2014 ANNUAL REPORT
PUBLIC SECTOR PENSION INVESTMENT BOARD

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.

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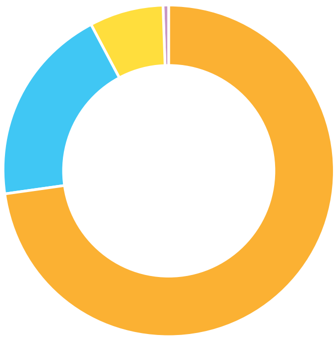
HIGHLIGHTS
FISCAL YEAR 2014

- **TOTAL PORTFOLIO RETURN OF 16.3%**
- Ten-year annualized net return of **7.0%** (or 5.2% after inflation) exceeding the return objective of **6.1%** (or 4.3% after inflation) for the period.
- Consolidated net assets increased by $17.6 billion or **23%** to $93.7 billion in FY2014.
- Net investment income of **$12.6** billion and net contributions of $5.0 billion.
- All five investment units **outperformed** their respective benchmarks.
- Value-added of $1.8 billion above benchmark return of **13.9%**.
- Four-year annualized return of **11.0%**, investment income of $28.9 billion and value-added above benchmark of $4.9 billion.
- Consistent with our strategic plan, assets actively managed internally increased by **31%** to $38.0 billion and total assets managed internally increased by **25%** to $70.0 billion during FY2014.

FINANCIAL HIGHLIGHTS
FISCAL YEAR 2014

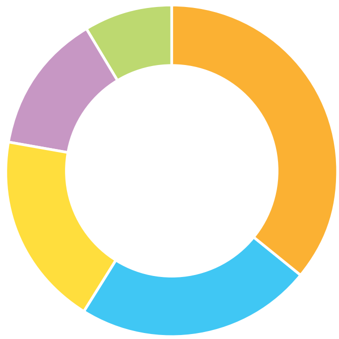
NET ASSETS

$93.7 billion



Net Assets per Pension Plan Account
As at March 31, 2014 (millions)

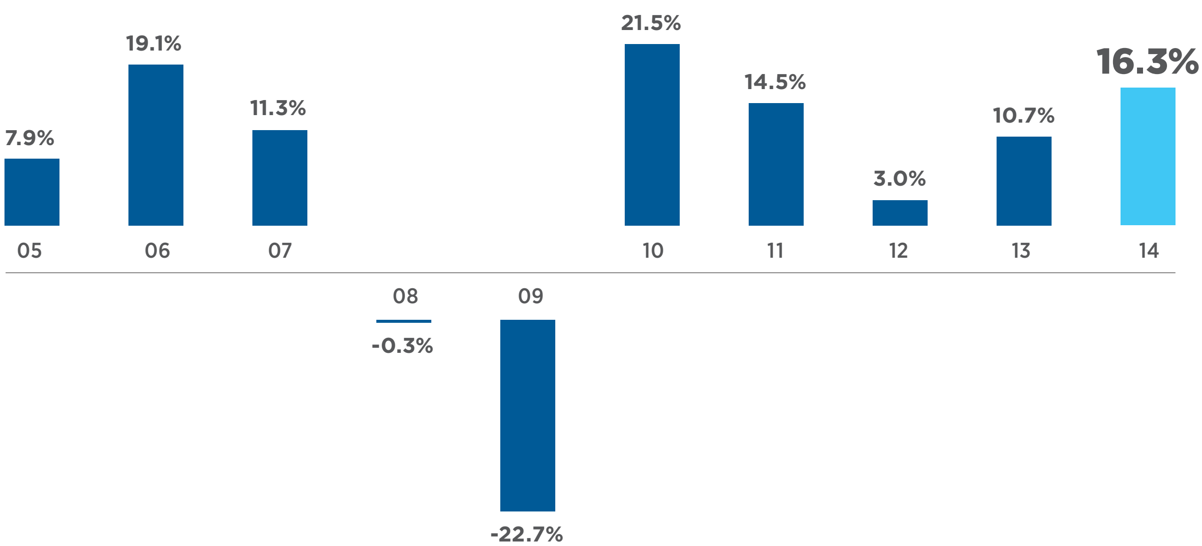
Public Service	72.9%	**$68,168**
Canadian Forces	19.5%	**$18,352**
RCMP	7.1%	**$6,720**
Reserve Force	0.5%	**$465**



Asset Mix
As at March 31, 2014

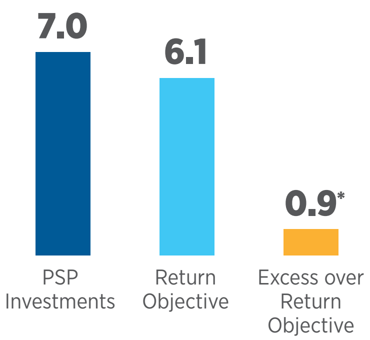
Foreign Equity	**35.0%**
Real Return Assets	**24.0%**
Canadian Equity	**17.8%**
Nominal Fixed Income	**14.2%**
Private Equity	**9.0%**

Annual Performance
As at March 31



Excess Return over Return Objective
10-Yr Annualized Net Return (%)

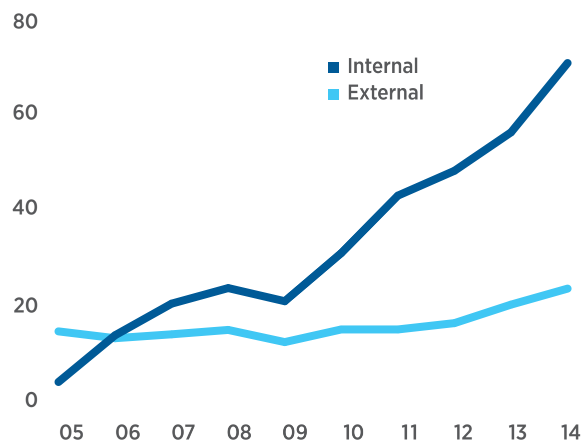
0.9% per year



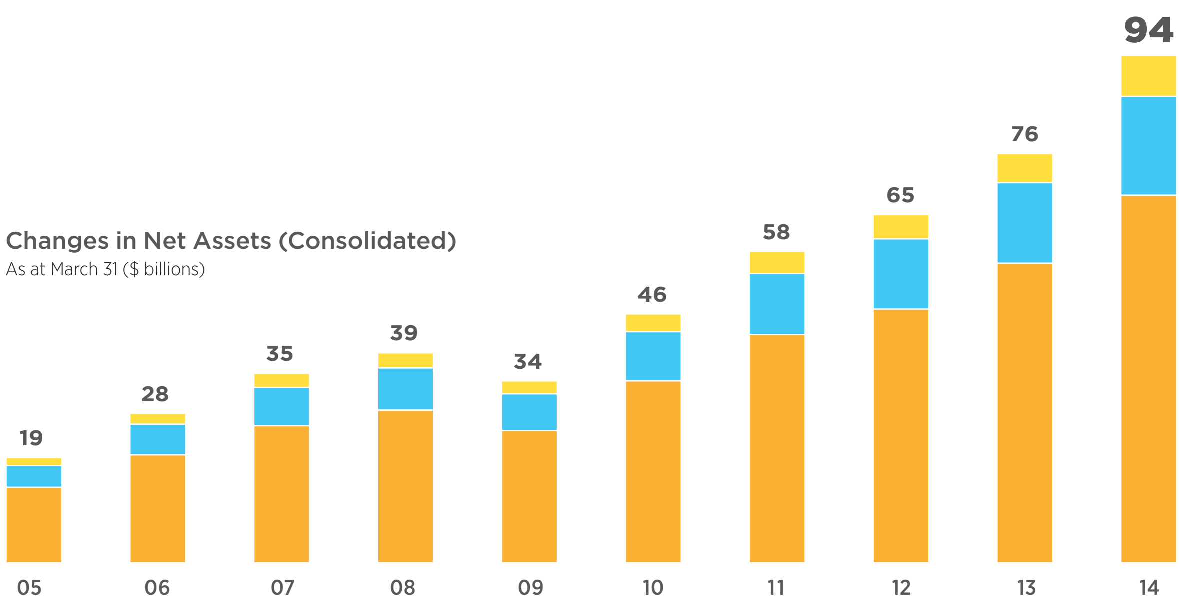
* Taking into account the size and timing of cash inflows, this 0.9% excess return per year translates into a cumulative $7.7B of investment gains.

Growth in Internal Management
As at March 31 ($ billions)

$70 billion



Changes in Net Assets (Consolidated)
As at March 31 ($ billions)



- Reserve Force Plan Account
- RCMP Plan Account
- Canadian Force Plan Account
- Public Service Plan Account

CORPORATE OBJECTIVES
FISCAL YEAR 2014

INVESTMENTS

Consider adding or expanding asset classes within the Policy Portfolio. Continue increasing internal and active management within Public Markets. Pursue Private Markets investments towards target allocation and increase investments in international markets.

ACHIEVEMENTS

- A review of the Policy Portfolio determined it remained effective for achieving the return objective, with an acceptable level of risk.
- 68% of all active strategies in Public Markets now managed internally, up from 65% last year.
- Value of Private Markets investments reached $25.8 billion, an increase of 25%.
- 62% of assets are invested outside of Canada.

TALENT MANAGEMENT

Continue supporting the deployment of investment strategies through the recruitment and development of top talent. Strengthen succession planning in leadership roles and increase manager capability at all levels of the Corporation. Complete employee engagement initiatives and measure progress with a new employee engagement survey.

ACHIEVEMENTS

- Increased headcount by 15% to support business growth, for a total of approximately 500 permanent employees.
- Achieved high employee engagement scores, in top quartile of Aon Hewitt's Canadian database.
- Reduced turnover ratio for the third year in a row.
- Launched a new Career Management Program for people managers and employees.
- Implemented an Employee Defined Contribution Pension Plan for employees hired after January 1, 2014.

STRATEGIC PLAN

Successfully implement second year of Vision 2015 Strategic Plan and perform mid three-year review to ensure progress is tracking according to plan.

ACHIEVEMENTS

- Interim review confirmed PSP Investments is on track to realize its Vision 2015 Strategic Plan.

ENTERPRISE RISK MANAGEMENT

Finalize and approve comprehensive Risk Appetite Statement to define PSP Investments' appetite, attitude and tolerance to risks, and enhance the risk-aware culture across the Corporation. Continue implementation of the Responsible Investment Policy. Complete interim update of Risk and Control Self-Assessment monitoring PSP Investments' top risks and continue refining the Fraud Risk Management Program. Maintain a competitive cost structure.

ACHIEVEMENTS

- Developed and approved a comprehensive Risk Appetite Statement defining PSP Investments' appetite, attitude and tolerance to risk. An overview was shared with all employees to ensure a common understanding of risk.
- Enhanced Board of Directors level reporting with the addition of new Board of Directors limits for increased risk transparency and governance.
- Responsible Investment Policy and Procedures were amended to further detail ESG governance, due diligence and monitoring processes.
- Completed the Risk and Control Self-Assessment interim update, whereby PSP Investments' top risks were identified, evaluated and communicated across the Corporation.
- Implementation of internal active management strategy has resulted in cost savings of between $180 and $265 million over similar external management strategies[1].

[1] Based on available market data with respect to investment implementation style.

KEY CORPORATE OBJECTIVES
FISCAL YEAR 2015

INVESTMENTS

- Expand international network of partners with an objective of increasing the deal flow for direct investments.
- Grow Public Markets internal management, roll-out active management of emerging markets equities.

TALENT MANAGEMENT

- Build leadership capacity and ensure we have the talent to execute strategic objectives.
- Sustain high employee engagement through actions which support a productive and positive work environment.
- Promote a diverse workforce and comprehensive development programs to drive corporate performance.

ENTERPRISE RISK MANAGEMENT

- Review and refine risk management processes including crisis management capabilities for a consistent approach to identifying, evaluating, managing monitoring and reporting risks across all facets of the organization.
- Review scalability of operating cost structure with a view of maintaining a competitive total investment cost structure.
- Further implement Environmental, social and corporate governance (ESG) investment strategy.

STRATEGIC PLAN

- Ensure individual objectives are aligned with third year of Vision 2015 and successfully complete strategic plan.
- With continued growth of assets, review the scalability and flexibility of the Policy Portfolio.
- Develop Vision 2018 and confirm alignment with Post-2000 liabilities and risk appetite.

