do not, typically, require an initial net investment. In certain cases, they require an initial net investment that is less than what would be required to hold the underlying position directly. PSP Investments uses derivative financial instruments to enhance 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:

(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, 2011

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 is 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 to purchase 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. 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. Although pricing models used are widely accepted and used by other market participants, in the case of collaterized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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. Except for credit derivatives [1], notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions disclosed below. 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)

	2011				2010			
		Fair Value				Fair Value		
INVESTMENTS	Notional Value	Assets	Liabilities	Net	Notional Value	Assets	Liabilities	Net
Equity and Commodity Derivatives								
Futures	$ 84	$ –	$ –	$ –	$ 22	$ –	$ –	$ –
Total Return Swaps	1,079	37	–	37	694	23	–	23
Warrants and Rights	–	–	–	–	–	–	–	–
Options: Listed-purchased	86	2	–	2	–	–	–	–
Listed-written	77	–	(4)	(4)	1	–	–	–
Currency Derivatives								
Forwards	3,330	62	(24)	38	2,005	60	(6)	54
Swaps	326	4	(2)	2	–	–	–	–
Options: OTC-purchased	197	1	–	1	129	1	–	1
OTC-written	36	–	–	–	34	–	–	–
Interest Rate Derivatives								
Bond Forwards	193	1	(1)	–	41	–	(1)	(1)
Futures	345	–	–	–	103	–	–	–
Interest Rate Swaps	3,416	3	(3)	–	769	5	(7)	(2)
Total Return Swaps	125	–	–	–	554	4	(3)	1
Swaptions	685	1	(1)	–	–	–	–	–
Options: Listed-purchased	1,041	1	–	1	84	–	–	–
Listed-written	1,463	–	(1)	(1)	230	–	–	–
Credit Derivatives [1]:								
Purchased	81	1	(1)	–	6	–	–	–
Sold	80	1	(2)	(1)	146	1	(65)	(64)
Total	$ 12,644	$ 114	$ (39)	$ 75	$ 4,818	$ 94	$ (82)	$ 12

[1] Credit derivatives include credit default swaps and collateralized debt obligations. 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, 2011

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives was as follows as at March 31, 2011:

($ millions)

Less than 3 months	$ 4,703
3 to 12 months	7,242
Over 1 year	699
Total	**$ 12,644**

(C) FAIR VALUE MEASUREMENT

Investments, investment-related assets and investment-related liabilities 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 assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities 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 assets or liabilities.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2011:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 4,863	$ 416	$ –	$ –	$ 5,279
Private Equity	–	–	1,067	–	1,067
Nominal Fixed Income	113	2,348	273	–	2,734
Real Return Assets					
World Inflation-Linked Bonds	–	580	–	–	580
Real Estate	–	–	1,292	–	1, 292
Infrastructure	–	–	527	–	527
Absolute Return	–	217	156	–	373
INVESTMENTS	$ 4,976	$ 3,561	$ 3,315	$ –	$ 11,852
Investment-Related Assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 136	$ 136
Interest receivable[1]	–	–	–	27	27
Dividends receivable[1]	–	–	–	10	10
Derivative-related receivables	4	110	–	–	114
Total Investment-Related Assets	$ 4	$ 110	$ –	$ 173	$ 287
Investment-Related Liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (211)	$ (211)
Interest payable[1]	–	–	–	(4)	(4)
Securities sold short	(8)	–	–	–	(8)
Securities sold under repurchase agreements	–	(100)	–	–	(100)
Derivative-related payables	(6)	(31)	(2)	–	(39)
Capital debt financing:					
Short-term	–	(137)	–	–	(137)
Long-term	–	(340)	–	–	(340)
Total Investment-Related Liabilities	$ (14)	$ (608)	$ (2)	$ (215)	$ (839)
NET INVESTMENTS	$ 4,966	$ 3,063	$ 3,313	$ (42)	$ 11,300

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described above, as at March 31, 2010:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 3,465	$ 277	$ –	$ –	$ 3,742
Private Equity	–	–	1,028	–	1,028
Nominal Fixed Income	24	2,231	253	–	2,508
Real Return Assets					
World Inflation-Linked Bonds	–	66	–	–	66
Real Estate	–	–	1,205	–	1,205
Infrastructure	–	–	464	–	464
Absolute Return	–	244	231	–	475
INVESTMENTS	$ 3,489	$ 2,818	$ 3,181	$ –	$ 9,488
Investment-Related Assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 32	$ 32
Interest receivable[1]	–	–	–	21	21
Dividends receivable[1]	–	–	–	11	11
Derivative-related receivables	–	93	1	–	94
Total Investment-Related Assets	$ –	$ 93	$ 1	$ 64	$ 158
Investment-Related Liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (90)	$ (90)
Interest payable[1]	–	–	–	(3)	(3)
Securities sold short	(22)	–	–	–	(22)
Derivative-related payables	–	(17)	(65)	–	(82)
Capital debt financing:					
Short-term	–	(128)	–	–	(128)
Long-term	–	(208)	–	–	(208)
Total Investment-Related Liabilities	$ (22)	$ (353)	$ (65)	$ (93)	$ (533)
NET INVESTMENTS	$ 3,467	$ 2,558	$ 3,117	$ (29)	$ 9,113

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The classification within the levels of the hierarchy is established at the time of the initial valuation of the asset or liability and reviewed on each subsequent reporting period-end.

There were no significant transfers between Level 1 and Level 2 during the year ended March 31, 2011 (no significant transfers during the year ended March 31, 2010).

Level 3 Reconciliation

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2011:

($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative–related receivables/payables (net)	Total
Opening Balance	$ 1,028	$ 253	$ 1,669	$ 231	$ (64)	$ 3,117
Purchases	184	13	338	9	40	584
Sales/Settlements	(274)	(5)	(229)	(103)	(1)	(612)
Total gains	132	12	41	19	23	227
Transfer out of Level 3	(3)	–	–	–	–	(3)
Closing Balance	$ 1,067	$ 273	$ 1,819	$ 156	$ (2)	$ 3,313

Total gains, for the year ended March 31, 2011, included in investment income and categorized within Level 3, are presented as follows:

($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative–related receivables/payables (net)	Total
Total realized gains (losses)	$ (43)	$ –	$ 22	$ (8)	$ (48)	$ (77)
Total unrealized gains	$ 175	$ 12	$ 19	$ 27	$ 71	$ 304
Total gains	$ 132	$ 12	$ 41	$ 19	$ 23	$ 227

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation (continued)

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities 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	$ 848	$ 225	$ 1,960	$ 136	$ (244)	$ 2,925
Purchases	175	–	144	44	–	363
Sales/Settlements	(72)	(12)	(170)	(2)	–	(256)
Total gains (losses)	77	40	(265)	53	180	85
Transfers into or out of Level 3	–	–	–	–	–	–
Closing Balance	$ 1,028	$ 253	$ 1,669	$ 231	$ (64)	$ 3,117

Total gains (losses), for the year ended March 31, 2010, included in investment income and categorized within Level 3, are presented as follows:

($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative–related receivables/ payables (net)	Total
Total realized gains	$ 7	$ 4	$ 5	$ –	$ –	$ 16
Total unrealized gains (losses)	$ 70	$ 36	$ (270)	$ 53	$ 180	$ 69
Total gains (losses)	$ 77	$ 40	$ (265)	$ 53	$ 180	$ 85

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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 2% increase/decrease (2010 – 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).

(D) INVESTMENT ASSET MIX

The SIP&P sets out the long-term target weights of the assets that will be invested for the Plan Account. 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 were as follows as at March 31:

	2011			2010		
($ millions)	Fair Value		Policy Portfolio Long–Term Target	Fair Value		Policy Portfolio Long–Term Target
World Equity						
Canadian Equity	$ 3,634	32.2%	30.0%	$ 2,668	29.2%	30.0%
Foreign Equity:						
US Large Cap Equity	746	6.6	5.0	416	4.6	5.0
EAFE Large Cap Equity	594	5.2	5.0	402	4.4	5.0
Small Cap Developed World Equity	627	5.5	5.0	389	4.3	5.0
Emerging Markets Equity	791	7.0	7.0	588	6.5	7.0
Private Equity	1,087	9.6	10.0	1,069	11.7	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	244	2.2	2.0	373	4.1	2.0
World Government Bonds	447	4.0	5.0	419	4.6	5.0
Canadian Fixed Income	1,049	9.3	8.0	951	10.4	8.0
Real Return Assets						
World Inflation-Linked Bonds	588	5.2	5.0	422	4.6	5.0
Real Estate	1,034	9.1	10.0	1,008	11.1	10.0
Infrastructure	459	4.1	8.0	408	4.5	8.0
NET INVESTMENTS	$ 11,300	100.0%	100.0%	$ 9,113	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, 2011

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. Lending and borrowing transactions under such programs do not transfer the risks or rewards of ownership of the securities to the counterparty. Consequently, PSP Investments does not derecognize securities lent or recognize securities borrowed.

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. PSP Investments and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at March 31, 2011, PSP Investments, on behalf of the Plan Account, has re-invested $292 million of collateral held (2010 – $349 million).

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

($ millions)	2011	2010
Securities Lending		
Securities lent	$ 1,124	$ 789
Collateral contractually receivable[1]	1,176	823
Securities Borrowing		
Securities borrowed	8	22
Collateral contractually payable[2]	9	23

[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.

(F) SECURITIES SOLD & COLLATERAL PLEDGED UNDER REPURCHASE AGREEMENTS

Securities sold under repurchase agreements are described in Note 3 (a) (ix) and involve pledging collateral consisting of cash or securities deemed acceptable by the counterparties. Collateral transactions are conducted under terms that are usual and customary in standard repurchase arrangements. Such terms require the respective counterparty to pledge additional collateral based on the changes in the fair value of the existing collateral pledged. The counterparties are authorized to sell, repledge or otherwise use collateral held. The securities pledged as collateral must be returned to the respective counterparty at the end of the contract, unless an event of default occurs. PSP Investments does not sell, repledge or otherwise use collateral held.

On behalf of the Plan Account, PSP Investments pledged collateral under the repurchase agreements with a fair value of $100 million at March 31, 2011 (2010 – nil).

4. INVESTMENT RISK MANAGEMENT

Risk Management is a central part of PSP Investments' operations. Included in the overall risk management framework is a continuous process whereby PSP Investments systematically addresses the investment risks related to its various investment activities with the goal of achieving a maximum rate of return without undue risk of loss.

A risk governance framework that includes required reporting on risk to all levels of the organization ensures that appropriate investment objectives are pursued and achieved in line with the fulfillment of PSP Investments' legislated mandate. The Board of Directors and its committees oversee all risk matters and receive assurances from senior management, including the Chief Risk Officer, as well as PSP Investments' independent internal auditor reporting directly to the Audit Committee.

PSP Investments has adopted an Investment Risk Management Policy which is an integral part of its risk control system and supplements the SIP&P. The objective of this policy is to provide a framework to manage the risks that PSP Investments is exposed to, namely market, credit and liquidity risks.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(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.

Market risk management focuses on the following two key components:

– Policy Portfolio

The Policy Portfolio (long-term asset mix), as defined in the SIP&P, determines a diversification strategy to mitigate risk whereby PSP Investments invests in a diversified portfolio expected to achieve a return at least equal to the Actuarial Rate of Return (ARR); defined as the rate of return assumption used by the Chief Actuary of Canada in the latest actuarial valuation reports of the Plans. In the absence of other factors affecting the funding of the Plans or changes to pension benefits under the Plans, the ARR is the rate of return required to maintain funding requirements and pension benefits at their current levels.

– Active Management

Active management is defined as the sum of investment strategies that deviate from the approved Policy Portfolio. It is designed to supplement the returns of the Policy Portfolio within an active risk budget.

The risks associated with these components are the Policy Portfolio market risk and the active risk. The Policy Portfolio market risk represents the investment risk arising from the exposure to approved asset classes in the approved weightings. In establishing its Policy Portfolio, PSP Investments also takes into consideration the impact of the Policy Portfolio market risk on the funding risk. The funding risk is the risk that the assets under management will be insufficient to meet the relevant pension liabilities of the Plans. The Policy Portfolio is reviewed at least annually as part of the review of the SIP&P, and this review includes changes, if any, to PSP Investments' long-term expectations of market conditions and other factors that may affect the funding levels of the Plans.

Active risk refers to all market risk arising from active management activities. It is managed in accordance with the Investment Risk Management Policy.

Measurement of Market Risk

The Value-at-Risk (VaR) is one of the methods used to measure market risk and is reported on a quarterly basis. It is not the maximum potential loss, but rather the maximum loss not exceeded with a given confidence level, over a given period of time. PSP Investments uses a Historical VaR model incorporating ten years' worth of market returns scaled to a twelve-month holding period at a 95% confidence level. In measuring Policy Portfolio risk, VaR represents the absolute loss expected from the Policy Portfolio (Policy Portfolio VaR). Whereas in terms of measuring the active risk, VaR reflects the loss relative to the Policy Portfolio benchmark (Active VaR).