Cheryl Barker

TOTAL PORTFOLIO RETURN
FOR FISCAL YEAR 2014

16.3%

INTERIM CHAIR'S REPORT

OVER THE COURSE OF A FISCAL YEAR MARKED BY STRONG RETURNS AND AN INCREASE OF 23% IN THE VALUE OF CONSOLIDATED NET ASSETS, THE BOARD OF DIRECTORS FOCUSED ON ENSURING THAT PSP INVESTMENTS HAS IN PLACE THE APPROPRIATE LEVEL OF RESOURCES AND RISK MANAGEMENT FRAMEWORK REQUIRED TO MANAGE ITS RAPID GROWTH AND TO COMPETE SUCCESSFULLY ON THE WORLD STAGE.

With a total portfolio return of 16.3% for fiscal year 2014, PSP Investments again exceeded the Policy Portfolio benchmark while growing its consolidated net assets to $93.7 billion. The Board and management have been collectively entrusted by the Government of Canada with stewardship of the almost $100 billion in assets on behalf of the contributors and beneficiaries of the Plans, with the real measure of success being the achievement of a real return of 4.1% over the long term. We embrace this responsibility and opportunity.

Our net assets have almost tripled over the five years since the global financial crisis and we expect they will reach $425 billion by 2035 — clearly making PSP Investments one of the fastest growing pension investment funds in Canada.

The Board of Directors has facilitated this continued rapid growth by approving significant investments in resources and systems that have enabled the Corporation to further diversify its portfolio and extend its reach into global markets. In doing so, we have been very conscious of the costs involved while taking into account the significant savings being realized through a strong focus on internal management and direct investments.

Effective governance is, of course, essential to safeguard the capital transferred to PSP Investments and ensure that the appropriate objectives are pursued and realized. Key Board responsibilities include the approval of strategies for achieving investment performance targets and making certain that effective enterprise, investment and operations risk policies are in place. In keeping with that mandate, fiscal year 2014 saw the successful realization of several Board-led initiatives designed to further enhance PSP Investments' risk management framework, and to gauge the progress being made in terms of delivering on its investment strategy.

Strategic plan interim review

In October, we undertook a mid-term review of the Vision 2015 Strategic Plan, to determine whether PSP Investments was on track to reach the objectives set out in the three-year blueprint approved by the Board in June 2012. Vision 2015 articulated strategic goals with respect to four key areas: Portfolio Management, Internal and Active Management, Scalable and Efficient Operations, and Talent Management.

The most critical component with respect to the strategic Goal No. 1, Portfolio Management, is the Policy Portfolio, which essentially stipulates how every dollar transferred to PSP Investments is allocated to asset classes. A key Board responsibility, the Policy Portfolio is reviewed annually. The review focuses on the liability structure under the pension plans and examines the appropriateness of the Policy Portfolio to meet these liabilities. This examination includes a major focus on PSP Investments' long-term capital market assumptions and related methodologies, which are key inputs in the design of the Policy Portfolio. Enhanced scenario testing has been undertaken to validate potential outcomes.

Consideration was given during fiscal year 2014 to adding or expanding asset classes. However, we concluded that the current Policy Portfolio, with its target of 42% Private Markets investments, remains effective and should enable PSP Investments to meet or exceed its long-term rate-of-return objective (4.1% after inflation), with an acceptable level of risk. Supporting this conclusion is the fact that, over 10 years, PSP Investments has outperformed the return objective by 0.9% per year. This excess return per year translates into a cumulative $7.7 billion of investment gains when taking into account the size and timing of cash inflows.

In accordance with the Strategic Plan's goal regarding Scalable and Efficient Operations, the Board and the Audit Committee have intensified their focus on PSP Investments' crucial information technology capabilities, to ensure that the requisite framework and data-management practices to support continued growth are in place.

Finally, with regard to strategy, in light of PSP Investments' increasingly global reach — with more than half our assets now invested in foreign markets — consideration was given to the desirability of opening offices in markets outside Canada. Upon reflection, the Board and senior mangement concurred that we continue to be well served by our current strategy, which entails working closely with select local partners to identify attractive potential investments abroad, while maintaining the organizational agility to respond quickly to such opportunities.

The strategic plan interim review confirmed that the Corporation's underlying strategic objectives continue to be reasonable and realistic and that we are indeed on track to meet the goals set out in all four areas addressed by Vision 2015. In short, PSP Investments is successfully fulfilling its mandate and delivering on its statutory mandate of maximizing returns without undue risk of loss.

Enterprise Risk Management

A key objective for fiscal year 2014 was met when the Board approved the Corporation's new Risk Appetite Statement — also an essential element in terms of achieving Goal No. 1 of the strategic plan. The creation of the Risk Appetite Statement was a milestone in the journey the Board is undertaking to drive a more effective approach to holistic risk management on an enterprise-wide basis. The Risk Appetite Statement pulled together and formalized key elements of risk management at PSP Investments: it defines the appetite, attitude and tolerances to risk of the Board and management; the role of the Board and that of management; and the risk governance structure. It also spells out the Government of Canada's assumed appetite for risk, risk being defined as the possible requirement to make supplementary pension contributions to the Plans as a result of less favourable investment performance.

Many elements incorporated in the Risk Appetite Statement already existed in other PSP Investments policies and procedures. But the process of creating this overarching document, which was overseen by a special committee of the Board, opened up discussions that have contributed to greater interaction between the Board and management with respect to risk management, internal processes and procedures, and stress testing of the Policy Portfolio.

The Board is committed to fostering and maintaining a risk-aware culture throughout the organization. An abbreviated version of the Risk Appetite Statement summarizing the main elements has been shared with employees and key stakeholders and posted on PSP Investments' website.

During fiscal year 2014, the Board also oversaw the implementation of an amended Responsible Investment Policy and related procedures, designed to ensure that environmental, social and governance (ESG) opportunities as well as ESG-related risks are identified, monitored and mitigated as might be required. As well, provisions for reporting on ESG-related risks to the Board and the public have been enhanced.

Mindful of potential reputational risks and to strengthen Board oversight, the Board also has assigned oversight responsibilities at the Corporation's wholly owned subsidiaries to the Internal Audit function of PSP Investments, increasing the scope of its activities.

Developing talent

Given the steadily increasing size, scope and complexity of PSP Investments' operations, it is imperative that the Corporation attract and develop the talent required in both investment and support roles to successfully manage the rapid growth — which saw the number of full-time employees increase by 15% to approximately 500 during the latest fiscal year. Accordingly, the Board continues to provide direction in key areas such as executive compensation, benefits and succession planning, while supporting management in its on-going efforts to instill a culture of learning that will enable employees to realize their full potential as they develop their capabilities. Fiscal year 2014 saw the roll out of a comprehensive career-management program that reaches across all levels and all functions, along with development of an internal mentoring program to be launched in fiscal year 2015.

OVER THE PAST 10 YEARS, PSP INVESTMENTS HAS OUTPERFORMED THE RETURN OBJECTIVE BY 0.9% PER YEAR.

Board appointments

I am pleased to formally welcome two new Board members appointed during the fiscal year, both of whom bring valuable skill sets, competencies and experience to the Board. Timothy E. Hodgson, Managing Partner of Alignvest Management Corporation, who previously served as CEO of Goldman Sachs Canada and as a special advisor to the Governor of the Bank of Canada, was appointed to the PSP Investments Board effective December 17, 2013. Martin Glynn, a former President and CEO of HSBC Bank USA and HSBC Bank Canada, joined the Board effective January 30, 2014. I am also pleased to note that, in addition to filling the two vacant seats, several other Directors whose terms expired during the year were re-appointed, which is interpreted as a vote of confidence in the quality of governance that has become a hallmark of PSP Investments.

Acknowledgements

I wish to thank the independent Nominating Committee, whose job it is to identify and recommend highly qualified and experienced candidates to serve on our Board. You may rest assured we will carry on doing our collective best to ensure that the public's confidence is merited — that PSP Investments continues to fulfill its mandate to manage the funds transferred to it in the best interests of the Plans' contributors and beneficiaries.

I also wish to express my gratitude to my fellow Board members for their wise counsel and support.

Finally, on behalf of the entire Board, I would like to congratulate the senior management team for guiding PSP Investments to another year of solid performance, and to thank all our employees for their hard work and commitment.

Cheryl Barker
Interim Chair

PRESIDENT'S REPORT

Gordon J. Fyfe

STRONG 4-YEAR PERFORMANCE

INVESTMENT INCOME

$28.9 BILLION

VALUE-ADDED ABOVE BENCHMARK

$4.9 BILLION

PSP INVESTMENTS DELIVERED STRONG RESULTS AND OUTPERFORMED ITS KEY BENCHMARK FOR A FIFTH CONSECUTIVE YEAR. PERFORMANCE WAS STRONG ACROSS THE BOARD, A TESTAMENT TO THE OUTSTANDING TEAM WE HAVE BUILT, OUR EXCELLENT NETWORK OF PARTNERS AND THE QUALITY OF OUR ASSETS. OUR TOTAL PORTFOLIO RETURN OF 16.3% FOR FISCAL YEAR 2014 COMPARED FAVOURABLY WITH THE POLICY PORTFOLIO BENCHMARK OF 13.9%.

While we are pleased with our strong performance for the year, the effectiveness of our long-term investment strategy cannot fully be judged on a single year's results. Perhaps most tellingly from a performance perspective, we have continued to exceed the targeted long-term "return objective" — currently 4.1% after inflation. This is the rate of return used by the Chief Actuary of Canada to determine the level of contributions required to fund the Post-2000 Liabilities. Over the past ten years, PSP Investments has generated net annualized returns of 7.0%, or 5.2% after inflation, despite the fact that this period was punctuated by an unprecedented market collapse. Consequently, we estimate that any pension funding deficit resulting from investment performance has been erased.

Consolidated net assets increased by 23% to reach a new high of $93.7 billion as at March 31, 2014, taking into account net investment income of $12.6 billion, as well as $5.0 billion of funds transferred by the Government of Canada for the Plans.

Over the past four fiscal years, PSP Investments has recorded a compound annualized rate of return of 11.0%, compared with 9.1% for the Policy Portfolio Benchmark, while generating investment income of $28.9 billion and $4.9 billion of value-added above the benchmark.

Adhering to a strategy designed to take advantage of our large cash inflows by buying quality long-term assets has enabled PSP Investments to capitalize on the volatility that roiled markets in the wake of the 2008-2009 global financial crisis and deliver an annualized return of 13.0% for the five-year period, among the best in Canada. Over the course of five fiscal years since the financial crisis, net assets have climbed from $33.8 billion to $93.7 billion. The majority of that increase stemmed from investment income — including some $5.5 billion in value-added.

Pursuing Further Diversification

Succeeding in today's intensely competitive global investment marketplace entails seeking out attractive opportunities that will deliver superior returns. During fiscal year 2014, we continued to pursue further diversification with respect to both asset classes and geographic market regions. We have been opportunistically investing in fast-growing emerging markets with expanding middle-class populations, in line with the young nature of the Post-2000 Liabilities, as well as in developed markets where economic growth is more modest. More than 50% of PSP Investments' total assets are now invested outside Canada. Although Public Markets still account for a substantial portion (70.5%) of PSP Investments' overall portfolio, we have been steadily growing our investments in Private Markets, which increased by 25.2% to $25.8 billion as at the fiscal year-end. In addition to Private Equity, the Private Markets portfolio includes investments in Real Return assets (Infrastructure, Real Estate and Renewable Resources) that are a good match for the inflation-sensitive nature of the long-term liabilities under the Plans. Investments in illiquid asset classes also afford us the opportunity to take advantage of PSP Investments' large annual capital inflows to capture illiquidity premiums that translate into higher returns.

Focused on Internal Active Management

Fiscal year 2014 saw the continuation of our increased focus on internal active management, in accordance with PSP Investments' Vision 2015 strategic plan. At year's end more than $70 billion or 75% of consolidated net assets was being managed internally. Some $38 billion of that amount was actively managed by our own teams — representing an increase of 31% from the previous year-end. This contrasts sharply with the situation back in fiscal year 2004, when only $1.7 billion of assets were being actively managed in-house. While actively managing many of our own portfolios involved building the requisite high-calibre teams, it has enabled us to realize significant savings estimated at between $180 million and $265 million in fiscal year 2014 alone. Thanks in large part to the internal active management strategy, PSP Investments' cost ratio has been trending downwards in recent years and compares favourably with peers in the Canadian pension investment industry. Moreover, results indicate that our internal investment managers have in many instances been significantly outperforming our externally-managed investments.

Strong Partnerships Remain Key

Notwithstanding the increased emphasis on internal management, PSP Investments continues to forge strong relationships with select partners, including other leading pension investment managers. Such partnerships enable us to benefit from local market knowledge and gain privileged access to investment opportunities in key global market regions, while retaining our competitive edge in terms of being able to respond quickly to such opportunities by virtue of centralized decision-making at our Montreal headquarters.

By way of example, it was thanks to our strong relationship with a prominent fund in the Asia-Pacific region that the Private Equity team was able to acquire a significant equity interest in a leading Asian life insurer during the latest fiscal year. With some $21 billion in assets, ING Life Korea is that country's fifth-largest life insurance company. This investment fits well with PSP Investments' aim of expanding its holdings in developing economies.

In line with our increased focus on direct and co-investments, the Private Equity team also divested approximately $US1.3 billion of private equity funds during the year through a competitive auction process.

Enhancing the Portfolio

Other noteworthy transactions during fiscal year 2014 included the Infrastructure team's purchase of AviAlliance GmbH (formerly Hochtief AirPort GmbH), an airport investment and management company. AviAlliance held interests in the airports of Athens, Budapest, Dusseldorf, Hamburg, Sydney and Tirana which, combined, handle approximately 95 million passengers annually. The complexity of the transaction gave PSP Investments a competitive advantage to acquire an attractive portfolio of airports with long-term growth perspectives.

It was another deal-intensive year for our Real Estate team, which completed the sale of its Canadian Westin hotel portfolio — one of PSP Investments' first major real estate investments. The transaction generated solid annualized returns of close to 15% over eight years. As well, Revera Inc., PSP Investments' largest Private Markets holding, sold a 75% interest in a sizeable portfolio of Canadian retirement properties, thereby reducing PSP Investments' exposure while allying Revera with a credible strategic partner. Significant Real Estate acquisitions included a 50% stake in 1250 René-Lévesque, a million-square-foot-plus Class A office tower in downtown Montreal that houses the main business offices of PSP Investments; and the purchase with several partners of a large office property strategically situated on Park Avenue in Manhattan. We also created a $1.5-billion (€1-billion) logistics joint-venture with London-based SEGRO, a leading industrial/warehousing property owner, manager and developer listed on the London Exchange. The joint venture involves 34 estates in Western and Central Europe, totaling more than 17 million square feet.

Our Renewable Resources team formed a strategic agricultural joint venture with an established farmland investor and manager in Latin America, which will serve as PSP Investments' platform for the further acquisition, development and management of farmland in the region. Again, this transaction is consistent with PSP Investments' strategy to partner with best-in-class investors and operators in key regions.

PSP INVESTMENTS HAS BEEN ABLE TO CAPITALIZE ON THE VOLATILITY THAT ROILED MARKETS IN THE WAKE OF THE 2008-2009 GLOBAL FINANCIAL CRISIS AND DELIVERED AN ANNUALIZED RETURN OF 13.0% FOR THE FIVE-YEAR PERIOD, AMONG THE BEST IN CANADA.

Leveraging Key Strengths

Looking back at the past five years since the financial crisis, and the past 11 years since we launched our diversification drive, I believe PSP Investments' consistent excellent performance can be ascribed to what I regard as our key strengths: a clearly defined vision and strategy; outstanding partners — which arguably is key to our success and reflected in the quality of our assets; sound governance, including an arm's-length relationship with the Government of Canada that enables us to focus on generating risk-adjusted returns, unencumbered by political considerations or short-term economic objectives; and last, but by no means least, exceptional talent.

As well, we have made significant investments to build a robust technology and data-management infrastructure to support our rapid growth. We continue to strengthen our capabilities in that respect, focusing on the implementation of scalable systems that can effectively handle public and private market transactions from end to end. As PSP Investments' portfolios continue to expand, these systems also allow for enhanced monitoring, reporting, analysis and risk management.

World-Class Team

As I indicated at the beginning of this report, the solid results we posted for fiscal year 2014 reflect PSP Investments' exceptional bench strength. The team we have built in Montreal is the equal of any similar-sized pension investment organization anywhere in the world. In that regard, I would suggest our performance speaks for itself. But you need not take my word for it: in the course of my frequent travels to meet with people around the globe with whom we do business, it is gratifying to hear the near universal respect and high regard our partners express for the men and women of PSP Investments with whom they deal.

The calibre of our team reflects our uncompromising efforts to identify, attract, retain and develop top-flight talent, be it the "cream of the crop" of new graduates or proven industry professionals — those "A" players everyone covets. In that vein, I am pleased to note that some 50 of the best and brightest young people from leading North American colleges and universities pursued internships with PSP Investments during fiscal year 2014. Comprehensive career-management and succession-planning initiatives, which encompass every area and every level of the organization, are designed to ensure that employees have the opportunity to thrive in our performance culture — and that they are duly recognized and rewarded.

The benefits of this approach were reflected in the results of a recent employee engagement survey conducted by consultants Aon Hewitt, which found a level of drive and commitment that ranked PSP Investments in the top quartile of Canadian employers. That is quite a compliment for an organization as young as ours.

Acknowledgements

I would like to take this opportunity to reiterate how proud and privileged I am to lead the PSP Investments team, and to thank all our employees for their contributions to our collective success. Finally, I wish to express my appreciation to the Board of Directors for their continued support.

Gordon J. Fyfe
President and Chief Executive Officer

MANAGEMENT'S DISCUSSION OF FUND PERFORMANCE AND RESULTS

Mandate, Objective and Investment Approach

PSP INVESTMENTS' MANDATE

PSP Investments manages the assets earmarked for the funding of the Post-2000 Liabilities under the Plans. PSP Investments' statutory mandate is described in Section 4 of the *Public Sector Pension Investment Board Act* (the "Act"):

To manage the amounts transferred to it in the best interests of contributors and beneficiaries under the Plans with respect to the Post-2000 Liabilities; and to maximize returns without undue risk of loss, having regard to the funding, policies and requirements of the Plans and the ability of those Plans to meet their financial obligations.

Based on these statutory objectives, PSP Investments implemented an investment approach aimed at achieving a return consistent with the funding of the Post-2000 Liabilities, with an acceptable level of risk.

RETURN OBJECTIVE

The return objective is currently set at a long-term real return of 4.1% (i.e. after inflation). This return objective for the pension assets managed by PSP Investments is communicated by the Treasury Board Secretariat, which oversees the Government of Canada's ("Government") relationship with PSP Investments. This return objective is the long-term rate of return assumption currently used by the Chief Actuary of Canada to determine the level of pension contributions for the funding of the Post-2000 Liabilities under the Plans. In the absence of other factors affecting the funding of the Plans, achieving such return would maintain contributions and pension benefits at their current levels.

RISK APPETITE

Investments that would guarantee to deliver the return objective on a risk-free basis simply do not exist. Therefore, PSP Investments must take investment risks to achieve the return objective. In fiscal year 2014, PSP Investments has further formalized its investment approach by adopting a Risk Appetite Statement. The Risk Appetite Statement articulates PSP Investments' appetite, attitude and tolerances to risk in pursuit of the return objective.

A key element of the Risk Appetite Statement is the Government of Canada's assumed appetite for risk ("risk appetite"), risk being defined as the possible requirement to make supplementary pension contributions to the Plans as a result of less favourable investment performance.

The risk appetite is determined by evaluating, through an asset–liability management study, the pension funding risk that would result from investing in a simple, passively managed portfolio comprised of public, liquid securities (stocks and bonds). This passive portfolio is designed to achieve the return objective with the lowest possible investment risk.

INVESTMENT APPROACH

Based on the return objective and risk appetite, PSP Investments' Board of Directors implemented an investment approach around two key pillars, as illustrated below:

MANDATE AND STRATEGIC OBJECTIVES		PILLARS OF INVESTMENT		
Return Objective	Risk Appetite	Policy Portfolio	Active Management	= Actual Portfolio
Long-term Actuarial Return CPI +4.1%	Maximum Allowed Level of Funding Risk	Target Allocations	Risk-controlled Deviation vs. Benchmarks	

FIRST PILLAR: POLICY PORTFOLIO

The first pillar of PSP Investments' approach is the Policy Portfolio, which represents the long-term target asset allocation among various asset classes approved by the Board of Directors. PSP Investments' Policy Portfolio is designed to achieve a return at least equal to the return objective over the long term, assuming a level of risk that is within the defined risk appetite. It is a diversified portfolio that is reviewed at least annually within an asset-liability management framework. This integrated framework recognizes that the assets are managed to meet the financial obligations of the Plans and, as such, the Policy Portfolio takes into account the specific characteristics of the Post-2000 Liabilities and their funding.

As an illustration, the Post-2000 Liabilities under the Plans are long-term with no liquidity expected to be required from PSP Investments for pension benefit payments before 2030. Therefore, PSP Investments can make long-term investments in assets with lower liquidity (e.g. Private Markets) than typical Public Markets assets. We expect the lower liquidity of these investments to be compensated with higher returns over time. In addition, it is recognized that the pension liabilities are sensitive to inflation. Hence, investing in assets with inflation-hedging characteristics (e.g. Real Return Assets) is expected to provide for a good match with the inflation-sensitive nature of the pension liabilities. An investment approach that better matches the liabilities' characteristics is expected to reduce the funding risk.

Policy Portfolio
As at March 31, 2014

LONG-TERM TARGET ASSET ALLOCATION

WORLD EQUITY	54%	Public Market Equity	40%
		Private Equity	14%
REAL RETURN ASSETS	33%	Real Estate	13%
		Infrastructure	13%
		World Inflation-Linked Bond	5%
		Renewable Resources	2%
NOMINAL FIXED INCOME	13%	Fixed Income	11%
		Cash & Cash Equivalents	2%

There were no changes to the Policy Portfolio in fiscal year 2014.

SECOND PILLAR: ACTIVE MANAGEMENT

Active management activities form the second pillar of PSP Investments' approach. These activities are implemented within an active risk budget and the risk appetite to generate additional returns over the Policy Portfolio. PSP Investments seeks to invest in companies and securities that, based on thorough and proprietary research, offer better expected risk-adjusted returns than the overall market. 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 makes the deployment of active management strategies particularly advantageous. Notably, this approach offers economies of scale and increases the scope of activities in selected asset classes. Accordingly, PSP Investments has been increasing the proportion of its assets under internal active management and expanding relationships with selected partners. Increasing the share of assets managed internally provides for better control in terms of risk, cost savings and increased influence over major decisions.

PERFORMANCE OBJECTIVES

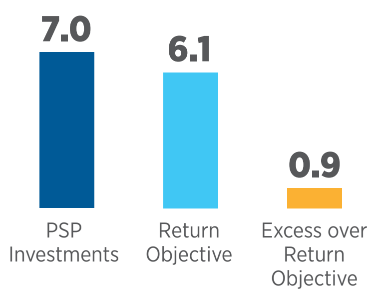
The following objectives were established to assess the performance of the investment approach and active management:

1. Investment approach: achieve an absolute return, net of expenses, at least equal to the return objective over 10-year periods;
2. Active management: achieve a return exceeding the Policy Portfolio benchmark over 4-year periods.

As of March 31, 2014, both objectives were met. PSP Investments outperformed the return objective by 0.9% per year over the past 10 years (or 15.5% cumulative over the period). Active management activities generated 1.9% of return in excess of the Policy Portfolio per year over the past four years.

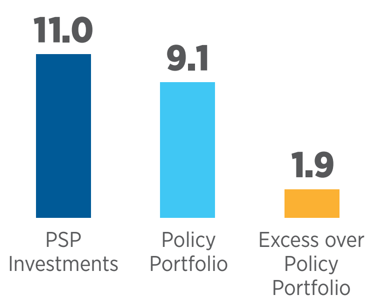
1. Investment Approach

10-Yr Annualized Net Return (%)



2. Active Management

4-Yr Annualized Return (%)



FY2014 ANNUAL REVIEW

The investment approach was reviewed by the Board of Directors during FY2014. Although consideration was given to adding or expanding asset classes within the Policy Portfolio, it was concluded that the current Policy Portfolio, with its target of 42% to Private Markets investments, remains effective and should enable PSP Investments to meet or exceed its long-term rate-of-return objective (4.1% after inflation), with an acceptable level of risk.