VaR is statistically valid under normal market conditions and does not specifically consider losses from severe market events. It also assumes that the future will behave in a pattern similar to the past. Consequently, if future market conditions differ significantly from those of the past, potential losses may differ from those originally estimated.

The following table shows the Total VaR consisting of the Policy Portfolio VaR, the Active VaR and the diversification effect, calculated as a percentage of net investments, as at March 31. The diversification effect captures the impact of holding different types of assets which may react differently in various types of situations and thus reduces the Total VaR.

	2011	2010
Policy Portfolio VaR	**22.4%**	21.2%
Active VaR	**2.2**	1.8
Total VaR (Undiversified)	**24.6**	23.0
Diversification Effect	**(2.9)**	(2.0)
Total VaR	**21.7%**	21.0%

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Stress Testing

Although VaR is a widely accepted risk measure, it is complemented by other risk measurement methodologies that provide greater insight on market risk. PSP Investments 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 reacts under such circumstances. Stress testing and scenario analysis are also deployed to assess new product performance.

(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 Account'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 were as follows as at March 31, 2011:

	Terms to Maturity				
($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Total
Government of Canada bonds	$ 5	$ 224	$ 11	$ 92	$ 332
Provincial and Territorial bonds	23	88	138	80	329
Municipal bonds	2	8	8	1	19
Corporate bonds	25	177	129	68	399
ABTNs	–	9	233	–	242
Total Canadian Fixed Income	**$ 55**	**$ 506**	**$ 519**	**$ 241**	**$ 1,321**
Total World Government & Corporate Bonds	**$ 155**	**$ 202**	**$ 91**	**$ 108**	**$ 556**
Total World Inflation-Linked Bonds	**$ –**	**$ 155**	**$ 162**	**$ 263**	**$ 580**
Real Estate Debt [1]	**$ 43**	**$ 14**	**$ –**	**$ –**	**$ 57**
Grand Total	**$ 253**	**$ 877**	**$ 772**	**$ 612**	**$ 2,514**

[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 is not significant due to their short-term nature.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 or cross currency swaps, positions in foreign currencies. PSP Investments' policy is to hedge a target of 50% of its foreign currency investments. Additional factors are considered when implementing the hedging target for investments in emerging countries, namely, total relative exposure and cost effectiveness.

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

Currency (in millions of Canadian $)	2011 Fair Value	2011 % of Total	2010 Fair Value	2010 % of Total
US Dollar	**$ 1,848**	**54.0%**	$ 1,236	51.2%
Euro	**464**	**13.6**	357	14.8
British Pound	**259**	**7.6**	153	6.4
Brazilian Real	**172**	**5.0**	132	5.5
Japanese Yen	**138**	**4.0**	85	3.5
Hong Kong Dollar	**129**	**3.8**	100	4.1
Korean Won	**92**	**2.7**	69	2.9
Australian Dollar	**60**	**1.7**	30	1.2
New Taiwan Dollar	**54**	**1.6**	39	1.6
South African Rand	**33**	**1.0**	31	1.3
Others	**170**	**5.0**	180	7.5
Total	**$ 3,419**	**100.0%**	$ 2,412	100.0%

PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $775 million ($688 million US, €72 million and R48 million South African Rands) for the Plan Account which were not included in the foreign currency exposure table.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 that the counterparty to a derivative contract, to a securities lending and borrowing transaction or to securities sold under repurchase agreements, 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 and counterparty that transacts with PSP Investments. 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. Except for ABTNs, 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 Account was as follows as at March 31:

	2011	2010
Investment grade (AAA to BBB–)	**98.0%**	98.1%
Below investment grade (BB+ and below)	**0.4**	0.2
Not rated:		
Rated by a single credit rating agency	**–**	0.2
Not rated by credit rating agencies	**1.6**	1.5
Total	**100.0%**	100.0%

The breakdown of credit concentration risk for the Plan Account did not include investments in distressed debt included in pooled funds in the amount of approximately $0.4 billion as at March 31, 2011 (2010 – approximately $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, 2011, the Plan Account also had a net notional exposure of $51 million (2010 – $121 million) to various tranches of collateralized debt obligations, of which approximately 44% (2010 – approximately 64%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities of a maximum amount of $190 million (2010 – $190 million) to support potential margin calls on the ABTNs (Note 3 (a) (iii)).

As at March 31, 2011, the Plan Account's maximum exposure to credit risk, excluding collateral held and the investments in distressed debt and collateralized debt obligations described above, amounted to approximately $3 billion (2010 – approximately $3 billion). This amount also excludes the impact of guarantees and indemnities disclosed in Note 10.

(i) Counterparty Risk

Counterparty risk represents the credit risk from current and potential exposure related to transactions involving derivative contracts, securities lending and borrowing as well as securities sold under repurchase agreements. In order to minimize 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. With respect to derivative contracts, PSP Investments has the ability to terminate all trades with most counterparties who have their credit rating downgraded below "A–" subsequent to the trade date.

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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSP Investments to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments did not deposit nor did it pledge any securities as collateral with respect to derivative contracts at March 31, 2011 (2010 – $41 million). All collateral deposited or pledged was held, in the prior fiscal year, with counterparties having a minimum credit rating of "A–". Securities with a fair value of $26 million were received from counterparties as collateral at March 31, 2011 (2010 – $35 million). PSP Investments does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

With respect to transactions involving securities lending and borrowing as well as securities sold under repurchase agreements, collateral requirements are in place to mitigate counterparty risk. Notes 3 (e) and 3 (f) describe collateral requirements in securities lending and borrowing programs as well as securities sold under repurchase agreements, respectively.

In the case of the securities lending program, PSP Investments' exposure to counterparty risk is further mitigated as the custodian of the securities lent assumes the risk that a counterparty will be unable to meet its obligations associated with the collateral requirements.

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 and Treasury utilize 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 are disclosed in Note 3 (b).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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, 2011:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities[1]				
Amounts payable from pending trades	$ (211)	$ –	$ –	$ (211)
Interest payable	–	(4)	–	(4)
Securities sold short	(8)	–	–	(8)
Securities sold under repurchase agreements	(100)	–	–	(100)
Capital debt financing	(112)	(25)	(340)	(477)
Accounts payable and other liabilities	(8)	(1)	(3)	(12)
Total	$ (439)	$ (30)	$ (343)	$ (812)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial assets and liabilities				
Derivative-related assets	$ 46	$ 66	$ 2	$ 114
Derivative-related liabilities[1]	(25)	(9)	(5)	(39)
Total	$ 21	$ 57	$ (3)	$ 75

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

5. FUND TRANSFERS

On behalf of the Plan Account, PSP Investments received fund transfers of $828 million for the year ended March 31, 2011 (2010 – $866 million) from the Fund.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

6. INVESTMENT INCOME

(A) INVESTMENT INCOME

Investment income, for the years ended March 31, was as follows:

($ millions)	2011	2010
Interest income	$ 100	$ 81
Dividend income	118	81
Other income	36	42
Dividend expense	(4)	(4)
Interest expense (Note 8)	(12)	(10)
Transaction costs	(11)	(4)
External investment management fees [1]	(8)	(7)
	219	179
Net realized gains [2]	355	302
Net unrealized gains	802	1,028
Investment Income	**$ 1,376**	$ 1,509

[1] Includes amounts incurred for public market investments that are paid directly by PSP Investments (Note 1). This excludes certain public market pooled fund investment fees, primarily related to performance, in the amount of $16 million for the year ended March 31, 2011 (2010 – $2 million) as well as Private Market Investments' management fees that are not paid directly by PSP Investments.

Private Market Investments' management fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, amounted to $27 million for the year ended March 31, 2011 (2010 – $30 million).

[2] Includes foreign currency gains of $22 million for the year ended March 31, 2011 (2010 – $124 million).

(B) INVESTMENT INCOME BY ASSET MIX

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

($ millions)	2011	2010
World Equity		
Canadian Equity	$ 591	$ 733
Foreign Equity:		
US Large Cap Equity	58	49
EAFE Large Cap Equity	34	50
Small Cap Developed World Equity	95	56
Emerging Markets Equity	88	201
Private Equity	204	239
Nominal Fixed Income		
Cash & Cash Equivalents	4	9
World Government Bonds	9	(69)
Canadian Fixed Income	48	38
Real Return Assets		
World Inflation-Linked Bonds	17	(50)
Real Estate	125	6
Infrastructure	(9)	31
Absolute Return [1]	112	216
Investment Income	**$ 1,376**	$ 1,509

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

7. EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the Plan Accounts 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 was 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 years ended March 31, were allocated in proportion to the annual amount of net assets in each Plan Account as follows:

	2011	2010
Public Service Pension Plan Account	**72.7%**	72.5%
Canadian Forces Pension Plan Account	**19.7**	20.0
Royal Canadian Mounted Police Pension Plan Account	**7.1**	7.2
Reserve Force Pension Plan Account	**0.5**	0.3
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 years ended March 31, consisted of the following:

($ thousands)	2011	2010
Salaries and benefits	**$ 13,810**	$ 10,681
Professional and consulting fees	**1,588**	1,857
Office supplies and equipment	**2,479**	2,240
Other operating expenses	**963**	840
Depreciation of fixed assets	**1,938**	1,418
Occupancy costs	**946**	864
Custodial fees	**465**	311
Remuneration earned by Directors	**150**	158
Travel and related expenses for Directors	**37**	35
Communication expenses	**38**	63
Total	**$ 22,414**	$ 18,467

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

8. CAPITAL DEBT FINANCING

PSP Investments' Capital Debt Financing program consists of the private placement of short-term promissory notes as well as medium-term notes issued by PSP Capital Inc., a wholly-owned subsidiary of PSP Investments. The capital raised is primarily used to finance investments in the Real Estate and Infrastructure asset classes. It is unconditionally and irrevocably guaranteed by PSP Investments in accordance with its corporate leverage policy.

During the year ended March 31, 2011, the Board of Directors amended the maximum amount authorized for the Capital Debt Financing program. Pursuant to such amendment, as at March 31, 2011, the maximum amount authorized was 7.5% of the net investments plus all recourse debt outstanding of PSP Investments. Within such amount, the short-term promissory note component cannot exceed $3 billion. As at March 31, 2010, the maximum amount authorized by the Board of Directors for the short-term promissory notes and medium-term notes was $2 billion and $2 billion, respectively.

The following outlines the terms as well as the fair value of the notes issued under the Capital Debt Financing program allocated to the Plan Account as at March 31:

($ millions)	**2011**	2010
Short-term promissory notes, bearing interest between 1% and 1.39% and maturing within 29 and 363 days of issuance (March 31, 2010 – 14 and 120 days)	**$ 137**	$ 128
Medium-term notes Series 1, bearing interest of 4.57% per annum and maturing on December 9, 2013	**$ 205**	$ 208
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**$ 135**	$ –
Total	**$ 477**	$ 336

The capital amounts allocated to the Plan Account to be paid at maturity are $137 million for the short-term promissory notes, and $195 million and $136 million for the Series 1 and Series 2 medium-term notes, respectively.

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

Interest expense, for the years ended March 31, was as follows:

($ thousands)	**2011**	2010
Short-term promissory notes	**$ 1,745**	$ 1,473
Medium-term notes	**10,235**	9,045
Total	**$ 11,980**	$ 10,518

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, having regard to the funding, policies and requirements of the pension plans established under the *Superannuation Acts* and the ability of the Plans to meet their financial obligations. 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.

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, 2011

10. GUARANTEES AND INDEMNITIES

PSP Investments provides indemnification to its Directors, its Officers, its vice-presidents 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 or made any payment for such indemnity.

In certain cases, PSP Investments also provides indemnification to third parties in the normal course of business. As a result, PSP Investments may be required to indemnify such third parties in connection with the performance of their contractual obligations. To date, PSP Investments has not received any claims nor made any payments for such indemnities.

As at March 31, 2011, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan Account could assume the obligation up to $81 million (2010 – $81 million) plus interest and other related costs.

As part of an investment transaction entered into during the year ended March 31, 2011, a wholly-owned subsidiary of PSP Investments has agreed to provide indemnification with respect to the contractual obligations and commitments of a third-party. In the event of a default by such third-party, the subsidiary may be required to assume an obligation of up to $195 million, of which $38 million may be allocated to the Plan Account, as estimated at the time of the completion of the investment transaction. The subsidiary would also have direct recourse against the defaulting third party in all circumstances. The guarantee expires in April 2012.