Asset-liability management studies conducted on behalf of the Board of Directors indicate that the increased diversification and the liability-matching characteristics of the Policy Portfolio, combined with its implementation through active management activities, provides a higher likelihood of meeting the return objective over the long-term, with an equivalent or even lower level of funding risk when compared to a portfolio composed solely of public, liquid asset classes, thus within the risk appetite.

PSP INVESTMENTS

ONE-YEAR RATE OF RETURN 16.3%

NET INVESTMENT INCOME **$12.6 BILLION**

NET CONTRIBUTIONS **$5.0 BILLION**

NET ASSETS **$93.7 BILLION**

Change in Net Assets and Fund Performance

PERFORMANCE MEASUREMENT AND EVALUATION

Based on its Statement of Investment Policies, Standards and Procedures (SIP&P), PSP Investments evaluates its investment strategies, as well as individual investment mandates, through performance measurement.

PSP Investments measures its performance on a gross basis.

The time-weighted rate of return methodology is used to calculate returns for Public Market asset classes and the Total Portfolio while the internal rate of return methodology is used to calculate returns for the Real Estate, Private Equity, Infrastructure and Renewable Resources asset classes.

For the total portfolio return and for the asset classes investment income and returns, performance is calculated gross of direct expenses and excludes external investment management fees for Public Market asset classes and excludes transaction costs for Private Market asset classes. Additionally, the Private Market asset class returns are presented net of currency hedging. Reporting performance on a gross basis allows for better comparability across the industry. PSP Investments also evaluates its cost structure to ensure the cost of delivering its return net of fees is competitive as described on page 32.

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 2014.

Asset Class	Benchmark
World Equity	
Canadian Equity	S&P/TSX Composite Index
Foreign Equity US Large Cap Equity EAFE Large Cap Equity Small Cap Equity Emerging Markets Equity	 S&P 500 Index MSCI EAFE Index S&P 600 Index 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
Fixed Income	JP Morgan Government Bond Index Global and DEX Universe Bond Index
Real Return Assets	
World Inflation-Linked Bonds	Four Country ILB Index [1]
Real Estate	Real Estate Cost of Capital [1]
Infrastructure	Inflation Adjusted Infrastructure Risk Premium and Infrastructure Cost of Capital [1]
Renewable Resources	Renewable Resources Cost of Capital [1]

[1] Customized benchmark.

CHANGE IN NET ASSETS

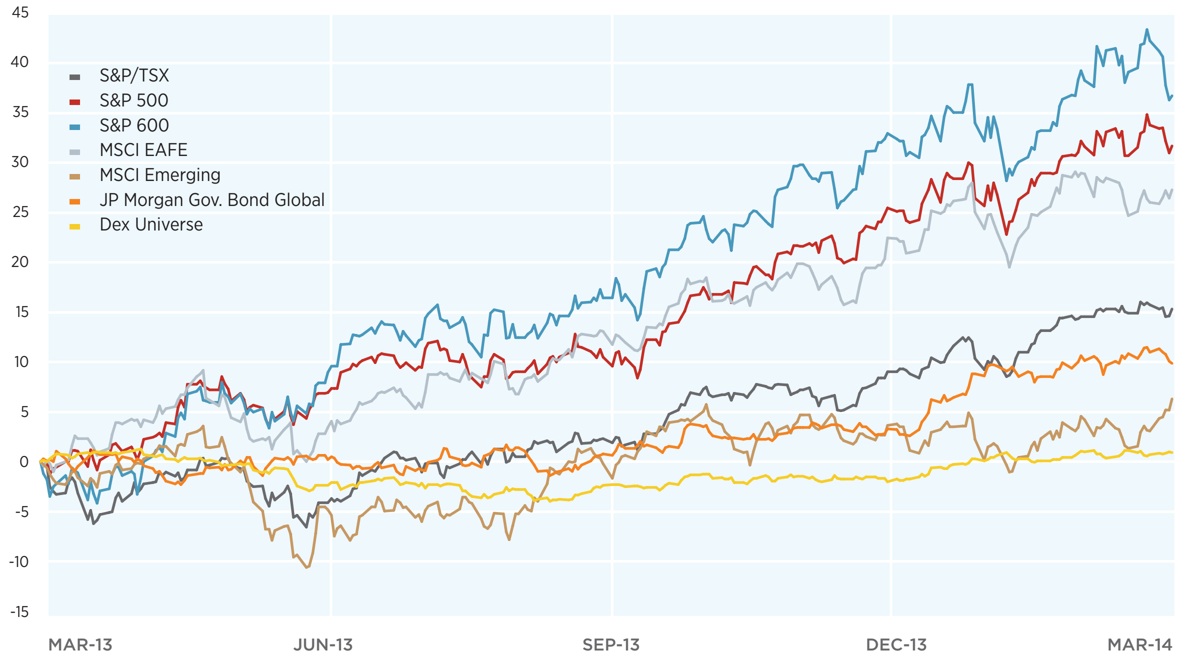
The net assets of PSP Investments increased by $17.6 billion during fiscal year 2014, a gain of 23% that was attributable to a combination of strong investment performance and net contributions. Net assets at the end of fiscal year 2014 were $93.7 billion, up from $76.1 billion at the end of the previous fiscal year.

PSP Investments generated net income from operations of $12.6 billion during the latest fiscal year, compared to $7.0 billion in fiscal year 2013. The results for fiscal year 2014 represent a consolidated rate of return of 16.3%, compared to 10.7% in fiscal year 2013. PSP Investments received $5.0 billion in net contributions during fiscal year 2014.

MARKET OVERVIEW

Performance of Major World Indices

Fiscal year 2014 ($ CAD, percent)



While developed market equity indices continued to record solid gains, emerging markets did not fare nearly as well. The combination of extremely accommodative monetary policy, modest economic growth and attractive valuations propelled developed market equities sharply higher, with the MSCI World Index recording a 29.4% gain. With the fiscal uncertainty that had been gripping the U.S. resolved, the US indices continued to hit new peaks and European indices posted solid gains as the recovery from the euro zone recession got firmly underway. Canada's S&P/TSX, however, underperformed its US counterparts with soft commodity prices and the country's economic performance weighing on equity prices. Meanwhile, concerns about the extent of the Chinese economic slowdown and the impact on growth of the required adjustments to external imbalances in several other economies caused emerging market indices to lose their shine. Correspondingly, the MSCI Emerging Markets Index recorded a more modest 7.1% gain.

It was a more difficult year for fixed-income markets. While the US Federal Reserve continued to signal its intention to keep its Fed Funds rate at extremely low levels for an extended period of time, it started to unwind its asset purchase program, gradually "tapering" its purchases of Treasuries and Asset-Backed Securities. As a result, Treasury yields increased noticeably, pulling most developed economy bond yields higher. The notable exception was in peripheral Europe where yields declined as the situation in the eurozone continued to normalize. As a result, the JP Morgan Global Index managed only a meagre gain of 1.0% in local currency terms, although the Canadian dollar depreciation boosted the return to 9.6%.

CONSOLIDATED RETURNS

PSP Investments achieved a 16.3% rate of return in fiscal year 2014, driven in part by the strong performance of global markets described above. The total portfolio return of 16.3% for fiscal year 2014 exceeded the Policy Benchmark rate of return by 2.4% and added $1.8 billion in value over and above the Policy Benchmark return. Over the past four fiscal years, PSP Investments has recorded a compound annualized rate of return of 11.0%, compared to the Policy Benchmark rate of return of 9.1% for that same period resulting in $4.9 billion in value-added.

All investment portfolios recorded positive investment returns in the latest fiscal year. The strong overall performance was driven primarily by the Public Markets Equities, Private Equity, Renewable Resources, Real Estate and Infrastructure portfolios. Investment returns for all Public Markets Equities portfolios were positive, ranging from 6.1% for Emerging Markets Equity to 38.7% for the Small Cap Equity portfolio. On an aggregate basis, the Public Markets Equities portfolios recorded an investment return of 21.5% for the year largely as a result of the strong performance of Small Cap Equity as well as the US and EAFE Large Cap Equity stock markets.

The excess return of 2.4% (relative to the Policy Benchmark) achieved during fiscal year 2014 was generated primarily by the Real Estate, Private Equity, Public Markets absolute-return mandates, Infrastructure and Renewable Resources portfolios. The main drivers of the excess returns for each asset class are presented in further detail on pages 22 to 31 of this annual report.

The 11-year return since the start of the diversification strategy is 8.9% and the return since inception is 5.8%.

PORTFOLIO AND BENCHMARK RETURNS

As at March 31, 2014

Asset Class	Fiscal Year 2014				4-year	
	Fair Value (millions $)[1]	Fair Value %	Portfolio Returns %	Benchmark Returns %	Portfolio Returns %	Benchmark Returns %
World Equity						
Canadian Equity	16,731	17.8	16.1	16.0	7.4	7.3
Foreign Equity						
US Large Cap Equity	9,097	9.7	29.5	32.4	17.3	17.3
EAFE Large Cap Equity	9,000	9.6	28.3	27.7	10.7	10.3
Small Cap Equity	6,535	7.0	38.7	38.9	20.8	20.5
Emerging Markets Equity	8,116	8.7	6.1	7.1	4.7	4.2
Private Equity	8,425	9.0	24.0	14.7	16.9	13.7
Nominal Fixed Income						
Cash & Cash Equivalents[2]	1,756	1.9	1.4	1.0	1.3	0.9
Fixed Income	11,578	12.3	4.0	4.0	5.5	5.2
Real Return Assets						
World Inflation-Linked Bonds	5,036	5.4	6.9	6.9	8.4	8.4
Real Estate	10,650	11.4	12.2	5.2	12.6	5.9
Infrastructure	6,011	6.4	9.4	4.6	6.0	7.0
Renewable Resources[3]	795	0.8	20.0	5.5	15.5	5.1
Total	**93,730**	**100.0**	**16.3**	**13.9**	**11.0**	**9.1**

[1] The 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.

[2] Includes amounts related to absolute-return strategies.

[3] The Renewable Resources asset class was created in fiscal year 2012. The four-year portfolio and benchmark returns presented are since inception (2.75 years).

Except as otherwise indicated, returns are time-weighted rates of return.

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

The total portfolio return includes the performance impact of absolute-return strategies and is calculated gross of direct expenses. Private Market asset class returns are presented net of currency hedging.

PUBLIC MARKETS

ONE-YEAR RATE OF RETURN 17.8%

INVESTMENT INCOME **$9.9 BILLION**

NET ASSETS **$66.1 BILLION**

70.5% OF TOTAL NET ASSETS

Public Markets is composed of Canadian Equity, Foreign Equity, Fixed Income and World Inflation-Linked Bonds. Net assets in Public Markets totalled $66.1 billion at the end of fiscal year 2014, an increase of $12.0 billion from $54.1 billion at the end of fiscal year 2013.

Public Markets recorded investment income of $9.9 billion in fiscal year 2014 for an overall return of 17.8%. The benchmark return for fiscal year 2014 was 17.4%.

Public Markets investments are overseen by both internal and external managers using a combination of active and index-replication strategies. Net assets managed in active strategies totalled $26.0 billion at the end of fiscal year 2014, an increase of $5.2 billion from $20.8 billion at the end of fiscal year 2013, reflecting the Corporation's intensified focus on internal active management. The proportion of active strategies managed internally increased to 68%, compared with 65% at the end of the previous fiscal year.

TOTAL VALUE-ADDED

External global macro and fixed income absolute-return strategies added $124 million of relative value, mainly as a result of good individual credit selection. Internal absolute-return mandates added $86 million of relative value, attributable primarily to merger arbitrage and event-driven investment strategies. Asset-backed term notes contributed $82 million of relative value, as PSP Investments continued to fully benefit from a reduction of risk on the underlying assets as they approach maturity.

EQUITIES

Net assets in Public Markets equities totalled $49.4 billion at the end of fiscal year 2014, an increase of $9.2 billion from the $40.2 billion total at the end of fiscal year 2013.

Public Markets equities recorded an investment gain of $8.7 billion for a return of 21.5% in fiscal year 2014, versus the benchmark return of 22.0%. This marginal underperformance vis-à-vis the benchmark was primarily due to a negative relative performance from US Large Cap portfolios.

As noted in the Market Overview, the performance of equity markets in fiscal year 2014 varied greatly across regions, most notably between developed and emerging markets: the Canadian Equity portfolio gained 16.1%; the US Large Cap Equity portfolio 29.5%; the EAFE Large Cap Equity portfolio 28.3%; and the Small Cap Equity portfolio 38.7%. By contrast, Emerging Markets Equity posted relatively modest returns of 6.1%.

FIXED INCOME

Net assets in Fixed Income and World Inflation-Linked Bonds totalled $16.6 billion at the end of fiscal year 2014, compared with $13.9 billion at the end of fiscal year 2013. Over all, these fixed income portfolios earned $770 million in investment income for a return of 4.9% in fiscal year 2014, matching the benchmark return of 4.9%.

REAL ESTATE

ONE-YEAR RATE OF RETURN 12.2%

INVESTMENT INCOME **$1.1 BILLION**

NET ASSETS **$10.6 BILLION**

11.4% OF TOTAL NET ASSETS

Net assets of the Real Estate portfolio totalled $10.6 billion at the end of fiscal year 2014, an increase of $1.2 billion from $9.4 billion at the end of fiscal year 2013.

Real Estate investments generated $1.1 billion in investment income, for a total return of 12.2% in fiscal year 2014, compared to a benchmark of 5.2%.

The strong returns in Real Estate this year are partially reflective of valuation increases from a high volume of new investments made post-financial crisis. These returns are composed of a combination of consistent cash flows generated by direct investments in core properties diversified across multiple property types and geographies, plus various value-added initiatives undertaken with respect to specific assets within the portfolio, strategic investments in real estate debt instruments and indirect investments in a limited number of top-performing funds. Significant valuation increases during the year were recognized from our portfolio of multi-family properties in Canada, the United States, Germany and the United Kingdom, from office buildings in Canada and the U.S., and from our investments in high-yielding and distressed real estate debt. Significant gains were realized on the sales of properties outlined below.

Over a four-year period, Real Estate investments generated a 12.6% annualized return, compared to a benchmark return of 5.9% for the same period. Since the inception of this asset class in October 2003, Real Estate investments generated a 10.1% annualized return compared to a benchmark return of 6.6%.

The year-over-year increase in net assets reflects both new investments (net of dispositions) and valuation gains from existing assets. During fiscal year 2014, Real Estate increased its European exposure by acquiring a core logistics portfolio with assets situated in prime locations in continental Europe, and a high-quality office building in central Paris. Other notable direct investments included acquisitions of Class-A core office buildings in New York, in Montreal and in Perth and Brisbane, Australia, as well as several retail malls in key US cities and our first direct residential investment in South Africa.

Real Estate expanded its relationships with debt providers, which led to investments in debt instruments on upscale hotels and office properties throughout continental Europe and multi-family properties in the U.S. Commitments were also made, but not yet fully funded, with respect to both direct and fund structures involving development opportunities in China, the U.S. (Boston and California) and South Africa. Over the course of the year, several properties in the U.S., Brazil and Canada, where the respective business plans had been achieved and markets were offering attractive valuations, were disposed of. Those transactions included the sale of a Canadian hotel portfolio and a 75% interest in 47 retirement homes in the Revera portfolio.

As at March 31, 2014, direct ownership and co-investments accounted for 82% of the assets in Real Estate, a slight decrease from 84% at the end of the previous fiscal year.

Real Estate

Diversification by Geography

As at March 31, 2014

United States	**36.6%**
Canada	**30.5%**
Europe	**15.3%**
Developed Asia and Australia	**9.6%**
Emerging Countries	**8.0%**

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

Real Estate

Diversification by Sector

As at March 31, 2014

Office	**38.3%**
Retirement/Residential	**26.3%**
Retail	**9.5%**
Industrial	**7.4%**
Health Care	**7.0%**
Real Estate Debt	**6.2%**
Other	**5.3%**

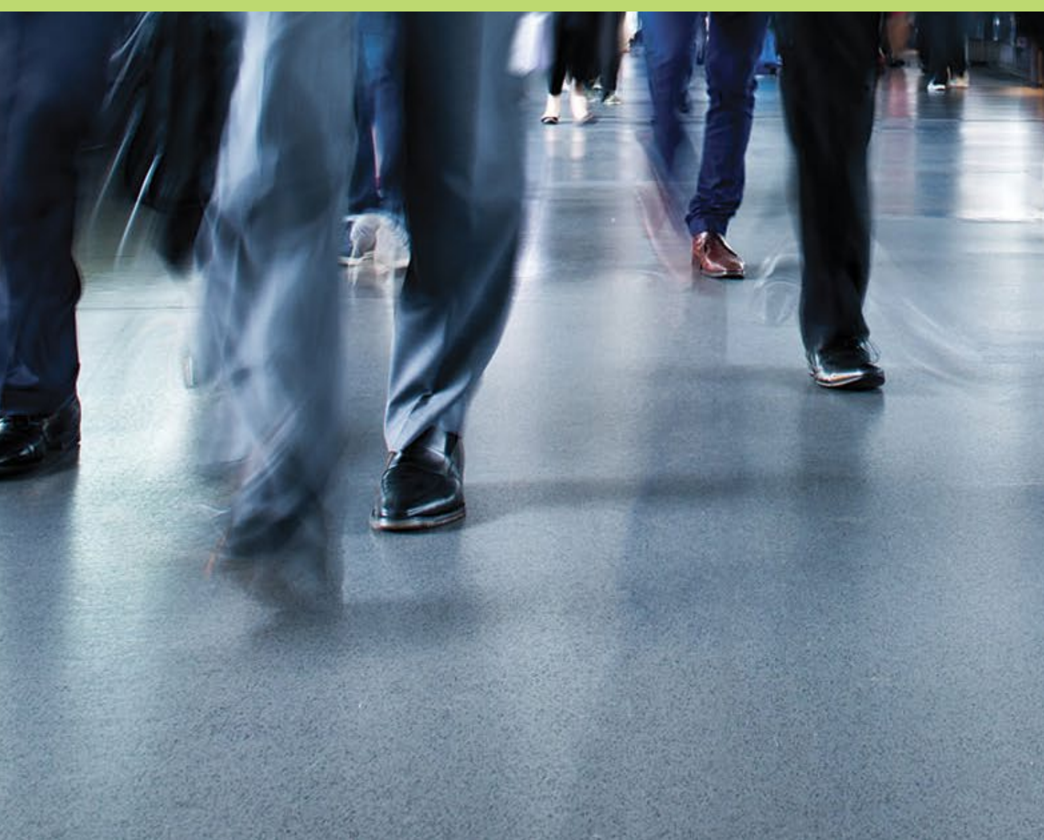
PRIVATE EQUITY

ONE-YEAR RATE OF RETURN 24.0%

INVESTMENT INCOME **$1.6 BILLION**

NET ASSETS **$8.4 BILLION**

9.0% OF TOTAL NET ASSETS



Net assets of the Private Equity portfolio totalled $8.4 billion at the end of fiscal year 2014, an increase of $1.5 billion from the $6.9 billion total at the end of fiscal year 2013.

Private Equity generated $1.6 billion in investment income, for a rate of return of 24.0% for fiscal year 2014, exceeding the benchmark return by 9.3%. The income generated from co-investments was $898 million, reflecting a 39.9% internal rate of return (IRR), and the income generated from funds was $712 million, for an IRR of 16.0%.

The strong performance of the co-investment portfolio particularly benefited from a successful IPO of Noodles & Company, as well as continued EBITDA growth and strong cash flow generation at Telesat. Those two investments contributed $572 million of investment income, while the fund returns were earned from a select number of key partners.

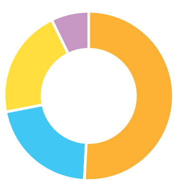
From a total-portfolio perspective, exposures to both the US and Canadian markets performed particularly well, while Asian and European exposures lagged. On a four-year basis, Private Equity investments generated a 16.9% annualized return, compared to a benchmark return of 13.7% for the same period. Since the inception of this asset class in July 2004, Private Equity investments generated a 9.2% annualized return compared to a benchmark return of 4.9%.

The Private Equity strategy is focused on long-term investments, targeting individual investments of $200 million to $500 million, usually held for between five to ten years. The portfolio is invested globally in cooperation with select strategic partners with whom PSP Investments has established close relationships. PSP Investments continues to concentrate its Private Equity portfolio with bespoke funds and an increasing number of co-investments. In keeping with this strategy, the Private Equity Group completed a secondary divestiture of eight "traditional" funds during the year, resulting in a reduction of $1.3 billion in total fund exposure.

During the year, Private Equity committed strategically to two funds selected on the basis of their unique and specialized investment strategies, underpinned by a strong alignment of interests, preferred terms and strong potential co-investments deal flow.

Among the year's noteworthy transactions was the acquisition of ING Life Insurance (Korea), which was partnered alongside MBK Partners.

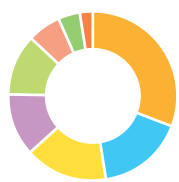
As at March 31, 2014, co-investments accounted for 44% of the assets of the Private Equity portfolio.



Private Equity
Diversification by Geography
As at March 31, 2014

United States	**51.1%**
Canada	**21.0%**
Asia	**20.9%**
Europe	**7.0%**

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



Private Equity
Diversification by Sector
As at March 31, 2014

Communications	**30.9%**
Consumer Cyclical	**16.6%**
Consumer Non-Cyclical	**15.9%**
Financial	**12.0%**
Technology	**11.8%**
Industrial	**6.3%**
Energy	**4.1%**
Other	**2.4%**

INFRASTRUCTURE

ONE-YEAR RATE OF RETURN 9.4%
INVESTMENT INCOME **$424 MILLION**
NET ASSETS **$6.0 BILLION**
6.4% OF TOTAL NET ASSETS

The net assets of the Infrastructure portfolio totalled $6.0 billion at the end of fiscal year 2014, an increase of $2.1 billion from the $3.9 billion at the end of fiscal year 2013.

The Infrastructure portfolio generated $424 million in investment income, for a return of 9.4% in fiscal year 2014, compared to the benchmark return of 4.6%. This income included $276 million of distributions. The portfolio return was driven mainly by direct investments in the transportation and energy sectors in Europe, Canada and emerging markets. In the energy sector, movements in oil and natural gas markets, as well as relative differences in commodity prices across geographies, have created both opportunities and challenges for the portfolio.

Over a four-year period, Infrastructure investments generated a 6.0% annualized return compared to a benchmark return of 7.0% for the same period. The investment horizon of Infrastructure investments is more than 10 years. Since the inception of this asset class in June 2006, Infrastructure investments have generated a 6.1% annualized return, compared to a benchmark return of 5.2%.

The year-over-year increase in net assets in Infrastructure included new direct investments totalling $1.7 billion, the majority of which are in Europe. Over the course of the fiscal year, the Infrastructure group acquired the airport unit of Hochtief AG, a portfolio of participations in six airports located in Europe and Australia. The group also invested in a wind development portfolio in Turkey, alongside new strategic partners. In addition, the Infrastructure group committed approximately $400 million with new partners in India and North America. The diverse nature of these investments, in a variety of sectors and regions, contributed to enhanced portfolio diversification.

The Infrastructure strategy remains focused on building partnerships with other financial investors and strategic operators to acquire assets offering a good mix of predictable cash flows and growth opportunities, and owning these investments for many years.

As at March 31, 2014, direct and co-investments accounted for 89% of the assets of the Infrastructure portfolio, up from 85% at the end of the previous fiscal year.