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. The portion of PSP Investments' commitments that would be assumed by the Plan Account was as follows as at March 31, 2011:

($ millions)

Private Equity	$ 494
Real Estate	183
Infrastructure	152
Public markets	50
Total	**$ 879**

ROYAL CANADIAN MOUNTED POLICE PENSION PLAN ACCOUNT

INDEPENDENT AUDITORS' REPORT

To the Minister of Public Safety

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Public Sector Pension Investment Board – Royal Canadian Mounted Police Pension Plan Account (the Royal Canadian Mounted Police Pension Plan Account), which comprise the balance sheet as at March 31, 2011, and the statement of net income from operations and comprehensive income and the statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Royal Canadian Mounted Police Pension Plan Account as at March 31, 2011, 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the *Financial Administration Act,* we report that, in our opinion, Canadian generally accepted accounting 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

May 12, 2011
Montreal, Canada

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

May 12, 2011
Ottawa, Canada

BALANCE SHEET

As at March 31

($ millions)	2011	2010
ASSETS		
Investments (Note 3 (a))	**$ 4,306**	$ 3,408
Investment-related assets (Note 3 (a))	**105**	58
Other assets	**3**	3
TOTAL ASSETS	**$ 4,414**	$ 3,469
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 305**	$ 193
Accounts payable and other liabilities	**4**	3
Due to the Public Service Pension Plan Account	**3**	2
TOTAL LIABILITIES	**$ 312**	$ 198
NET ASSETS	**$ 4,102**	$ 3,271
Accumulated net income from operations and comprehensive income	**$ 1,058**	$ 568
Accumulated fund transfers	**3,044**	2,703
NET ASSETS	**$ 4,102**	$ 3,271

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 Committee

STATEMENT OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

For the years ended March 31

($ millions)	2011	2010
INVESTMENT INCOME (Note 6)	$ 498	$ 539
OPERATING EXPENSES (Note 7)	$ 8	$ 7
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	$ 490	$ 532

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

STATEMENT OF CHANGES IN NET ASSETS

For the years ended March 31

($ millions)	2011	2010
NET ASSETS, BEGINNING OF YEAR	$ 3,271	$ 2,416
Fund transfers (Note 5)	341	323
Net income from operations and comprehensive income	490	532
Increase in net assets for the year	831	855
NET ASSETS, END OF YEAR	$ 4,102	$ 3,271

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) is a Crown corporation created under the *Public Sector Pension Investment Board Act* ("the Act") to manage and invest amounts that are transferred to it, under the *Superannuation Acts*, by the funds (as defined in the Act) of the pension plans established under the *Public Service Superannuation Act*, the *Canadian Forces Superannuation Act* (CFSA), the *Royal Canadian Mounted Police Superannuation Act* (collectively "the *Superannuation Acts*"), and certain regulations under the CFSA ("the CFSA Regulations"). The pension plans established under the *Superannuation Acts* consist of the Public Service pension plan, the Canadian Forces pension plan, and the Royal Canadian Mounted Police pension plan, whereas the pension plan established under the CFSA Regulations is the Reserve Force pension plan. They are herein referred to individually as "the Plan" and collectively as "the Plans".

The fund from which amounts are currently transferred to PSP Investments ("the Fund") relates to pension obligations under the Royal Canadian Mounted Police pension plan for service on or after April 1, 2000. The account managed by PSP Investments for the Fund is herein referred to as "the Plan Account". PSP Investments maintains records of the 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 from the Fund 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, having regard to the funding, policies and requirements of the *Royal Canadian Mounted Police Superannuation Act* and the Royal Canadian Mounted Police pension plan's ability to meet its financial obligations.

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 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 Fund. The financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). 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 carried 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.

At trade date, the best evidence of fair value is the transaction price. At each subsequent reporting period-end, market prices are used to determine fair value where an active market exists (such as a recognized securities exchange), as they reflect actual and regularly occurring market transactions on an arm's length basis. If quoted market prices are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the end of the reporting year that are derived from observable market data.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

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).

VALUATION OF CAPITAL DEBT FINANCING

PSP Investments' short-term capital debt financing is recorded at cost plus accrued interest, which approximate 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 by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment. 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).

INCOME RECOGNITION

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

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 or payable on securities sold short are reflected as dividend expense. Other income includes securities lending income (net of fees on securities borrowed), and Private Market Investments' distributions from pooled funds, limited partnerships or from direct investments and co-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 period-end date. The resulting realized and unrealized gains (losses) on foreign exchange are included in investment income (loss).

FUND TRANSFERS

Amounts received from the Fund are recorded in the 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 makes certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of Private Market Investments, ABTNs, OTC 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, 2011

2. FUTURE CHANGES IN ACCOUNTING POLICIES

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises would converge with International Financial Reporting Standards (IFRS) effective January 1, 2011.

In April 2010, the AcSB issued an exposure draft that proposed a scope expansion to Section 4600 "Pension Plans" 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 do not themselves have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments and would continue to account for and report its investments at fair value.

Concurrent with the aforementioned standard-setting activities in Canada, the International Accounting Standards Board (IASB) had announced that it intended to propose that investment companies be exempt from consolidation and should account for their controlled investments at fair value.

In light of the announcement from the IASB, the AcSB announced in June 2010 that it had decided not to proceed with the scope expansion of Section 4600, but that it would reconsider this need once the IASB finalizes its standard.

In January 2011, the AcSB decided to defer the adoption of IFRS by investment companies, currently applying AcG-18 to annual periods starting on or after January 1, 2013. This deferral delays PSP Investments' transition to IFRS until the March 31, 2014 annual consolidated financial statements. PSP Investments will finalize its assessment of the impact of its transition to IFRS once the investment company standard is issued.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 was as follows as at March 31:

($ millions)

	2011		2010	
Asset Class	**Fair Value**	**Cost**	Fair Value	Cost
World Equity				
Canadian Equity	**$ 1,001**	**$ 815**	$ 731	$ 638
Foreign Equity:				
US Large Cap Equity	**275**	**251**	151	145
EAFE Large Cap Equity	**219**	**228**	146	168
Small Cap Developed World Equity	**225**	**189**	138	127
Emerging Markets Equity	**200**	**169**	178	159
Private Equity	**387**	**340**	369	397
Nominal Fixed Income				
Cash, Cash Equivalents & Other [1]	**311**	**322**	326	336
World Government & Corporate Bonds	**201**	**211**	77	83
Canadian Fixed Income	**480**	**458**	497	484
Real Return Assets				
World Inflation-Linked Bonds	**211**	**217**	24	25
Real Estate	**469**	**455**	433	436
Infrastructure	**191**	**207**	167	171
Absolute Return	**136**	**96**	171	159
INVESTMENTS	**$ 4,306**	**$ 3,958**	$ 3,408	$ 3,328
Investment-Related Assets				
Amounts receivable from pending trades	**$ 49**	**$ 49**	$ 12	$ 12
Interest receivable	**10**	**10**	7	7
Dividends receivable	**4**	**4**	4	4
Derivative-related receivables	**42**	**2**	35	–
Total Investment-Related Assets	**$ 105**	**$ 65**	$ 58	$ 23
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (77)**	**$ (77)**	$ (33)	$ (33)
Interest payable	**(1)**	**(1)**	(1)	(1)
Securities sold short	**(4)**	**(3)**	(9)	(9)
Securities sold under repurchase agreements	**(36)**	**(36)**	–	–
Derivative-related payables	**(14)**	**(2)**	(29)	–
Capital debt financing:				
Short-term	**(49)**	**(49)**	(46)	(46)
Long-term	**(124)**	**(121)**	(75)	(71)
Total Investment-Related Liabilities	**$ (305)**	**$ (289)**	$ (193)	$ (160)
NET INVESTMENTS	**$ 4,106**	**$ 3,734**	$ 3,273	$ 3,191

[1] Includes floating rate notes with maturities greater than one year with a fair value of $89 million for the Plan Account (2010 – $99 million).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 and co-investments in companies as well as fund investments. They include investments in various private entities as well as mezzanine debt and distressed debt.

The Real Estate asset class is comprised of direct investments in various private entities, properties and third-party debts, as well as 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, partnerships and companies operating in the office, retail, industrial, hospitality and residential sectors, as well as private funds 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, other structured finance products as well as real estate debt funds (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, 2011, 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 Account was $150 million (2010 – $151 million).

The Infrastructure asset class is comprised of direct investments and co-investments in various private entities and fund investments. They include investments in companies engaged in the management, ownership or operation of assets in power, transportation and other regulated businesses. The Infrastructure asset class is accounted for net of all third-party financings. As at March 31, 2011, the total amount of third-party financing included in the Infrastructure asset class contracted by direct investments controlled by PSP Investments for the Plan Account was $4 million (2010 – $6 million).

Valuation Techniques

The fair value of Private Market Investments is determined at least annually, using acceptable industry valuation methods. During the year, the fair value is reviewed and adjusted, as appropriate, to reflect the impact of any significant market or investment-specific events or circumstances. For each investment, the relevant methodology is applied consistently over time as appropriate in the prevailing circumstances.

In cases where the services of third-party appraisers are used, 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 direct investments and co-investments in Infrastructure, valuation methods used include discounted cash flows, 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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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, prices of recent comparable transactions and the direct capitalization approach. 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, Infrastructure fund investments as well as Private Equity co-investments, the annual 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 & Other, World Government & Corporate Bonds and Canadian Fixed Income. Cash Equivalents include short-term instruments having a maximum term to maturity of one year. Floating rate notes are included in Cash, Cash Equivalents & Other, provided the final maturity date does not exceed three years and the coupons reset more than once per year. World Government & Corporate Bonds and Canadian Fixed Income include government bonds, provincial and territorial bonds, municipal bonds and corporate 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 Account.

PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, 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 Account. As at March 31, 2011, the margin funding facilities have not been drawn upon since inception. The agreement to exchange the non-bank ABCP for ABTNs included a moratorium preventing collateral calls for an 18-month period that ended on July 16, 2010.

Management's best estimate of the fair value of PSP Investments' ABTNs allocated to the Plan Account as at March 31, 2011 was equal to $87 million (2010 – $84 million). This amount was net of principal repayments and corresponding gains, together amounting to $3 million for the year ended March 31, 2011 (for the year ended March 31, 2010 – $10 million). PSP Investments recorded an increase of $4 million in the fair value of the ABTNs allocated to the Plan Account during the year ended March 31, 2011 (increase of $14 million during the year ended March 31, 2010). The fair value of the ABTNs allocated to the Plan Account was reduced by the impact of the funding facilities amounting to $4 million as at March 31, 2011 (2010 – $5 million).

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, expected returns, an average maturity of six years as well as liquidity estimates.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 that consist of externally managed investments. Such investments take advantage of specific opportunities aimed to perform positively irrespective of market performance. Such opportunities include investments in equity, fixed income and derivative instruments.

Valuation Techniques

The fair value of these investments is obtained from the investment's external manager and reflects the fair value of the underlying equity, fixed income or derivative instruments.

(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 year.

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 year.

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) Interest & Dividends Receivable

Interest and dividends are recorded at the amounts expected to be received as at the reporting date.

(vii) Interest Payable

Interest accrued is recorded at the amount expected to be paid as at the reporting date.

(viii) 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.

(ix) Securities Sold under Repurchase Agreements

PSP Investments is party to agreements which involve the sale of securities with a simultaneous agreement to repurchase such securities at a specified price and specified future date.

Securities sold under the repurchase agreements are not derecognized as PSP Investments retains all related risks and rewards of ownership. As such, all related income (loss) continues to be reported in Investment Income (Loss).

Obligations to repurchase the securities sold are accounted for as Investment-Related Liabilities. Interest expense related to such obligations is reported in Investment Income (Loss).

Valuation Techniques

Obligations to repurchase the securities sold under repurchase agreements are recorded at cost plus accrued interest, which approximate fair value.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date, the value of which is derived from changes in underlying assets, interest or exchange rates. Derivative financial instruments do not, typically, require an initial net investment. In certain cases, they require an initial net investment that is less than what would be required to hold the underlying position directly. PSP Investments uses derivative financial instruments to enhance 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:

(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, 2011

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 is 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 to purchase 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. 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. Although pricing models used are widely accepted and used by other market participants, in the case of collaterized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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. Except for credit derivatives[1], notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions disclosed below. 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)

	2011				2010			
	Notional	Fair Value			Notional	Fair Value		
INVESTMENTS	Value	Assets	Liabilities	Net	Value	Assets	Liabilities	Net
Equity and Commodity Derivatives								
Futures	$ 30	$ –	$ –	$ –	$ 8	$ –	$ –	$ –
Total Return Swaps	392	14	–	14	249	9	–	9
Warrants and Rights	–	–	–	–	–	–	–	–
Options: Listed-purchased	32	1	–	1	–	–	–	–
Listed-written	28	–	(1)	(1)	–	–	–	–
Currency Derivatives								
Forwards	1,210	22	(8)	14	720	23	(2)	21
Swaps	119	2	(1)	1	–	–	–	–
Options: OTC-purchased	71	1	–	1	46	–	–	–
OTC-written	13	–	–	–	12	–	–	–
Interest Rate Derivatives								
Bond Forwards	70	–	–	–	15	–	–	–
Futures	125	–	–	–	37	–	–	–
Interest Rate Swaps	1,241	1	(2)	(1)	276	2	(3)	(1)
Total Return Swaps	46	–	–	–	199	1	(1)	–
Swaptions	249	–	–	–	–	–	–	–
Options: Listed-purchased	378	1	–	1	30	–	–	–
Listed-written	531	–	(1)	(1)	82	–	–	–
Credit Derivatives[1]:								
Purchased	30	–	–	–	2	–	–	–
Sold	29	–	(1)	(1)	53	–	(23)	(23)
Total	$ 4,594	$ 42	$ (14)	$ 28	$ 1,729	$ 35	$ (29)	$ 6

[1] Credit derivatives include credit default swaps and collateralized debt obligations. 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, 2011

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives was as follows as at March 31, 2011:

($ millions)

Less than 3 months	$ 1,709
3 to 12 months	2,631
Over 1 year	254
Total	**$ 4,594**

(C) FAIR VALUE MEASUREMENT

Investments, investment-related assets and investment-related liabilities 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 assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities 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 assets or liabilities.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2011:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 1,768	$ 152	$ –	$ –	$ 1,920
Private Equity	–	–	387	–	387
Nominal Fixed Income	41	852	99	–	992
Real Return Assets					
World Inflation-Linked Bonds	–	211	–	–	211
Real Estate	–	–	469	–	469
Infrastructure	–	–	191	–	191
Absolute Return	–	78	58	–	136
INVESTMENTS	$ 1,809	$ 1,293	$ 1,204	$ –	$ 4,306
Investment-Related Assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 49	$ 49
Interest receivable[1]	–	–	–	10	10
Dividends receivable[1]	–	–	–	4	4
Derivative-related receivables	1	41	–	–	42
Total Investment-Related Assets	$ 1	$ 41	$ –	$ 63	$ 105
Investment-Related Liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (77)	$ (77)
Interest payable[1]	–	–	–	(1)	(1)
Securities sold short	(4)	–	–	–	(4)
Securities sold under repurchase agreements	–	(36)	–	–	(36)
Derivative-related payables	(1)	(12)	(1)	–	(14)
Capital debt financing:					
Short-term	–	(49)	–	–	(49)
Long-term	–	(124)	–	–	(124)
Total Investment-Related Liabilities	$ (5)	$ (221)	$ (1)	$ (78)	$ (305)
NET INVESTMENTS	$ 1,805	$ 1,113	$ 1,203	$ (15)	$ 4,106

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2010:

($ millions)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 1,245	$ 99	$ –	$ –	$ 1,344
Private Equity	–	–	369	–	369
Nominal Fixed Income	8	801	91	–	900
Real Return Assets					
World Inflation-Linked Bonds	–	24	–	–	24
Real Estate	–	–	433	–	433
Infrastructure	–	–	167	–	167
Absolute Return	–	88	83	–	171
INVESTMENTS	$ 1,253	$ 1,012	$ 1,143	$ –	$ 3,408
Investment-Related Assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 12	$ 12
Interest receivable[1]	–	–	–	7	7
Dividends receivable[1]	–	–	–	4	4
Derivative-related receivables	–	35	–	–	35
Total Investment-Related Assets	$ –	$ 35	$ –	$ 23	$ 58
Investment-Related Liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (33)	$ (33)
Interest payable[1]	–	–	–	(1)	(1)
Securities sold short	(9)	–	–	–	(9)
Derivative-related payables	–	(6)	(23)	–	(29)
Capital debt financing:					
Short-term	–	(46)	–	–	(46)
Long-term	–	(75)	–	–	(75)
Total Investment-Related Liabilities	$ (9)	$ (127)	$ (23)	$ (34)	$ (193)
NET INVESTMENTS	$ 1,244	$ 920	$ 1,120	$ (11)	$ 3,273

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The classification within the levels of the hierarchy is established at the time of the initial valuation of the asset or liability and reviewed on each subsequent reporting period-end.

There were no significant transfers between Level 1 and Level 2 during the year ended March 31, 2011 (no significant transfers during the year ended March 31, 2010).

Level 3 Reconciliation

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2011:

($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative–related receivables/payables (net)	Total
Opening Balance	$ 369	$ 91	$ 600	$ 83	$ (23)	$ 1,120
Purchases	77	5	127	4	16	229
Sales/Settlements	(114)	(2)	(90)	(48)	–	(254)
Total gains	56	5	23	19	6	109
Transfer out of Level 3	(1)	–	–	–	–	(1)
Closing Balance	$ 387	$ 99	$ 660	$ 58	$ (1)	$ 1,203

Total gains, for the year ended March 31, 2011, included in investment income and categorized within Level 3, are presented as follows:

($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative–related receivables/payables (net)	Total
Total realized gains (losses)	$ (15)	$ –	$ 8	$ (3)	$ (18)	$ (28)
Total unrealized gains	$ 71	$ 5	$ 15	$ 22	$ 24	$ 137
Total gains	$ 56	$ 5	$ 23	$ 19	$ 6	$ 109

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation (continued)

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities 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	$ 303	$ 81	$ 701	$ 49	$ (88)	$ 1,046
Purchases	64	–	55	16	–	135
Sales/Settlements	(27)	(4)	(66)	–	–	(97)
Total gains (losses)	29	14	(90)	18	65	36
Transfers into or out of Level 3	–	–	–	–	–	–
Closing Balance	$ 369	$ 91	$ 600	$ 83	$ (23)	$ 1,120

Total gains (losses), for the year ended March 31, 2010, included in investment income and categorized within Level 3, are presented as follows:

($ millions)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative–related receivables/ payables (net)	Total
Total realized gains	$ 3	$ 1	$ 2	$ –	$ –	$ 6
Total unrealized gains (losses)	$ 26	$ 13	$ (92)	$ 18	$ 65	$ 30
Total gains (losses)	$ 29	$ 14	$ (90)	$ 18	$ 65	$ 36

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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 2% increase/decrease (2010 – 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).

(D) INVESTMENT ASSET MIX

The SIP&P sets out the long-term target weights of the assets that will be invested for the Plan Account. 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 were as follows as at March 31:

	2011			2010		
($ millions)	Fair Value		Policy Portfolio Long–Term Target	Fair Value		Policy Portfolio Long–Term Target
World Equity						
Canadian Equity	**$ 1,320**	**32.2%**	**30.0%**	$ 958	29.2%	30.0%
Foreign Equity:						
US Large Cap Equity	**271**	**6.6**	**5.0**	149	4.6	5.0
EAFE Large Cap Equity	**216**	**5.2**	**5.0**	145	4.4	5.0
Small Cap Developed World Equity	**228**	**5.5**	**5.0**	140	4.3	5.0
Emerging Markets Equity	**287**	**7.0**	**7.0**	211	6.5	7.0
Private Equity	**395**	**9.6**	**10.0**	384	11.7	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	**89**	**2.2**	**2.0**	134	4.1	2.0
World Government Bonds	**163**	**4.0**	**5.0**	150	4.6	5.0
Canadian Fixed Income	**381**	**9.3**	**8.0**	342	10.4	8.0
Real Return Assets						
World Inflation-Linked Bonds	**214**	**5.2**	**5.0**	152	4.6	5.0
Real Estate	**376**	**9.1**	**10.0**	362	11.1	10.0
Infrastructure	**166**	**4.1**	**8.0**	146	4.5	8.0
NET INVESTMENTS	**$ 4,106**	**100.0 %**	**100.0%**	$ 3,273	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, 2011

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. Lending and borrowing transactions under such programs do not transfer the risks or rewards of ownership of the securities to the counterparty. Consequently, PSP Investments does not derecognize securities lent or recognize securities borrowed.

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. PSP Investments and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at March 31, 2011, PSP Investments, on behalf of the Plan Account, has re-invested $106 million of collateral held (2010 – $125 million).

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

($ millions)	2011	2010
Securities Lending		
Securities lent	$ 409	$ 283
Collateral contractually receivable[1]	427	296
Securities Borrowing		
Securities borrowed	4	9
Collateral contractually payable[2]	3	8

[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.

(F) SECURITIES SOLD & COLLATERAL PLEDGED UNDER REPURCHASE AGREEMENTS

Securities sold under repurchase agreements are described in Note 3 (a) (ix) and involve pledging collateral consisting of cash or securities deemed acceptable by the counterparties. Collateral transactions are conducted under terms that are usual and customary in standard repurchase arrangements. Such terms require the respective counterparty to pledge additional collateral based on the changes in the fair value of the existing collateral pledged. The counterparties are authorized to sell, repledge or otherwise use collateral held. The securities pledged as collateral must be returned to the respective counterparty at the end of the contract, unless an event of default occurs. PSP Investments does not sell, repledge or otherwise use collateral held.

On behalf of the Plan Account, PSP Investments pledged collateral under the repurchase agreements with a fair value of $36 million at March 31, 2011 (2010 – nil).

4. INVESTMENT RISK MANAGEMENT

Risk Management is a central part of PSP Investments' operations. Included in the overall risk management framework is a continuous process whereby PSP Investments systematically addresses the investment risks related to its various investment activities with the goal of achieving a maximum rate of return without undue risk of loss.

A risk governance framework that includes required reporting on risk to all levels of the organization ensures that appropriate investment objectives are pursued and achieved in line with the fulfillment of PSP Investments' legislated mandate. The Board of Directors and its committees oversee all risk matters and receive assurances from senior management, including the Chief Risk Officer, as well as PSP Investments' independent internal auditor reporting directly to the Audit Committee.

PSP Investments has adopted an Investment Risk Management Policy which is an integral part of its risk control system and supplements the SIP&P. The objective of this policy is to provide a framework to manage the risks that PSP Investments is exposed to, namely market, credit and liquidity risks.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(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.

Market risk management focuses on the following two key components:

– Policy Portfolio

The Policy Portfolio (long-term asset mix), as defined in the SIP&P, determines a diversification strategy to mitigate risk whereby PSP Investments invests in a diversified portfolio expected to achieve a return at least equal to the Actuarial Rate of Return (ARR); defined as the rate of return assumption used by the Chief Actuary of Canada in the latest actuarial valuation reports of the Plans. In the absence of other factors affecting the funding of the Plans or changes to pension benefits under the Plans, the ARR is the rate of return required to maintain funding requirements and pension benefits at their current levels.

– Active Management

Active management is defined as the sum of investment strategies that deviate from the approved Policy Portfolio. It is designed to supplement the returns of the Policy Portfolio within an active risk budget.

The risks associated with these components are the Policy Portfolio market risk and the active risk. The Policy Portfolio market risk represents the investment risk arising from the exposure to approved asset classes in the approved weightings. In establishing its Policy Portfolio, PSP Investments also takes into consideration the impact of the Policy Portfolio market risk on the funding risk. The funding risk is the risk that the assets under management will be insufficient to meet the relevant pension liabilities of the Plans. The Policy Portfolio is reviewed at least annually as part of the review of the SIP&P, and this review includes changes, if any, to PSP Investments' long-term expectations of market conditions and other factors that may affect the funding levels of the Plans.

Active risk refers to all market risk arising from active management activities. It is managed in accordance with the Investment Risk Management Policy.

Measurement of Market Risk

The Value-at-Risk (VaR) is one of the methods used to measure market risk and is reported on a quarterly basis. It is not the maximum potential loss, but rather the maximum loss not exceeded with a given confidence level, over a given period of time. PSP Investments uses a Historical VaR model incorporating ten years' worth of market returns scaled to a twelve-month holding period at a 95% confidence level. In measuring Policy Portfolio risk, VaR represents the absolute loss expected from the Policy Portfolio (Policy Portfolio VaR). Whereas in terms of measuring the active risk, VaR reflects the loss relative to the Policy Portfolio benchmark (Active VaR).

VaR is statistically valid under normal market conditions and does not specifically consider losses from severe market events. It also assumes that the future will behave in a pattern similar to the past. Consequently, if future market conditions differ significantly from those of the past, potential losses may differ from those originally estimated.

The following table shows the Total VaR consisting of the Policy Portfolio VaR, the Active VaR and the diversification effect, calculated as a percentage of net investments, as at March 31. The diversification effect captures the impact of holding different types of assets which may react differently in various types of situations and thus reduces the Total VaR.

	2011	2010
Policy Portfolio VaR	**22.4%**	21.2%
Active VaR	**2.2**	1.8
Total VaR (Undiversified)	**24.6**	23.0
Diversification Effect	**(2.9)**	(2.0)
Total VaR	**21.7%**	21.0%

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Stress Testing

Although VaR is a widely accepted risk measure, it is complemented by other risk measurement methodologies that provide greater insight on market risk. PSP Investments 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 reacts under such circumstances. Stress testing and scenario analysis are also deployed to assess new product performance.