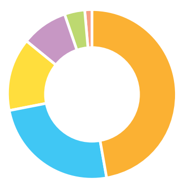
Infrastructure

Diversification by Geography

As at March 31, 2014

Europe	**30.9%**
North America	**22.6%**
United Kingdom	**13.9%**
Australia	**13.5%**
Latin America	**13.3%**
Asia and Others	**5.8%**

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



Infrastructure

Diversification by Sector

As at March 31, 2014

Transportation	**47.4%**
Electrical Generation and Transmission	**24.7%**
Oil and Gas Storage and Transport	**13.9%**
Oil and Gas Exploration and Production	**8.8%**
Water Utilities	**4.0%**
Other	**1.2%**

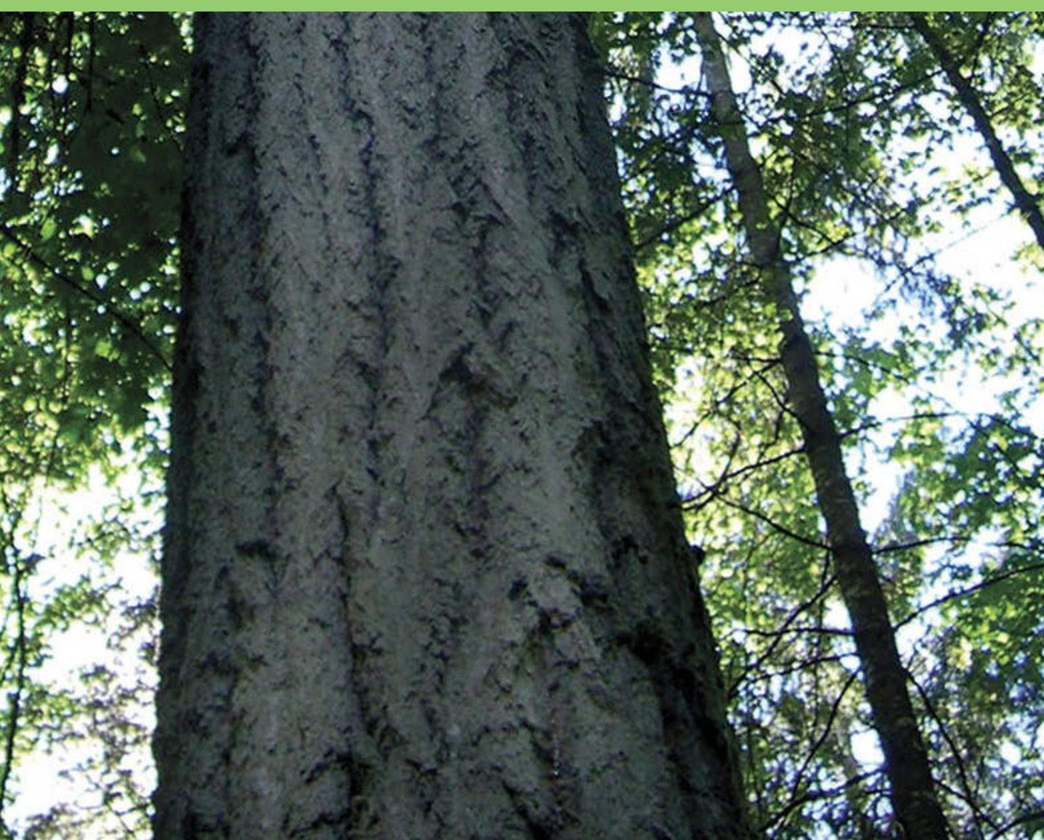
RENEWABLE RESOURCES

ONE-YEAR RATE OF RETURN 20.0%

INVESTMENT INCOME **$128 MILLION**

NET ASSETS **$795 MILLION**

0.8% OF TOTAL NET ASSETS



Net assets of the Renewable Resources portfolio totalled $795 million at the end of fiscal year 2014, an increase of $413 million from $382 million at the end of fiscal year 2013.

Renewable Resources generated investment income of $128 million, for a rate of return of 20.0% in fiscal year 2014. This compares to a benchmark return of 5.5%. Investment income was evenly split between distributions and valuation gains. Portfolio returns were attributable to positive performance from the group's timber investments, which benefitted from higher log prices driven by continued growth in Asian demand for wood fibre, and the steady recovery of US housing starts.

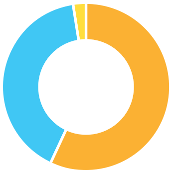
Since inception in June 2011, Renewable Resources has generated a 15.5% annualized return, compared to a benchmark return of 5.1% for the same period.

During fiscal year 2014, the Renewable Resources team completed its investment in a significant participation in New Zealand's Kaingaroa Forest. The estate totals approximately 178,000 hectares (440,000 acres) of planted forest and is the largest contiguous softwood plantation in the southern hemisphere.

Also during the year, the team closed two investments in agricultural platforms in Latin America and Oceania. The platforms are focused on row crops and dairy, and represent a combined commitment of US$500 million to be deployed over the next three to five years.

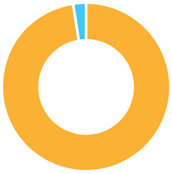
The strategy for Renewable Resources is focused on direct, long-term investments and involves engaging with like-minded peers and top-of-class operators in order to participate in sizeable off-market transactions. For geographies and sectors where finding investments of scale is challenging, the focus is on creating platforms to acquire smaller assets.

As at March 31, 2014, direct investments accounted for 100% of the assets in the Renewable Resources portfolio.



Renewable Resources
Diversification by Geography
As at March 31, 2014

Oceania	**57.2%**
Canada	**40.5%**
Latin America	**2.3%**



Renewable Resources
Diversification by Sector
As at March 31, 2014

Timberland	**97.7%**
Agriculture	**2.3%**

Operating and Asset Management Expenses

PSP Investments' total operating expenses for fiscal year 2014 increased to $216 million, compared to $184 million for fiscal year 2013. However, expressed as a percentage of net investment assets, operating expenses for the latest year declined to 25.7 basis points, or 25.7 cents per $100 of average net investment assets, compared to 26.8 basis points or 26.8 cents per $100 of average net investment assets in fiscal year 2013.

The increase in operating expenses for fiscal year 2014 is mainly related to the higher level of internal actively-managed assets and the increase in assets under management.

For fiscal year 2014, PSP Investments' cost ratio amounted to 59.3 basis points, or 59.3 cents per $100 of average net investment assets, compared to 56.9 basis points, or 56.9 cents per $100 of average net investment assets in fiscal 2013. Asset-management expenses include management fees paid to external asset managers and transaction costs. The increase in the cost ratio for the latest fiscal year is mainly attributable to higher transaction costs for Private Markets investments. Transaction costs can vary significantly year over year, depending on the complexity and size of Private Markets investment activities. Excluding transaction costs, PSP Investments' cost ratio amounted to 48.1 basis points in fiscal 2014, compared to 49.6 basis points in fiscal 2013.

As asset levels increased sharply over the past several years, PSP Investments has been rigorously overseeing its cost ratio (i.e. operating expenses plus asset-management expenses as a percentage of average net investment assets), which has been on the decline — falling almost one third, from 86.9 basis points (86.9 cents per $100 of average net investment assets) in fiscal year 2009 to less than 60 basis points in the latest fiscal year. The decline is primarily attributable to PSP Investments' internal active management strategy, adopted in fiscal 2004. Assets managed internally increased to approximately $70 billion at the end of fiscal 2014, compared to $56 billion at the end of the previous fiscal year. Over the past five fiscal years, internally managed assets have increased by approximately $49 billion, while operating expenses grew by $130 million. Based on available market data with respect to investment-implementation style, it is estimated that, for fiscal year 2014 alone, the increase in internally managed assets of $49 billion has resulted in estimated savings ranging from $180 million to $265 million, compared to what costs would have been had PSP Investments deployed those assets with external investment managers.

International Financial Reporting Standards (IFRS)

In 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 2011, the AcSB decided to defer the adoption of IFRS by investment companies, currently applying Accounting Guideline 18 "Investment Companies" (AcG-18), to annual periods starting on or after January 1, 2014.

In October 2012, the International Accounting Standards Board (IASB) issued "Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)". Such amendments require qualifying investment entities to measure particular subsidiaries at fair value through profit or loss, rather than consolidate them. The amendments are effective for annual periods beginning on or after January 1, 2014.

In December 2012, the AcSB approved the incorporation of the above amendments to IFRS into Part I of the Chartered Professional Accountants of Canada (CPA Canada) Handbook – Accounting. The AcSB also confirmed the previously announced IFRS adoption date for Canadian investment companies applying Accounting Guideline 18 "Investment Companies" (AcG-18) is annual periods starting on or after January 1, 2014.

The first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015. Consequently, PSP Investments' transition date is April 1, 2013 – the first day of the earliest comparative period required to be presented under IFRS.

Management is at an advanced stage in its analysis of the impact of adopting IFRS on PSP Investments' consolidated financial statements. To date, the impact on the opening consolidated statement of financial position of PSP Investments as at April 1, 2013 is not expected to be significant. Other impacts expected consist of presenting a statement of cash flows as well as additional note disclosures.

RISK MANAGEMENT

Enterprise Risk Management

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

Accordingly, the Corporation emphasizes continuous improvement of its risk management capabilities. During fiscal year 2014, the Board of Directors approved a comprehensive Risk Appetite Statement ("RAS"), developed by management and the special Risk Committee of the Board of Directors. The RAS defines PSP Investments' appetite, attitude and tolerance to both investment and non-investment risks that may be taken in pursuit of its objectives.

RISK APPETITE STATEMENT

The RAS emphasizes that all employees are not only active participants in risk identification, but also in risk evaluation, management, mitigation, reporting and monitoring. Furthermore, the RAS reiterates that all investments and activities must be in accordance with applicable laws, regulations and other mandatory industry practices. An abbreviated version of the RAS, summarizing its main elements, has been shared with all PSP Investments employees to ensure they have a consistent, universal understanding of risk appetite and related tolerances and is also available on our Website.

The RAS is an overarching document that complements other key policies and procedures which set out the guiding principles governing the Corporation's overall approach, philosophy, culture and values with respect to risk management. Among them: the Statement of Investment Policies, Standards and Procedures ("SIP&P"); the Enterprise Risk Management ("ERM") Policy; the Investment Risk Management ("IRM") Policy; and the Operational Risk Management ("ORM") Policy.

ENTERPRISE RISK MANAGEMENT POLICY

The ERM Policy provides a framework for identifying, evaluating, managing, monitoring and reporting the various investment and non-investment risks faced by the Corporation. As risk management strategies and processes — as well as the business environment — continue to evolve, PSP Investments strives to ensure that the framework remains effective.

The framework is guided by the following principles:

- Promote a risk-aware culture involving all employees;
- Integrate enterprise risk management into strategic and financial objectives;
- Operationalize sound risk management processes supporting investment and non-investment activities; and
- Ensure effective and transparent communication of emerging risk trends.

PSP Investments' Enterprise Risk Categories

The ERM Policy defines and categorizes enterprise risks to facilitate a universal understanding of all the risks faced by PSP Investments. The Corporation's enterprise risk categories are defined as:

- Investment risk: the risk of loss inherent in achieving investment objectives, including market, liquidity, credit and counterparty, leverage and concentration risks.
- Strategic risk: the risk of not achieving strategic goals or business objectives. This risk may arise if inappropriate strategic choices are made, or if strategies or related plans are not implemented successfully.
- Governance risk: the risk of a lack of consistent corporate management, cohesive policies, or organizational structure alignment.
- Stakeholder risk: the risk of not maintaining efficient relations with the sponsor of PSP Investments' pension plans and key business partners.
- Legal and regulatory risk: the risk of non-compliance with applicable regulations, or changes in legislation, regulations or other mandatory industry practices.
- Operational risk: the risk of a direct or indirect loss resulting from inadequate or failed internal processes, people or systems, or from external events.
- Reputational risk: the risk that an activity undertaken by PSP Investments or its representatives or key business partners impairs its image in the community or lowers public opinion and stakeholder confidence in it.

Each risk category encompasses different types of underlying risks that must be taken into account in order to accurately identify and efficiently manage all investment risks inherent in PSP Investments' activities.

Investment Risk				
Market Risk	Liquidity Risk	Credit and Counterparty Risk	Leverage Risk	Concentration Risk

Non-Investment Risk		
Strategic Risk	**Governance Risk**	**Stakeholder Risk**
– Strategic Planning – Strategy Implementation	– Corporate Oversight and Management – Organizational Structure – Policies and Tolerance Levels	– Plan Sponsor Relations – Business Partner Relations
Legal and Regulatory Risk	**Operational Risk**	**Reputational Risk**
– Misinterpretation of Regulations – Change in Regulations	– People Management – Process and Information Management – Systems and Data Management – Fraud and Corruption – Business Disruption – Model and Valuation	– Corporate Visibility – Responsible Investing

Risk Management Governance

Sound internal governance forms the foundation of an effective risk management framework. Following the approval of the RAS, the governance sections of related risk management policies were reviewed for enhanced clarity with respect to the role of the Board of Directors, its committees and senior management.