(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 Account'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 were as follows as at March 31, 2011:

	Terms to Maturity				
($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Total
Government of Canada bonds	$ 2	$ 81	$ 5	$ 33	$ 121
Provincial and Territorial bonds	8	32	50	30	120
Municipal bonds	1	3	3	–	7
Corporate bonds	9	64	47	25	145
ABTNs	–	4	83	–	87
Total Canadian Fixed Income	**$ 20**	**$ 184**	**$ 188**	**$ 88**	**$ 480**
Total World Government & Corporate Bonds	**$ 56**	**$ 72**	**$ 33**	**$ 40**	**$ 201**
Total World Inflation-Linked Bonds	**$ –**	**$ 56**	**$ 59**	**$ 96**	**$ 211**
Real Estate Debt [1]	**$ 16**	**$ 5**	**$ –**	**$ –**	**$ 21**
Grand Total	**$ 92**	**$ 317**	**$ 280**	**$ 224**	**$ 913**

[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 is not significant due to their short-term nature.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 or cross currency swaps, positions in foreign currencies. PSP Investments' policy is to hedge a target of 50% of its foreign currency investments. Additional factors are considered when implementing the hedging target for investments in emerging countries, namely, total relative exposure and cost effectiveness.

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

	2011		2010	
Currency (in millions of Canadian $)	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 672**	**54.0%**	$ 444	51.2%
Euro	**169**	**13.6**	128	14.8
British Pound	**94**	**7.6**	55	6.4
Brazilian Real	**62**	**5.0**	47	5.5
Japanese Yen	**50**	**4.0**	30	3.5
Hong Kong Dollar	**47**	**3.8**	36	4.1
Korean Won	**33**	**2.7**	25	2.9
Australian Dollar	**21**	**1.7**	10	1.2
New Taiwan Dollar	**20**	**1.6**	15	1.6
South African Rand	**12**	**1.0**	11	1.3
Others	**62**	**5.0**	66	7.5
Total	**$ 1,242**	**100.0%**	$ 867	100.0%

PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $282 million ($250 million US, €26 million and R17 million South African Rands) for the Plan Account which were not included in the foreign currency exposure table.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 that the counterparty to a derivative contract, to a securities lending and borrowing transaction or to securities sold under repurchase agreements, 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 and counterparty that transacts with PSP Investments. 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. Except for ABTNs, 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 Account was as follows as at March 31:

	2011	2010
Investment grade (AAA to BBB–)	**98.0%**	98.1%
Below investment grade (BB+ and below)	**0.4**	0.2
Not rated:		
Rated by a single credit rating agency	**–**	0.2
Not rated by credit rating agencies	**1.6**	1.5
Total	**100.0%**	100.0%

The breakdown of credit concentration risk for the Plan Account did not include investments in distressed debt included in pooled funds in the amount of approximately $0.1 billion as at March 31, 2011 (2010 – approximately $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, 2011, the Plan Account also had a net notional exposure of $19 million (2010 – $43 million) to various tranches of collateralized debt obligations, of which approximately 44% (2010 – approximately 64%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities of a maximum amount of $69 million (2010 – $69 million) to support potential margin calls on the ABTNs (Note 3 (a) (iii)).

As at March 31, 2011, the Plan Account's maximum exposure to credit risk, excluding collateral held and the investments in distressed debt and collateralized debt obligations described above, amounted to approximately $1 billion (2010 – approximately $1 billion). This amount also excludes the impact of guarantees and indemnities disclosed in Note 10.

(i) Counterparty Risk

Counterparty risk represents the credit risk from current and potential exposure related to transactions involving derivative contracts, securities lending and borrowing as well as securities sold under repurchase agreements. In order to minimize 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. With respect to derivative contracts, PSP Investments has the ability to terminate all trades with most counterparties who have their credit rating downgraded below "A–" subsequent to the trade date.

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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSP Investments to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments did not deposit nor did it pledge any securities as collateral with respect to derivative contracts at March 31, 2011 (2010 – $15 million). All collateral deposited or pledged was held, in the prior fiscal year, with counterparties having a minimum credit rating of “A–”. Securities with a fair value of $10 million were received from counterparties as collateral at March 31, 2011 (2010 – $12 million). PSP Investments does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

With respect to transactions involving securities lending and borrowing as well as securities sold under repurchase agreements, collateral requirements are in place to mitigate counterparty risk. Notes 3 (e) and 3 (f) describe collateral requirements in securities lending and borrowing programs as well as securities sold under repurchase agreements, respectively.

In the case of the securities lending program, PSP Investments’ exposure to counterparty risk is further mitigated as the custodian of the securities lent assumes the risk that a counterparty will be unable to meet its obligations associated with the collateral requirements.

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 and Treasury utilize 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 are disclosed in Note 3 (b).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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, 2011:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities[1]				
Amounts payable from pending trades	$ (77)	$ –	$ –	$ (77)
Interest payable	–	(1)	–	(1)
Securities sold short	(4)	–	–	(4)
Securities sold under repurchase agreements	(36)	–	–	(36)
Capital debt financing	(40)	(9)	(124)	(173)
Accounts payable and other liabilities	(3)	–	(1)	(4)
Total	$ (160)	$ (10)	$ (125)	$ (295)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial assets and liabilities				
Derivative-related assets	$ 17	$ 24	$ 1	$ 42
Derivative-related liabilities[1]	(9)	(3)	(2)	(14)
Total	$ 8	$ 21	$ (1)	$ 28

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

5. FUND TRANSFERS

On behalf of the Plan Account, PSP Investments received fund transfers of $341 million for the year ended March 31, 2011 (2010 – $323 million) from the Fund.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

6. INVESTMENT INCOME

(A) INVESTMENT INCOME

Investment income, for the years ended March 31, was as follows:

($ millions)	2011	2010
Interest income	$ 36	$ 29
Dividend income	42	29
Other income	13	16
Dividend expense	(1)	(2)
Interest expense (Note 8)	(4)	(4)
Transaction costs	(4)	(2)
External investment management fees[1]	(3)	(2)
	79	64
Net realized gains[2]	129	108
Net unrealized gains	290	367
Investment Income	$ 498	$ 539

[1] Includes amounts incurred for public market investments that are paid directly by PSP Investments (Note 1). This excludes certain public market pooled fund investment fees, primarily related to performance, in the amount of $6 million for the year ended March 31, 2011 (2010 – $1 million) as well as Private Market Investments' management fees that are not paid directly by PSP Investments.

Private Market Investments' management fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, amounted to $10 million for the year ended March 31, 2011 (2010 – $11 million).

[2] Includes foreign currency gains of $8 million for the year ended March 31, 2011 (2010 – $44 million).

(B) INVESTMENT INCOME BY ASSET MIX

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

($ millions)	2011	2010
World Equity		
Canadian Equity	$ 215	$ 262
Foreign Equity:		
US Large Cap Equity	21	18
EAFE Large Cap Equity	12	17
Small Cap Developed World Equity	34	20
Emerging Markets Equity	32	72
Private Equity	73	86
Nominal Fixed Income		
Cash & Cash Equivalents	2	3
World Government Bonds	3	(25)
Canadian Fixed Income	17	14
Real Return Assets		
World Inflation-Linked Bonds	6	(18)
Real Estate	45	2
Infrastructure	(3)	11
Absolute Return[1]	41	77
Investment Income	$ 498	$ 539

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

7. EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the Plan Accounts 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 was 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 years ended March 31, were allocated in proportion to the annual amount of net assets in each Plan Account as follows:

	2011	2010
Public Service Pension Plan Account	**72.7%**	72.5%
Canadian Forces Pension Plan Account	**19.7**	20.0
Royal Canadian Mounted Police Pension Plan Account	**7.1**	7.2
Reserve Force Pension Plan Account	**0.5**	0.3
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 years ended March 31, consisted of the following:

($ thousands)	**2011**	2010
Salaries and benefits	**$ 4,958**	$ 3,826
Professional and consulting fees	**571**	665
Office supplies and equipment	**891**	802
Other operating expenses	**346**	301
Depreciation of fixed assets	**695**	508
Occupancy costs	**339**	309
Custodial fees	**168**	111
Remuneration earned by Directors	**54**	58
Travel and related expenses for Directors	**13**	12
Communication expenses	**14**	23
Total	**$ 8,049**	$ 6,615

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

8. CAPITAL DEBT FINANCING

PSP Investments' Capital Debt Financing program consists of the private placement of short-term promissory notes as well as medium-term notes issued by PSP Capital Inc., a wholly-owned subsidiary of PSP Investments. The capital raised is primarily used to finance investments in the Real Estate and Infrastructure asset classes. It is unconditionally and irrevocably guaranteed by PSP Investments in accordance with its corporate leverage policy.

During the year ended March 31, 2011, the Board of Directors amended the maximum amount authorized for the Capital Debt Financing program. Pursuant to such amendment, as at March 31, 2011, the maximum amount authorized was 7.5% of the net investments plus all recourse debt outstanding of PSP Investments. Within such amount, the short-term promissory note component cannot exceed $3 billion. As at March 31, 2010, the maximum amount authorized by the Board of Directors for the short-term promissory notes and medium-term notes was $2 billion and $2 billion, respectively.

The following outlines the terms as well as the fair value of the notes issued under the Capital Debt Financing program allocated to the Plan Account as at March 31:

($ millions)	2011	2010
Short-term promissory notes, bearing interest between 1% and 1.39% and maturing within 29 and 363 days of issuance (March 31, 2010 – 14 and 120 days)	**$ 49**	$ 46
Medium-term notes Series 1, bearing interest of 4.57% per annum and maturing on December 9, 2013	**$ 75**	$ 75
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**$ 49**	$ –
Total	**$ 173**	$ 121

The capital amounts allocated to the Plan Account to be paid at maturity are $50 million for the short-term promissory notes, and $71 million and $49 million for the Series 1 and Series 2 medium-term notes, respectively.

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

Interest expense, for the years ended March 31, was as follows:

($ thousands)	2011	2010
Short-term promissory notes	**$ 631**	$ 527
Medium-term notes	**3,699**	3,235
Total	**$ 4,330**	$ 3,762

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, having regard to the funding, policies and requirements of the pension plans established under the *Superannuation Acts* and the ability of the Plans to meet their financial obligations. 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.

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, 2011

10. GUARANTEES AND INDEMNITIES

PSP Investments provides indemnification to its Directors, its Officers, its vice-presidents 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 or made any payment for such indemnity.

In certain cases, PSP Investments also provides indemnification to third parties in the normal course of business. As a result, PSP Investments may be required to indemnify such third parties in connection with the performance of their contractual obligations. To date, PSP Investments has not received any claims nor made any payments for such indemnities.

As at March 31, 2011, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan Account could assume the obligation up to $29 million (2010 – $29 million) plus interest and other related costs.

As part of an investment transaction entered into during the year ended March 31, 2011, a wholly-owned subsidiary of PSP Investments has agreed to provide indemnification with respect to the contractual obligations and commitments of a third-party. In the event of a default by such third-party, the subsidiary may be required to assume an obligation of up to $195 million, of which $14 million may be allocated to the Plan Account, as estimated at the time of the completion of the investment transaction. The subsidiary would also have direct recourse against the defaulting third party in all circumstances. The guarantee expires in April 2012.

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. The portion of PSP Investments' commitments that would be assumed by the Plan Account was as follows as at March 31, 2011:

($ millions)

Private Equity	$ 180
Real Estate	66
Infrastructure	56
Public markets	18
Total	**$ 320**

RESERVE FORCE PENSION PLAN ACCOUNT

INDEPENDENT AUDITORS' REPORT

To the Minister of National Defence

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Public Sector Pension Investment Board – Reserve Force Pension Plan Account (the Reserve Force Pension Plan Account), which comprise the balance sheet as at March 31, 2011, and the statement of net income from operations and comprehensive income and the statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Reserve Force Pension Plan Account as at March 31, 2011, 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the *Financial Administration Act,* we report that, in our opinion, Canadian generally accepted accounting 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

May 12, 2011
Montreal, Canada

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

May 12, 2011
Ottawa, Canada

RESERVE FORCE PENSION PLAN ACCOUNT

BALANCE SHEET

As at March 31

($ thousands)	2011	2010
ASSETS		
Investments (Note 3 (a))	**$339,327**	$240,642
Investment-related assets (Note 3 (a))	**8,223**	4,012
Other assets	**85**	63
TOTAL ASSETS	**$347,635**	$244,717
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 24,008**	$ 13,529
Accounts payable and other liabilities	**139**	61
Due to the Public Service Pension Plan Account	**241**	114
TOTAL LIABILITIES	**$ 24,388**	$ 13,704
NET ASSETS	**$323,247**	$231,013
Accumulated net income from operations and comprehensive income	**$ 43,730**	$ 5,541
Accumulated fund transfers	**279,517**	225,472
NET ASSETS	**$323,247**	$231,013

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 Committee

RESERVE FORCE PENSION PLAN ACCOUNT

STATEMENT OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

For the years ended March 31

($ thousands)	2011	2010
INVESTMENT INCOME (Note 6)	$ 38,759	$ 31,854
OPERATING EXPENSES (Note 7)	$ 570	$ 315
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	$ 38,189	$ 31,539

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

STATEMENT OF CHANGES IN NET ASSETS

For the years ended March 31

($ thousands)	2011	2010
NET ASSETS, BEGINNING OF YEAR	$231,013	$115,238
Fund transfers (Note 5)	54,045	84,236
Net income from operations and comprehensive income	38,189	31,539
Increase in net assets for the year	92,234	115,775
NET ASSETS, END OF YEAR	$323,247	$231,013

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) is a Crown corporation created under the *Public Sector Pension Investment Board Act* ("the Act") to manage and invest amounts that are transferred to it, under the *Superannuation Acts*, by the funds (as defined in the Act) of the pension plans established under the *Public Service Superannuation Act*, the *Canadian Forces Superannuation Act* (CFSA), the *Royal Canadian Mounted Police Superannuation Act* (collectively "the *Superannuation Acts*"), and certain regulations under the CFSA ("the CFSA Regulations"). The pension plans established under the *Superannuation Acts* consist of the Public Service pension plan, the Canadian Forces pension plan, and the Royal Canadian Mounted Police pension plan, whereas the pension plan established under the CFSA Regulations is the Reserve Force pension plan. They are herein referred to individually as "the Plan" and collectively as "the Plans".

The fund from which amounts are currently transferred to PSP Investments ("the Fund") relates to pension obligations under the Reserve Force pension plan for service on or after March 1, 2007. The account managed by PSP Investments for the Fund is herein referred to as "the Plan Account". PSP Investments maintains records of the 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 from the Fund 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, having regard to the funding, policies and requirements of the *Canadian Forces Superannuation Act* and the Reserve Force pension plan's ability to meet its financial obligations.

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 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 Fund. The financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). 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 carried 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.

At trade date, the best evidence of fair value is the transaction price. At each subsequent reporting period-end, market prices are used to determine fair value where an active market exists (such as a recognized securities exchange), as they reflect actual and regularly occurring market transactions on an arm's length basis. If quoted market prices are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the end of the reporting year that are derived from observable market data.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

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).

VALUATION OF CAPITAL DEBT FINANCING

PSP Investments' short-term capital debt financing is recorded at cost plus accrued interest, which approximate 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 by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment. 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).

INCOME RECOGNITION

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

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 or payable on securities sold short are reflected as dividend expense. Other income includes securities lending income (net of fees on securities borrowed), and Private Market Investments' distributions from pooled funds, limited partnerships or from direct investments and co-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 period-end date. The resulting realized and unrealized gains (losses) on foreign exchange are included in investment income (loss).

FUND TRANSFERS

Amounts received from the Fund are recorded in the 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 makes certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of Private Market Investments, ABTNs, OTC 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, 2011

2. FUTURE CHANGES IN ACCOUNTING POLICIES

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises would converge with International Financial Reporting Standards (IFRS) effective January 1, 2011.

In April 2010, the AcSB issued an exposure draft that proposed a scope expansion to Section 4600 "Pension Plans" 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 do not themselves have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments and would continue to account for and report its investments at fair value.

Concurrent with the aforementioned standard-setting activities in Canada, the International Accounting Standards Board (IASB) had announced that it intended to propose that investment companies be exempt from consolidation and should account for their controlled investments at fair value.

In light of the announcement from the IASB, the AcSB announced in June 2010 that it had decided not to proceed with the scope expansion of Section 4600, but that it would reconsider this need once the IASB finalizes its standard.

In January 2011, the AcSB decided to defer the adoption of IFRS by investment companies, currently applying AcG-18 to annual periods starting on or after January 1, 2013. This deferral delays PSP Investments' transition to IFRS until the March 31, 2014 annual consolidated financial statements. PSP Investments will finalize its assessment of the impact of its transition to IFRS once the investment company standard is issued.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 was as follows as at March 31:

($ thousands)

	2011		2010	
Asset Class	Fair Value	Cost	Fair Value	Cost
World Equity				
Canadian Equity	$ 78,794	$ 67,062	$ 51,622	$ 47,166
Foreign Equity:				
US Large Cap Equity	21,633	19,659	10,657	10,125
EAFE Large Cap Equity	17,210	16,604	10,311	10,673
Small Cap Developed World Equity	17,735	14,837	9,755	8,878
Emerging Markets Equity	15,759	12,841	12,566	10,659
Private Equity	30,542	25,312	26,072	26,634
Nominal Fixed Income				
Cash, Cash Equivalents & Other [1]	24,536	25,284	23,051	23,716
World Government & Corporate Bonds	15,918	16,302	5,413	5,589
Canadian Fixed Income	37,826	36,006	35,127	34,028
Real Return Assets				
World Inflation-Linked Bonds	16,616	16,881	1,671	1,550
Real Estate	36,986	39,539	30,564	34,329
Infrastructure	15,086	16,513	11,777	12,263
Absolute Return	10,686	3,080	12,056	6,629
INVESTMENTS	$339,327	$309,920	$240,642	$232,239
Investment-Related Assets				
Amounts receivable from pending trades	$ 3,886	$ 3,886	$ 814	$ 814
Interest receivable	780	780	526	526
Dividends receivable	279	279	285	285
Derivative-related receivables	3,278	156	2,387	27
Total Investment-Related Assets	$ 8,223	$ 5,101	$ 4,012	$ 1,652
Investment-Related Liabilities				
Amounts payable from pending trades	$ (6,043)	$ (6,043)	$ (2,288)	$ (2,288)
Interest payable	(117)	(117)	(70)	(70)
Securities sold short	(240)	(207)	(564)	(656)
Securities sold under repurchase agreements	(2,847)	(2,847)	–	–
Derivative-related payables	(1,101)	(133)	(2,075)	(13)
Capital debt financing:				
Short-term	(3,916)	(3,916)	(3,243)	(3,243)
Long-term	(9,744)	(9,542)	(5,289)	(5,052)
Total Investment-Related Liabilities	$ (24,008)	$ (22,805)	$ (13,529)	$ (11,322)
NET INVESTMENTS	$323,542	$292,216	$231,125	$222,569

[1] Includes floating rate notes with maturities greater than one year with a fair value of $6,996 thousand for the Plan Account (2010 – $6,974 thousand).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 and co-investments in companies as well as fund investments. They include investments in various private entities as well as mezzanine debt and distressed debt.

The Real Estate asset class is comprised of direct investments in various private entities, properties and third-party debts, as well as 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, partnerships and companies operating in the office, retail, industrial, hospitality and residential sectors, as well as private funds 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, other structured finance products as well as real estate debt funds (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, 2011, 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 Account was $11,778 thousand (2010 – $10,637 thousand).

The Infrastructure asset class is comprised of direct investments and co-investments in various private entities and fund investments. They include investments in companies engaged in the management, ownership or operation of assets in power, transportation and other regulated businesses. The Infrastructure asset class is accounted for net of all third-party financings. As at March 31, 2011, the total amount of third-party financing included in the Infrastructure asset class contracted by direct investments controlled by PSP Investments for the Plan Account was $285 thousand (2010 – $397 thousand).

Valuation Techniques

The fair value of Private Market Investments is determined at least annually, using acceptable industry valuation methods. During the year, the fair value is reviewed and adjusted, as appropriate, to reflect the impact of any significant market or investment-specific events or circumstances. For each investment, the relevant methodology is applied consistently over time as appropriate in the prevailing circumstances.

In cases where the services of third-party appraisers are used, 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 direct investments and co-investments in Infrastructure, valuation methods used include discounted cash flows, 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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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, prices of recent comparable transactions and the direct capitalization approach. 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, Infrastructure fund investments as well as Private Equity co-investments, the annual 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 & Other, World Government & Corporate Bonds and Canadian Fixed Income. Cash Equivalents include short-term instruments having a maximum term to maturity of one year. Floating rate notes are included in Cash, Cash Equivalents & Other, provided the final maturity date does not exceed three years and the coupons reset more than once per year. World Government & Corporate Bonds and Canadian Fixed Income include government bonds, provincial and territorial bonds, municipal bonds and corporate 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 Account.

PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, 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 Account. As at March 31, 2011, the margin funding facilities have not been drawn upon since inception. The agreement to exchange the non-bank ABCP for ABTNs included a moratorium preventing collateral calls for an 18-month period that ended on July 16, 2010.

Management's best estimate of the fair value of PSP Investments' ABTNs allocated to the Plan Account as at March 31, 2011 was equal to $6,926 thousand (2010 – $5,919 thousand). This amount was net of principal repayments and corresponding gains, together amounting to $1,007 thousand for the year ended March 31, 2011 (for the year ended March 31, 2010 – $2,774 thousand). PSP Investments recorded an increase of $1,102 thousand in the fair value of the ABTNs allocated to the Plan Account during the year ended March 31, 2011 (increase of $3,030 thousand during the year ended March 31, 2010). The fair value of the ABTNs allocated to the Plan Account was reduced by the impact of the funding facilities amounting to $319 thousand as at March 31, 2011 (2010 – $325 thousand).

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, expected returns, an average maturity of six years as well as liquidity estimates.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 that consist of externally managed investments. Such investments take advantage of specific opportunities aimed to perform positively irrespective of market performance. Such opportunities include investments in equity, fixed income and derivative instruments.

Valuation Techniques

The fair value of these investments is obtained from the investment's external manager and reflects the fair value of the underlying equity, fixed income or derivative instruments.

(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 year.

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 year.

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) Interest & Dividends Receivable

Interest and dividends are recorded at the amounts expected to be received as at the reporting date.

(vii) Interest Payable

Interest accrued is recorded at the amount expected to be paid as at the reporting date.

(viii) 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.

(ix) Securities Sold under Repurchase Agreements

PSP Investments is party to agreements which involve the sale of securities with a simultaneous agreement to repurchase such securities at a specified price and specified future date.

Securities sold under the repurchase agreements are not derecognized as PSP Investments retains all related risks and rewards of ownership. As such, all related income (loss) continues to be reported in Investment Income (Loss).

Obligations to repurchase the securities sold are accounted for as Investment-Related Liabilities. Interest expense related to such obligations is reported in Investment Income (Loss).

Valuation Techniques

Obligations to repurchase the securities sold under repurchase agreements are recorded at cost plus accrued interest, which approximate fair value.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date, the value of which is derived from changes in underlying assets, interest or exchange rates. Derivative financial instruments do not, typically, require an initial net investment. In certain cases, they require an initial net investment that is less than what would be required to hold the underlying position directly. PSP Investments uses derivative financial instruments to enhance 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:

(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, 2011

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 is 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 to purchase 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. 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. Although pricing models used are widely accepted and used by other market participants, in the case of collaterized debt obligations, the nature of such instruments requires more significant assumptions about the behaviour of the default correlation. Such assumptions are not observable in the market.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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. Except for credit derivatives [1], notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions disclosed below. 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:

($ thousands)	2011				2010			
	Notional	Fair Value			Notional	Fair Value		
INVESTMENTS	Value	Assets	Liabilities	Net	Value	Assets	Liabilities	Net
Equity and Commodity Derivatives								
Futures	$ 2,398	$ –	$ –	$ –	$ 565	$ –	$ –	$ –
Total Return Swaps	30,891	1,064	(1)	1,063	17,602	578	(6)	572
Warrants and Rights	12	11	–	11	6	5	–	5
Options: Listed-purchased	2,466	69	–	69	–	–	–	–
Listed-written	2,204	–	(106)	(106)	26	–	–	–
Currency Derivatives								
Forwards	95,329	1,762	(675)	1,087	50,860	1,548	(139)	1,409
Swaps	9,323	135	(61)	74	–	–	–	–
Options: OTC-purchased	5,628	32	–	32	3,267	20	–	20
OTC-written	1,019	–	(10)	(10)	853	–	(4)	(4)
Interest Rate Derivatives								
Bond Forwards	5,536	29	(15)	14	1,027	–	(11)	(11)
Futures	9,867	–	–	–	2,605	–	–	–
Interest Rate Swaps	97,808	78	(92)	(14)	19,498	121	(192)	(71)
Total Return Swaps	3,599	–	(1)	(1)	14,041	93	(68)	25
Swaptions	19,635	35	(17)	18	–	–	–	–
Options: Listed-purchased	29,805	36	–	36	2,120	–	–	–
Listed-written	41,876	–	(39)	(39)	5,817	–	(2)	(2)
Credit Derivatives [1]:								
Purchased	2,331	17	(21)	(4)	142	6	–	6
Sold	2,278	10	(63)	(53)	3,714	16	(1,653)	(1,637)
Total	$362,005	$ 3,278	$(1,101)	$ 2,177	$122,143	$ 2,387	$(2,075)	$ 312