To help ensure appropriate accountability and further clarify responsibilities for enterprise risk management, both the ERM and ORM Policies incorporate a "three lines of defence" framework:

- First line of defence: business units and management.
- Second line of defence: independent risk management and compliance functions.
- Third line of defence: an independent review.

Three-line of defence framework

BOARD/AUDIT COMMITTEE			
SENIOR MANAGEMENT – INTERNAL COMMITTEES			
First Line of Defence	Second Line of Defence	Third Line of Defence	
Business Units and Support Groups	– Risk Management – Compliance – Others (e.g. Finance and Administration)	Internal Audit	External Audit

RISK CULTURE

Given that it faces risks in all aspects of its activities, PSP Investments promotes a corporate-wide risk-aware culture and strives for a universal understanding of key risks inherent to the Corporation's activities. As outlined in the RAS as well as the "three lines of defence" framework, senior management and employees are not only active participants in risk identification, but also in risk evaluation, management, monitoring and reporting.

BOARD OF DIRECTORS OVERSIGHT

The Board of Directors establishes its risk oversight by:

- Establishing the RAS, investment objectives, the SIP&P and the Policy Portfolio;
- Participating in the definition of PSP Investments' risk philosophy;
- Ensuring that PSP Investments' management has established effective enterprise risk management within the Corporation; and
- Being apprised of material 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 relies on various committees, including the Management Investment Committee, the Management Operations Committee, the Risk Steering Committee, the Valuation Committee, the New Business Activity Committee and the Information Technology Governance Committee.

Risk Management Department

Headed by the Chief Risk Officer, the Risk Management department's mandate is derived from PSP Investments' ERM Policy established by the Board of Directors. The Risk Management department is responsible for establishing practices and processes to effectively manage risks within the boundaries of PSP Investments' risk appetite.

The Risk Management department supports PSP Investments' activities and is responsible for ensuring the management of investment and non-investment risks. In step with the rapid growth of assets under management and the evolving environment within which PSP Investments operates, the department has enhanced its core responsibilities and expertise to proactively implement industry-recognized risk management practices.

RISK MANAGEMENT TOOLS AND PROCESSES

The use of risk data and information is key to the department's ability to provide the monitoring and management reporting capabilities required to support daily risk management activities. The Risk Management department continues to build on existing processes, tools and systems to meet new requirements and implement effective risk management practices.

In addition to ongoing automation of valuation and risks processes, recent enhancement of services includes the development of profit-and-loss decomposition reports.

RISK MANAGEMENT MONITORING AND REPORTING

The Risk Management department ensures that key metrics are monitored and reported regularly to senior management and the Board of Directors. Complementary metrics are tracked for both Public and Private Markets on an ongoing basis and escalated to senior management and to the Board of Directors level as may be required.

PUBLIC MARKETS RISK

The Public Markets Risk team monitors and reports on all aspects of investment risk for publicly-traded securities. Essentially the team is responsible for market, credit and counterparty risk. Market risk activities include measuring the value-at-risk related to the Policy Portfolio and active management, and performing portfolio stress tests, sensitivity analyses and risk metrics relevant for specific portfolios. In addition to aggregated risk figures, a thorough decomposition of various risk factors is performed for Public Markets portfolios for continuous improvement of portfolio analytics and reporting.

Credit and counterparty risk activities involve reviewing the credit ratings of all counterparties, and the evolution of credit ratings of all credit-sensitive financial securities. A formal fundamental credit analysis is performed on all counterparties and brokers. Regulation and country risk form part of the analysis and review process for a complete risk view. Market signals and a daily early-warning-signal monitoring tool add an additional layer of review and monitoring for prompt alerts of credit risk deterioration of any counterparty, broker or issuer above threshold levels. As part of these activities, the team employs the concept of Potential Future Exposure ("PFE") to account for potential volatility of its over-the-counter derivatives.

PRIVATE MARKETS RISK

Private Markets Risk is overseen by a dedicated team within the Risk Management department responsible for risk analysis of Private Markets assets.

In addition to quantitative analyses such as value-at-risk, the Private Markets Risk team also performs fundamental analysis for all significant Private Markets investments to complement quantitative parameters, and to internally ascribe and monitor internal risk ratings.

Fundamental analytical expertise is the cornerstone of PSP Investments' internal risk-rating system. A weighted average of more than 100 internal risk ratings currently attributed to different assets is a key risk-monitoring tool for senior management and the Board of Directors.

In order to develop and maintain thorough market knowledge of each segment where PSP Investments' Private Markets assets operate, the Risk Management team monitors industry events that may have an impact on the Corporation's investments.

LEVERAGE AND CONCENTRATION RISKS

In addition to the activities detailed above, the Risk Management department also tracks total leverage and its sub-components against pre-determined thresholds to ensure the best use of PSP Investments' balance sheet.

Concentration risk is monitored and managed by reviewing concentration evolution over time and by sector, market, country or other parameters versus predetermined thresholds. An automated reporting structure was implemented for on-demand aggregate views of exposures, while safeguarding drill-down capabilities.

LIQUIDITY RISK AND TREASURY

As an integrated part of the risk management function, the Treasury department is responsible for the monitoring and management of liquidity, corporate leverage and currency exposure. The team ensures that investments held meet high standards in terms of their liquidity and credit profiles, and that leverage and currency-hedging activities are within limits and guidelines established by PSP Investments and detailed within the Corporation's RAS.

CORPORATE RISK

The Corporate Risk team is primarily focused on operational risks and other non-investment risks.

The Corporate Risk team ensures the management of identified risks is aligned to both business objectives and the strategic plan, and that PSP Investments' risk management framework is aligned to industry standards. The team is also responsible for the development and refinement of sound risk management processes for the implementation of successful enterprise and operational risk management programs.

Management of Investment Risks

As part of the ERM Policy, PSP Investments has developed an IRM Policy to support the management of risks incurred through the Corporation's investment processes. The Policy establishes an IRM framework, with a goal of ensuring that investment activities respect the risk philosophy of PSP Investments and are within the tolerances and limits of its risk appetite.

The IRM Policy also supplements the SIP&P. It is designed to effectively manage all investment risks related to the implementation of the Policy Portfolio and to active management activities:

- The Policy Portfolio, as defined in the SIP&P and described on page 15, includes a strategy to mitigate risk through a diversified investment portfolio.
- 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.

During fiscal year 2014, PSP Investments undertook the following initiatives designed to further improve the management of various types of investment risk:

- Market risk: Further refined active risk measurement and attribution through improved derivative positions reporting, sensitivity analysis and exposure reports.
- Currency risk: Reviewed the foreign-exchange exposure monitoring process and implemented a revised currency hedging policy.
- Liquidity risk: Enhanced the liquidity framework through improved cash-flow projections.
- Credit and counterparty risk: Ensured successful implementation of OTC Cleared Derivatives trading according to the Dodd-Frank regulation, as well as Swap Execution Facility ("SEF") trading.
- Leverage risk: Carried out an in-depth review of all potential sources of leverage, which led to the establishment of a detailed limit structure.
- Concentration risk: Developed a comprehensive view of PSP Investments' aggregated portfolio across all asset classes.
- Private Markets risk: Enhanced reporting for risk indicators for all Private Markets investments and strengthened monitoring tools for all internal credit ratings.

Management of Non-Investment Risks

Given that the management of different categories of risk entails utilizing different approaches, all of the various risk management policies and procedures in force are regularly reviewed to ensure that they are in accordance with the guiding principles stated in the ERM Policy.

Operational risk is one of the key enterprise risks that PSP Investments is exposed to in its daily activities. An ORM Policy has been developed to supplement the ERM Policy. PSP Investments' employees are active participants in mitigating all sources of potential operational failure, whether internal or external.

During fiscal year 2014, PSP Investments took the following actions to enhance the management of non-investment risks:

- Risk Assessment: A Risk and Control Self-Assessment ("RCSA") update was presented to the Board of Directors, identifying PSP Investments' most significant risks, their key impacts, mitigation factors and the adequacy of the mitigation environment. PSP Investments' top risks were communicated across the organization to ensure all employees have a consistent understanding of the risks inherent in our core activities and how they could hinder our ability to achieve our business objectives. Along with PSP's RAS, the RCSA is designed to raise risk awareness and encourage open discussions about the risks inherent to our activities.
- Responsible Investing: PSP Investments further amended its Responsible Investment Policy and related procedures to describe more fully its environmental, social and governance, and due-diligence and monitoring processes.
- Fraud Prevention: During fiscal year 2014 the Fraud Risk Management Program was further formalized through the implementation of a Fraud and Corruption Prevention Procedure, which describes PSP Investments' overall approach to enterprise-wide fraud and corruption risk management. Additional initiatives pertaining to fraud prevention and detection were also performed, such as the development and implementation of a mandatory Fraud and Corruption Risk Awareness training session for all employees, and select continuous-auditing techniques to monitor certain processes and activities that represent a higher risk of fraud.

INTERNAL AUDIT AND COMPLIANCE

Internal audit

The Internal Audit function is an independent, objective assurance and consulting activity designed to add value and improve PSP Investments' operations. It helps to achieve PSP Investments' objectives by using a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

MANDATE

The Internal Audit department's role involves auditing all of PSP Investments' activities, including its wholly-owned subsidiaries, focusing on high-risk areas and promoting sound governance, risk management and control processes, and providing recommendations to management and the Audit Committee of the Board of Directors that support decision making at the operational and strategic levels. This is achieved through the use of a flexible annual audit plan for PSP Investments and its wholly-owned subsidiaries, utilizing an appropriate risk-based methodology, including any explicit risks or control concerns identified by management or the Audit Committee.

With the support of experts from outside consulting firms, the Internal Audit department carried out a number of risk-based recurring and non-recurring internal audit mandates during fiscal year 2014. These mandates were undertaken as part of the annual review of PSP Investments' overall control environment as well as key internal controls, including those related to fraud risk, as required under Section 28 of the Act. The definition of internal control adhered to by PSP Investments is derived from the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") Internal Control Integrated Framework.

Additionally, at the request of management and the Audit Committee, several advisory activities were conducted. Recommendations issued by the Internal Audit department help PSP Investments continuously strengthen its controls and improve the efficiency of its processes.

EXTERNAL QUALITY ASSESSMENT OF PSP INVESTMENTS' INTERNAL AUDIT FUNCTION

As stipulated by the Institute of Internal Auditors (the "IIA"), the global professional association for internal auditing, an independent consulting firm was engaged to conduct an external quality assessment of PSP Investments' Internal Audit function. The assessment resulted in PSP Investments obtaining the highest possible rating, confirming that the Corporation's Internal Audit function operates in compliance with the IIA Standards.

Compliance

The Compliance department's core activities consist of ensuring that PSP Investments employees, business practices and behavior are fully aligned with internal policies and procedures, as well as overseeing and monitoring PSP Investments' investment activities.

ETHICS

The standards of integrity and ethics that PSP Investments' employees must uphold at all times are found in the Code of Conduct for Officers, Employees and Others (the "Employee Code"). Rigorous adherence to these standards and compliance with relevant laws and statutory requirements as well as internal policies and procedures, including the Employee Code, is one of the Compliance department's main objectives.

PSP Investments takes the Employee Code seriously. Violators are subject to appropriate disciplinary measures, including termination of employment or engagement. The Employee Code also contains a whistleblowing and non-retaliation provision designed to encourage and protect employees, and those subject to its provisions, who step forward and report fraudulent or inappropriate activities.

The Compliance Officer is responsible for the Employee Code's procedures and reports quarterly to the Governance Committee of the Board, which is responsible for monitoring application of the Employee Code. The Employee Code may be consulted on PSP Investments' website at **www.investpsp.ca**.

INVESTMENT COMPLIANCE, OVERSIGHT AND ADVISORY

In addition to its responsibilities involving the monitoring of daily trading, monthly oversight activities and quarterly reporting to the Audit Committee, the Compliance department monitors, in conjunction with the Legal Affairs department, regulatory changes and implements the required controls to support PSP Investments' operations.