[1] Credit derivatives include credit default swaps and collateralized debt obligations. 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, 2011

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives was as follows as at March 31, 2011:

($ thousands)

Less than 3 months	$134,649
3 to 12 months	207,353
Over 1 year	20,003
Total	**$362,005**

(C) FAIR VALUE MEASUREMENT

Investments, investment-related assets and investment-related liabilities 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 assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities 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 assets or liabilities.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2011:

($ thousands)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$139,213	$ 11,918	$ –	$ –	$151,131
Private Equity	–	–	30,542	–	30,542
Nominal Fixed Income	3,250	67,222	7,808	–	78,280
Real Return Assets					
World Inflation-Linked Bonds	–	16,616	–	–	16,616
Real Estate	–	–	36,986	–	36,986
Infrastructure	–	–	15,086	–	15,086
Absolute Return	–	6,210	4,476	–	10,686
INVESTMENTS	$142,463	$101,966	$ 94,898	$ –	$339,327
Investment-Related Assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 3,886	$ 3,886
Interest receivable[1]	–	–	–	780	780
Dividends receivable[1]	–	–	–	279	279
Derivative-related receivables	108	3,155	15	–	3,278
Total Investment-Related Assets	$ 108	$ 3,155	$ 15	$ 4,945	$ 8,223
Investment-Related Liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (6,043)	$ (6,043)
Interest payable[1]	–	–	–	(117)	(117)
Securities sold short	(240)	–	–	–	(240)
Securities sold under repurchase agreements	–	(2,847)	–	–	(2,847)
Derivative-related payables	(145)	(898)	(58)	–	(1,101)
Capital debt financing:					
Short-term	–	(3,916)	–	–	(3,916)
Long-term	–	(9,744)	–	–	(9,744)
Total Investment-Related Liabilities	$ (385)	$ (17,405)	$ (58)	$ (6,160)	$ (24,008)
NET INVESTMENTS	$142,186	$ 87,716	$ 94,855	$ (1,215)	$323,542

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2010:

($ thousands)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 87,882	$ 7,029	$ –	$ –	$ 94,911
Private Equity	–	–	26,072	–	26,072
Nominal Fixed Income	605	56,569	6,417	–	63,591
Real Return Assets					
World Inflation-Linked Bonds	–	1,671	–	–	1,671
Real Estate	–	–	30,564	–	30,564
Infrastructure	–	–	11,777	–	11,777
Absolute Return	–	6,187	5,869	–	12,056
INVESTMENTS	$ 88,487	$ 71,456	$ 80,699	$ –	$240,642
Investment-Related Assets					
Amounts receivable from pending trades[1]	$ –	$ –	$ –	$ 814	$ 814
Interest receivable[1]	–	–	–	526	526
Dividends receivable[1]	–	–	–	285	285
Derivative-related receivables	–	2,361	26	–	2,387
Total Investment-Related Assets	$ –	$ 2,361	$ 26	$ 1,625	$ 4,012
Investment-Related Liabilities					
Amounts payable from pending trades[1]	$ –	$ –	$ –	$ (2,288)	$ (2,288)
Interest payable[1]	–	–	–	(70)	(70)
Securities sold short	(564)	–	–	–	(564)
Derivative-related payables	(2)	(420)	(1,653)	–	(2,075)
Capital debt financing:					
Short-term	–	(3,243)	–	–	(3,243)
Long-term	–	(5,289)	–	–	(5,289)
Total Investment-Related Liabilities	$ (566)	$ (8,952)	$ (1,653)	$ (2,358)	$ (13,529)
NET INVESTMENTS	$ 87,921	$ 64,865	$ 79,072	$ (733)	$231,125

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The classification within the levels of the hierarchy is established at the time of the initial valuation of the asset or liability and reviewed on each subsequent reporting period-end.

There were no significant transfers between Level 1 and Level 2 during the year ended March 31, 2011 (no significant transfers during the year ended March 31, 2010).

Level 3 Reconciliation

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2011:

($ thousands)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative–related receivables/ payables (net)	Total
Opening Balance	$ 26,072	$ 6,417	$ 42,341	$ 5,869	$ (1,627)	$ 79,072
Purchases	13,558	908	26,094	511	2,400	43,471
Sales/Settlements	(19,329)	(260)	(15,153)	(5,110)	(70)	(39,922)
Total gains (losses)	10,549	743	(1,210)	3,206	(746)	12,542
Transfer out of Level 3	(308)	–	–	–	–	(308)
Closing Balance	$ 30,542	$ 7,808	$ 52,072	$ 4,476	$ (43)	$ 94,855

Total gains (losses), for the year ended March 31, 2011, included in investment income and categorized within Level 3, are presented as follows:

($ thousands)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative–related receivables/ payables (net)	Total
Total realized gains (losses)	$ (1,220)	$ 7	$ 614	$ (225)	$ (1,270)	$ (2,094)
Total unrealized gains (losses)	$ 11,769	$ 736	$ (1,824)	$ 3,431	$ 524	$ 14,636
Total gains (losses)	$ 10,549	$ 743	$ (1,210)	$ 3,206	$ (746)	$ 12,542

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation (continued)

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities 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	$ 14,473	$ 3,846	$ 33,440	$ 2,329	$ (4,172)	$ 49,916
Purchases	15,901	–	13,294	5,479	8	34,682
Sales/Settlements	(7,557)	(1,411)	(16,442)	(102)	(3)	(25,515)
Total gains (losses)	3,255	3,982	12,049	(1,837)	2,540	19,989
Transfers into or out of Level 3	–	–	–	–	–	–
Closing Balance	$ 26,072	$ 6,417	$ 42,341	$ 5,869	$ (1,627)	$ 79,072

Total gains (losses), for the year ended March 31, 2010, included in investment income and categorized within Level 3, are presented as follows:

($ thousands)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative–related receivables/ payables (net)	Total
Total realized gains (losses)	$ 584	$ –	$ 218	$ (1)	$ 1	$ 802
Total unrealized gains (losses)	$ 2,671	$ 3,982	$ 11,831	$ (1,836)	$ 2,539	$ 19,187
Total gains (losses)	$ 3,255	$ 3,982	$ 12,049	$ (1,837)	$ 2,540	$ 19,989

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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 2% increase/decrease (2010 – 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).

(D) INVESTMENT ASSET MIX

The SIP&P sets out the long-term target weights of the assets that will be invested for the Plan Account. 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 were as follows as at March 31:

	2011			2010		
($ thousands)	Fair Value		Policy Portfolio Long–Term Target	Fair Value		Policy Portfolio Long–Term Target
World Equity						
Canadian Equity	**$104,048**	**32.2%**	**30.0%**	$ 67,657	29.2%	30.0%
Foreign Equity:						
US Large Cap Equity	**21,344**	**6.6**	**5.0**	10,544	4.6	5.0
EAFE Large Cap Equity	**17,014**	**5.2**	**5.0**	10,205	4.4	5.0
Small Cap Developed World Equity	**17,959**	**5.5**	**5.0**	9,873	4.3	5.0
Emerging Markets Equity	**22,645**	**7.0**	**7.0**	14,920	6.5	7.0
Private Equity	**31,115**	**9.6**	**10.0**	27,096	11.7	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	**6,988**	**2.2**	**2.0**	9,451	4.1	2.0
World Government Bonds	**12,812**	**4.0**	**5.0**	10,626	4.6	5.0
Canadian Fixed Income	**30,029**	**9.3**	**8.0**	24,124	10.4	8.0
Real Return Assets						
World Inflation-Linked Bonds	**16,844**	**5.2**	**5.0**	10,714	4.6	5.0
Real Estate	**29,610**	**9.1**	**10.0**	25,562	11.1	10.0
Infrastructure	**13,134**	**4.1**	**8.0**	10,353	4.5	8.0
NET INVESTMENTS	**$323,542**	**100.0%**	**100.0%**	$231,125	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, 2011

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. Lending and borrowing transactions under such programs do not transfer the risks or rewards of ownership of the securities to the counterparty. Consequently, PSP Investments does not derecognize securities lent or recognize securities borrowed.

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. PSP Investments and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at March 31, 2011, PSP Investments, on behalf of the Plan Account, has re-invested $8,348 thousand of collateral held (2010 – $8,840 thousand).

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

($ thousands)	2011	2010
Securities Lending		
Securities lent	$ 32,192	$ 20,003
Collateral contractually receivable[1]	33,676	20,873
Securities Borrowing		
Securities borrowed	240	564
Collateral contractually payable[2]	254	595

[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.

(F) SECURITIES SOLD & COLLATERAL PLEDGED UNDER REPURCHASE AGREEMENTS

Securities sold under repurchase agreements are described in Note 3 (a) (ix) and involve pledging collateral consisting of cash or securities deemed acceptable by the counterparties. Collateral transactions are conducted under terms that are usual and customary in standard repurchase arrangements. Such terms require the respective counterparty to pledge additional collateral based on the changes in the fair value of the existing collateral pledged. The counterparties are authorized to sell, repledge or otherwise use collateral held. The securities pledged as collateral must be returned to the respective counterparty at the end of the contract, unless an event of default occurs. PSP Investments does not sell, repledge or otherwise use collateral held.

On behalf of the Plan Account, PSP Investments pledged collateral under the repurchase agreements with a fair value of $2,847 thousand at March 31, 2011 (2010 – nil).

4. INVESTMENT RISK MANAGEMENT

Risk Management is a central part of PSP Investments' operations. Included in the overall risk management framework is a continuous process whereby PSP Investments systematically addresses the investment risks related to its various investment activities with the goal of achieving a maximum rate of return without undue risk of loss.

A risk governance framework that includes required reporting on risk to all levels of the organization ensures that appropriate investment objectives are pursued and achieved in line with the fulfillment of PSP Investments' legislated mandate. The Board of Directors and its committees oversee all risk matters and receive assurances from senior management, including the Chief Risk Officer, as well as PSP Investments' independent internal auditor reporting directly to the Audit Committee.

PSP Investments has adopted an Investment Risk Management Policy which is an integral part of its risk control system and supplements the SIP&P. The objective of this policy is to provide a framework to manage the risks that PSP Investments is exposed to, namely market, credit and liquidity risks.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(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.

Market risk management focuses on the following two key components:

– Policy Portfolio

The Policy Portfolio (long-term asset mix), as defined in the SIP&P, determines a diversification strategy to mitigate risk whereby PSP Investments invests in a diversified portfolio expected to achieve a return at least equal to the Actuarial Rate of Return (ARR); defined as the rate of return assumption used by the Chief Actuary of Canada in the latest actuarial valuation reports of the Plans. In the absence of other factors affecting the funding of the Plans or changes to pension benefits under the Plans, the ARR is the rate of return required to maintain funding requirements and pension benefits at their current levels.

– Active Management

Active management is defined as the sum of investment strategies that deviate from the approved Policy Portfolio. It is designed to supplement the returns of the Policy Portfolio within an active risk budget.

The risks associated with these components are the Policy Portfolio market risk and the active risk. The Policy Portfolio market risk represents the investment risk arising from the exposure to approved asset classes in the approved weightings. In establishing its Policy Portfolio, PSP Investments also takes into consideration the impact of the Policy Portfolio market risk on the funding risk. The funding risk is the risk that the assets under management will be insufficient to meet the relevant pension liabilities of the Plans. The Policy Portfolio is reviewed at least annually as part of the review of the SIP&P, and this review includes changes, if any, to PSP Investments' long-term expectations of market conditions and other factors that may affect the funding levels of the Plans.

Active risk refers to all market risk arising from active management activities. It is managed in accordance with the Investment Risk Management Policy.

Measurement of Market Risk

The Value-at-Risk (VaR) is one of the methods used to measure market risk and is reported on a quarterly basis. It is not the maximum potential loss, but rather the maximum loss not exceeded with a given confidence level, over a given period of time. PSP Investments uses a Historical VaR model incorporating ten years' worth of market returns scaled to a twelve-month holding period at a 95% confidence level. In measuring Policy Portfolio risk, VaR represents the absolute loss expected from the Policy Portfolio (Policy Portfolio VaR). Whereas in terms of measuring the active risk, VaR reflects the loss relative to the Policy Portfolio benchmark (Active VaR).

VaR is statistically valid under normal market conditions and does not specifically consider losses from severe market events. It also assumes that the future will behave in a pattern similar to the past. Consequently, if future market conditions differ significantly from those of the past, potential losses may differ from those originally estimated.

The following table shows the Total VaR consisting of the Policy Portfolio VaR, the Active VaR and the diversification effect, calculated as a percentage of net investments, as at March 31. The diversification effect captures the impact of holding different types of assets which may react differently in various types of situations and thus reduces the Total VaR.

	2011	2010
Policy Portfolio VaR	**22.4%**	21.2%
Active VaR	**2.2**	1.8
Total VaR (Undiversified)	**24.6**	23.0
Diversification Effect	**(2.9)**	(2.0)
Total VaR	**21.7%**	21.0%

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Stress Testing

Although VaR is a widely accepted risk measure, it is complemented by other risk measurement methodologies that provide greater insight on market risk. PSP Investments 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 reacts under such circumstances. Stress testing and scenario analysis are also deployed to assess new product performance.

(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 Account'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 were as follows as at March 31, 2011:

	Terms to Maturity				
($ thousands)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Total
Government of Canada bonds	$ 140	$ 6,403	$ 322	$ 2,632	$ 9,497
Provincial and Territorial bonds	648	2,524	3,952	2,306	9,430
Municipal bonds	59	229	236	33	557
Corporate bonds	732	5,054	3,683	1,947	11,416
ABTNs	–	269	6,657	–	6,926
Total Canadian Fixed Income	$ 1,579	$ 14,479	$ 14,850	$ 6,918	$ 37,826
Total World Government & Corporate Bonds	$ 4,434	$ 5,773	$ 2,607	$ 3,104	$ 15,918
Total World Inflation-Linked Bonds	$ –	$ 4,444	$ 4,633	$ 7,539	$ 16,616
Real Estate Debt [1]	$ 1,237	$ 403	$ –	$ –	$ 1,640
Grand Total	$ 7,250	$ 25,099	$ 22,090	$ 17,561	$ 72,000

[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 is not significant due to their short-term nature.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 or cross currency swaps, positions in foreign currencies. PSP Investments' policy is to hedge a target of 50% of its foreign currency investments. Additional factors are considered when implementing the hedging target for investments in emerging countries, namely, total relative exposure and cost effectiveness.

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

	2011		2010	
Currency (in thousands of Canadian $)	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 52,917**	**54.0%**	$ 31,343	51.2%
Euro	**13,297**	**13.6**	9,066	14.8
British Pound	**7,422**	**7.6**	3,883	6.4
Brazilian Real	**4,909**	**5.0**	3,342	5.5
Japanese Yen	**3,948**	**4.0**	2,143	3.5
Hong Kong Dollar	**3,702**	**3.8**	2,527	4.1
Korean Won	**2,618**	**2.7**	1,753	2.9
Australian Dollar	**1,704**	**1.7**	756	1.2
New Taiwan Dollar	**1,569**	**1.6**	997	1.6
South African Rand	**937**	**1.0**	786	1.3
Others	**4,872**	**5.0**	4,579	7.5
Total	**$ 97,895**	**100.0%**	$ 61,175	100.0%

PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $22,203 thousand ($19,698 thousand US, €2,062 thousand and R1,356 thousand South African Rands) for the Plan Account which were not included in the foreign currency exposure table.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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 that the counterparty to a derivative contract, to a securities lending and borrowing transaction or to securities sold under repurchase agreements, 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 and counterparty that transacts with PSP Investments. 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. Except for ABTNs, 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 Account was as follows as at March 31:

	2011	2010
Investment grade (AAA to BBB–)	**98.0%**	98.1%
Below investment grade (BB+ and below)	**0.4**	0.2
Not rated:		
Rated by a single credit rating agency	**–**	0.2
Not rated by credit rating agencies	**1.6**	1.5
Total	**100.0%**	100.0%

The breakdown of credit concentration risk for the Plan Account did not include investments in distressed debt included in pooled funds in the amount of approximately $11 million as at March 31, 2011 (2010 – approximately $10 million). 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, 2011, the Plan Account also had a net notional exposure of $1,453 thousand (2010 – $3,067 thousand) to various tranches of collateralized debt obligations, of which approximately 44% (2010 – approximately 64%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities of a maximum amount of $4,840 thousand (2010 – $4,840 thousand) to support potential margin calls on the ABTNs (Note 3 (a) (iii)).

As at March 31, 2011, the Plan Account's maximum exposure to credit risk, excluding collateral held and the investments in distressed debt and collateralized debt obligations described above, amounted to approximately $89 million (2010 – approximately $65 million). This amount also excludes the impact of guarantees and indemnities disclosed in Note 10.

(i) Counterparty Risk

Counterparty risk represents the credit risk from current and potential exposure related to transactions involving derivative contracts, securities lending and borrowing as well as securities sold under repurchase agreements. In order to minimize 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. With respect to derivative contracts, PSP Investments has the ability to terminate all trades with most counterparties who have their credit rating downgraded below "A–" subsequent to the trade date.

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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master agreement contractually binds both parties to use master-netting arrangements and, in the case of default of the counterparty, close-out netting. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSP Investments to contribute further collateral when requested. All collateral transactions are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments did not deposit nor did it pledge any securities as collateral with respect to derivative contracts at March 31, 2011 (2010 – $1,038 thousand). All collateral deposited or pledged was held, in the prior fiscal year, with counterparties having a minimum credit rating of "A–". Securities with a fair value of $762 thousand were received from counterparties as collateral at March 31, 2011 (2010 – $883 thousand). PSP Investments does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

With respect to transactions involving securities lending and borrowing as well as securities sold under repurchase agreements, collateral requirements are in place to mitigate counterparty risk. Notes 3 (e) and 3 (f) describe collateral requirements in securities lending and borrowing programs as well as securities sold under repurchase agreements, respectively.

In the case of the securities lending program, PSP Investments' exposure to counterparty risk is further mitigated as the custodian of the securities lent assumes the risk that a counterparty will be unable to meet its obligations associated with the collateral requirements.

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 and Treasury utilize 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 are disclosed in Note 3 (b).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

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, 2011:

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities[1]				
Amounts payable from pending trades	$ (6,043)	$ –	$ –	$ (6,043)
Interest payable	–	(117)	–	(117)
Securities sold short	(240)	–	–	(240)
Securities sold under repurchase agreements	(2,847)	–	–	(2,847)
Capital debt financing	(3,195)	(721)	(9,744)	(13,660)
Accounts payable and other liabilities	(101)	(13)	(25)	(139)
Total	$ (12,426)	$ (851)	$ (9,769)	$ (23,046)

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial assets and liabilities				
Derivative-related assets	$ 1,333	$ 1,890	$ 55	$ 3,278
Derivative-related liabilities[1]	(717)	(264)	(120)	(1,101)
Total	$ 616	$ 1,626	$ (65)	$ 2,177

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

5. FUND TRANSFERS

On behalf of the Plan Account, PSP Investments received fund transfers of $54,045 thousand for the year ended March 31, 2011 (2010 – $84,236 thousand) from the Fund.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

6. INVESTMENT INCOME

(A) INVESTMENT INCOME

Investment income, for the years ended March 31, was as follows:

($ thousands)	2011	2010
Interest income	$ 2,770	$ 1,781
Dividend income	3,239	1,789
Other income	968	931
Dividend expense	(106)	(112)
Interest expense (Note 8)	(335)	(237)
Transaction costs	(295)	(89)
External investment management fees [1]	(210)	(141)
	6,031	3,922
Net realized gains [2]	9,959	6,395
Net unrealized gains	22,769	21,537
Investment Income	$ 38,759	$ 31,854

[1] Includes amounts incurred for public market investments that are paid directly by PSP Investments (Note 1). This excludes certain public market pooled fund investment fees, primarily related to performance, in the amount of $470 thousand for the year ended March 31, 2011 (2010 – $56 thousand) as well as Private Market Investments' management fees that are not paid directly by PSP Investments.

Private Market Investments' management fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, amounted to $781 thousand for the year ended March 31, 2011 (2010 – $759 thousand).

[2] Includes foreign currency gains of $577 thousand for the year ended March 31, 2011 (2010 – $2,468 thousand).

(B) INVESTMENT INCOME BY ASSET MIX

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

($ thousands)	2011	2010
World Equity		
Canadian Equity	$ 16,826	$ 15,035
Foreign Equity:		
US Large Cap Equity	1,703	1,088
EAFE Large Cap Equity	1,015	964
Small Cap Developed World Equity	2,715	1,246
Emerging Markets Equity	2,495	4,002
Private Equity	5,634	5,865
Nominal Fixed Income		
Cash & Cash Equivalents	116	170
World Government Bonds	190	(1,471)
Canadian Fixed Income	1,265	813
Real Return Assets		
World Inflation-Linked Bonds	444	(1,104)
Real Estate	3,516	213
Infrastructure	(269)	743
Absolute Return [1]	3,109	4,290
Investment Income	$ 38,759	$ 31,854

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

7. EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the Plan Accounts 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 was 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 years ended March 31, were allocated in proportion to the annual amount of net assets in each Plan Account as follows:

	2011	2010
Public Service Pension Plan Account	**72.7%**	72.5%
Canadian Forces Pension Plan Account	**19.7**	20.0
Royal Canadian Mounted Police Pension Plan Account	**7.1**	7.2
Reserve Force Pension Plan Account	**0.5**	0.3
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 years ended March 31, consisted of the following:

($ thousands)	**2011**	2010
Salaries and benefits	**$ 351**	$ 182
Professional and consulting fees	**40**	32
Office supplies and equipment	**63**	38
Other operating expenses	**25**	14
Depreciation of fixed assets	**50**	24
Occupancy costs	**24**	15
Custodial fees	**12**	5
Remuneration earned by Directors	**3**	3
Travel and related expenses for Directors	**1**	1
Communication expenses	**1**	1
Total	**$ 570**	$ 315

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2011

8. CAPITAL DEBT FINANCING

PSP Investments' Capital Debt Financing program consists of the private placement of short-term promissory notes as well as medium-term notes issued by PSP Capital Inc., a wholly-owned subsidiary of PSP Investments. The capital raised is primarily used to finance investments in the Real Estate and Infrastructure asset classes. It is unconditionally and irrevocably guaranteed by PSP Investments in accordance with its corporate leverage policy.

During the year ended March 31, 2011, the Board of Directors amended the maximum amount authorized for the Capital Debt Financing program. Pursuant to such amendment, as at March 31, 2011, the maximum amount authorized was 7.5% of the net investments plus all recourse debt outstanding of PSP Investments. Within such amount, the short-term promissory note component cannot exceed $3 billion. As at March 31, 2010, the maximum amount authorized by the Board of Directors for the short-term promissory notes and medium-term notes was $2 billion and $2 billion, respectively.

The following outlines the terms as well as the fair value of the notes issued under the Capital Debt Financing program allocated to the Plan Account as at March 31:

($ thousands)	2011	2010
Short-term promissory notes, bearing interest between 1% and 1.39% and maturing within 29 and 363 days of issuance (March 31, 2010 – 14 and 120 days)	**$ 3,916**	$ 3,243
Medium-term notes Series 1, bearing interest of 4.57% per annum and maturing on December 9, 2013	**$ 5,885**	$ 5,289
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**$ 3,859**	$ –
Total	**$ 13,660**	$ 8,532

The capital amounts allocated to the Plan Account to be paid at maturity are $3,924 thousand for the short-term promissory notes, and $5,575 thousand and $3,902 thousand for the Series 1 and Series 2 medium-term notes, respectively.

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

Interest expense, for the years ended March 31, was as follows:

($ thousands)	2011	2010
Short-term promissory notes	**$ 49**	$ 31
Medium-term notes	**286**	206
Total	**$ 335**	$ 237

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, having regard to the funding, policies and requirements of the pension plans established under the *Superannuation Acts* and the ability of the Plans to meet their financial obligations. 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.

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, 2011

10. GUARANTEES AND INDEMNITIES

PSP Investments provides indemnification to its Directors, its Officers, its vice-presidents 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 or made any payment for such indemnity.

In certain cases, PSP Investments also provides indemnification to third parties in the normal course of business. As a result, PSP Investments may be required to indemnify such third parties in connection with the performance of their contractual obligations. To date, PSP Investments has not received any claims nor made any payments for such indemnities.

As at March 31, 2011, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan Account could assume the obligation up to $1,375 thousand (2010 – $1,375 thousand) plus interest and other related costs.

As part of an investment transaction entered into during the year ended March 31, 2011, a wholly-owned subsidiary of PSP Investments has agreed to provide indemnification with respect to the contractual obligations and commitments of a third-party. In the event of a default by such third-party, the subsidiary may be required to assume an obligation of up to $195 million, of which $1,088 thousand may be allocated to the Plan Account, as estimated at the time of the completion of the investment transaction. The subsidiary would also have direct recourse against the defaulting third party in all circumstances. The guarantee expires in April 2012.

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. The portion of PSP Investments' commitments that would be assumed by the Plan Account was as follows as at March 31, 2011:

($ thousands)

Private Equity	$ 14,160
Real Estate	5,230
Infrastructure	4,353
Public markets	1,437
Total	**$ 25,180**

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