GOVERNANCE

Effective governance is essential to safeguard the capital transferred to PSP Investments and to ensure that appropriate objectives are pursued and achieved, consistent with the fulfillment of the Corporation's statutory mandate. This section describes PSP Investments' governance framework, including its mandate, the roles of the Board of Directors and Board committees and key governance policies and practices that guide the Corporation'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 (the "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 Funds"), 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 for it as well. Employer and employee contributions in respect of service after the date of creation of a particular Pension Fund ("post-funding service") are credited to the relevant Pension Fund. Amounts equal to the net balances credited to these Pension Funds (that is contributions minus benefits payments for post-funding service, and plan administration expenses) are transferred to separate accounts maintained at PSP Investments (the "Pension Plan Accounts") for each of the Pension Funds, 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 and Emergency Preparedness for the RCMP Pension Plan. Pursuant to the Act, PSP Investments is the sole investment manager of the amounts transferred to the Pension Plan Accounts. Pursuant to the legislation governing the Plans, the Government of Canada may at any time call upon the net assets of PSP Investments allocated to a Pension Plan Account for amounts required for the purpose of paying benefits under the relevant Plan in respect of post-funding service or for the purpose of reducing any non-permitted surplus in the Pension Fund of such Plan.

Board of Directors

In accordance with the Act, PSP Investments' operations and activities are overseen by a Board of Directors composed of 11 members, including the Chair of the Board. 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 Canadian residents proposed by an external nominating committee established by the President of the Treasury Board (the "External Nominating Committee") pursuant to the Act. The External Nominating Committee operates separately from the Board of Directors, the President of the Treasury Board and the Treasury Board Secretariat. 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 designated 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.

In fiscal year 2014, two new directors were appointed to the Board. The Governor in Council appointed Mr. Timothy Hodgson on December 17, 2013, and Mr. Martin Glynn on January 30, 2014, for terms of four years. Also during fiscal year 2014, the terms of Mses. Cheryl Barker and Lynn Haight and Messrs. William A. MacKinnon and Michael P. Mueller were extended for an additional four years and the term of Mr. Anthony R. Gage was extended for an additional three years. On March 31, 2014, the Board was composed of the following 11 Directors:

- Cheryl Barker, Interim Chair
- Micheline Bouchard
- Anthony R. Gage
- Martin J. Glynn
- Timothy E. Hodgson
- Michael P. Mueller
- Diane Bean
- Léon Courville
- Garnet Garven
- Lynn Haight
- 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.

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. The most recent annual meeting was held on November 27, 2013, in Ottawa.

In addition, PSP Investments communicates on an ongoing basis with the Chief Actuary of the Office of the Superintendent of Financial Institutions Canada, Treasury Board officials and other Government of Canada officials in the execution of its statutory mandate.

Pursuant to the *Financial Administration Act* ("FAA"), the Auditor General of Canada and Deloitte LLP were appointed to serve as joint external auditors of PSP Investments for fiscal year 2014. The Auditor General of Canada is funded directly by Parliament and costs are paid from an annual appropriation. This funding mechanism ensures its independence from the organizations that it audits. For Deloitte LLP, PSP Investments has a formal process to evaluate the impacts of non-audit services on auditor independence. In fiscal year 2014, fees paid to Deloitte LLP totalled approximately $1.5 million, of which approximately $1.4 million were for audit and audit-related services and $0.1 million for non-audit services.

The external auditors are also responsible for conducting Special Examinations as stipulated in the FAA at least once every ten 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 formed part of the annual report for fiscal year 2011 as required by the Act.

Director Commitment, Skills and Competencies

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, preparation for meetings and travel.

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, economics and human resources. Biographies of each Director, as of March 31, 2014, can be found beginning on page 67.

In fiscal years 2013 and 2014, the Governance Committee updated its Board skills and competencies matrix in order to identify and manage any skill gaps at the Board level. This review proved useful for the Interim Chair when communicating desired candidate profiles to the External Nominating Committee.

Conduct of Board and Committee Meetings

Board members' deep knowledge of the Corporation allows them to exercise management oversight and provide insight, where appropriate, in terms of strategy. This leads to active discussion at the Board and committee levels between Directors and management.

All regular Board and committee meetings include in-camera sessions, where no member of management is in attendance. As discussed below, the Audit Committee also has in-camera meetings with each of the internal and external auditors. In addition, the Board has in-camera meetings with the President and CEO and the Investment Committee has in-camera meetings with the Chief Risk Officer, in which no other members of the management team are present.

Each year, strategic meetings are held to discuss PSP Investments' strategic plan and hold in-depth discussions on other investment and risk management related topics.

In order to fulfill their duties set out in the Act and in their respective Terms of Reference, the Board and its committees may use external advisors. This was the case for the Board as a whole as well as for the special Risk Committee and Human Resources and Compensation Committee during fiscal year 2014. While the Board and its committees take into account the independent recommendations of such advisors, final decisions are solely those of the Board or the committee in question, as the case may be.

Assessment of Board Performance

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 is overseen by the Governance Committee. 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 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.

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");
- Approval of a Risk Appetite Statement;
- 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;
- Approval of the remuneration of all officers, including the President and CEO; 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, the Chair of the Board and the Chair of a committee may be viewed in their entirety on PSP Investments' website **www.investpsp.ca**.

BOARD COMMITTEES

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

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

In addition to its standing committees, the Board of Directors established a special Risk Committee on October 3, 2012 that was wound-up on November 13, 2013.

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 under management.

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' systems 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 or inappropriate activities.

On March 31, 2014, the Audit Committee was composed of the following Directors:

- William A. MacKinnon, Chair
- Anthony R. Gage
- Lynn Haight
- Cheryl Barker
- Garnet Garven
- Timothy E. Hodgson[1]

All Audit Committee members are financially literate with accounting or finance expertise, and possess the requisite experience and knowledge to read and understand PSP Investments' and the Pension Plan Accounts' financial statements and properly fulfill their role. For more information on the experience of each committee member, as well as their occupations and education, please see their biographies on page 67.

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 skill sets and other recruiting capabilities to facilitate the identification by the independent External 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, 2014, the Governance Committee was composed of the following Directors:

- Cheryl Barker, Chair
- Garnet Garven
- Léon Courville
- Michael P. Mueller

[1] Mr. Timothy E. Hodgson was appointed to the Audit Committee on February 12, 2014.

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;
- 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, 2014, the Human Resources and Compensation Committee was composed of the following Directors:

- Michael P. Mueller, Chair
- Micheline Bouchard
- Martin J. Glynn[1]
- Diane Bean
- Léon Courville

All Human Resources and Compensation Committee members are knowledgeable about issues related to human resources, talent management, executive compensation and risk management. Understanding of such issues was gained by professional experience as former chief executives or senior officers with oversight of human resources functions. For more information on the experience of each committee member, as well as their occupations and education, please see their biographies on page 67.

RISK COMMITTEE

The Board of Directors established a special Risk Committee effective October 3, 2012. In fiscal years 2013 and 2014, the special Risk Committee played a lead role in overseeing the development of PSP Investments' Risk Appetite Statement and reviewing risk management practices and reporting.

In fiscal year 2014 up to its wind-up on November 13, 2013, the special Risk Committee was composed of the following Directors:

- Diane Bean, Chair
- Lynn Haight
- Anthony R. Gage
- Michael P. Mueller

Upon wind-up, the responsibilities of the special Risk Committee were shared among the Investment Committee, Audit Committee and Board of Directors.

[1] Mr. Martin J. Glynn was appointed to the Human Resources and Compensation Committee on March 26, 2014.

Code of Conduct for Directors

The Director Code together with the Employee Code were 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;
- Prohibits the acceptance of certain types of gifts;
- Prohibits any form of fraud, bribery or corrupt practice and requires the immediate reporting of any knowledge of such activity to the Chair of the Governance Committee; and
- Requires the Directors to pre-clear all personal trading of securities, 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 and Orientation

The Act requires the External 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. Each Director is allocated an individual education and training budget to be used primarily to strengthen their understanding of investment management. Directors are required to report annually on the nature of their individual development plans and the status with respect to implementation. As well as providing individual courses, conferences and reading material, the Director Education Program provides on occasion for the staging of group educational forums within Board of Directors meetings. During these sessions, speakers are invited to make presentations on a variety of topics that contribute to the individual and collective expertise of Board members. Topics covered during fiscal year 2014 included the state of the Canadian, European, Asian and emerging markets economies and the challenges and opportunities offered to institutional investors.

Furthermore, newly appointed Directors are expected to complete an in-house Orientation Program. The purpose of the Orientation Program is to provide newcomers with the information necessary to acquaint them with the operations and culture of the Corporation and enable them to contribute effectively to the Board of Directors as soon as possible after their appointment. In fiscal year 2014, both Mr. Hodgson and Mr. Glynn completed an Orientation Program prior to their first Board and Committee meetings.

Both the Director Education Program and the Orientation Program are monitored by the Governance Committee.

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 for fiscal year 2012, and the Board subsequently agreed that there would be no increase in these amounts for fiscal years 2013 and 2014:

- Annual retainer for the Interim Board Chair: $150,000
- Annual retainer for each Director other than the Board Chair: $30,000
- Annual retainer for each Chair of a committee of the Board: $10,000
- Attendance fee for each Board meeting: $1,500[1,2]
- Attendance fee for each committee meeting: $1,500[1,2]
- Travel fees 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 Interim Chair of the Board is not entitled to any meeting fees or annual retainer as Chair of a committee of the Board. 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 met nine times during fiscal year 2014 and its Committees held 30 meetings. This translated into remuneration for Directors of $731,502. The tables on the following two pages illustrate and break down the above-mentioned information.

[1] $500 for a meeting of less than one hour.

[2] A single meeting fee will be paid to a Director who attends meetings of the Board of Directors and the Investment Committee held concurrently.

Attendance of Directors Board and Committee Meetings Fiscal Year 2014[1]

	Board of Directors		Investment Committee		Audit Committee		Governance Committee		Human Resources and Compensation Committee		Risk Committee[2]
	Regular	Special	Regular[3]	Special[4]	Regular	Special	Regular[5]	Special	Regular	Special	Regular[6]
Number of meetings Fiscal Year 2014	8	1	6	1	6	1	4	1	6	1	4
Cheryl Barker[7]	8/8	1/1	6/6	1/1	5/6	1/1	4/4	1/1			
Diane Bean	8/8	0/1	6/6	0/1					6/6	0/1	4/4
Micheline Bouchard	7/8	1/1	5/6	1/1					5/6	1/1	
Léon Courville	7/8	1/1	5/6	1/1			3/4	1/1	5/6	1/1	
Anthony R. Gage	8/8	1/1	6/6	1/1	6/6	0/1					4/4
Garnet Garven	8/8	1/1	6/6	1/1	6/6	1/1	4/4	1/1			
Martin Glynn[8]	1/2	–	1/2	–					1/1	–	
Lynn Haight	6/8	0/1	5/6	0/1	6/6	1/1					3/4
Timothy E. Hodgson[9]	2/2	–	2/2	–	2/2	–					
William A. MacKinnon	7/8	1/1	6/6	1/1	5/6	1/1					
Michael P. Mueller	8/8	1/1	6/6	1/1			4/4	1/1	6/6	1/1	4/4

1 During fiscal year 2014, certain Directors were not able to attend all meetings due mainly to health issues or prior work commitments.

2 The Risk Committee was created on October 3, 2012 and wound-up on November 13, 2013.

3 One regular meeting of the Investment Committee was held concurrently with a regular meeting of the Board.

4 The special meeting of the Investment Committee was held concurrently with the special meeting of the Board.

5 One regular meeting and one special meeting of the Governance Committee were held concurrently with regular meetings of the Board.

6 One regular meeting of the Risk Committee was held concurrently with an Investment Committee meeting.

7 As Interim Chair of the Board, Ms. Barker attended a Human Resources and Compensation Committee meeting that was held concurrently with the Audit Committee meeting.

8 Mr. Glynn was appointed to the Board and Investment Committee on January 30, 2014 and to the Human Resources and Compensation Committee on March 26, 2014.

9 Mr. Hodgson was appointed to the Board and Investment Committee on December 17, 2013 and to the Audit Committee on February 12, 2014.

Remuneration of Directors Fiscal Year 2014[1]

Name	Remuneration[1]				
	Annual Retainer	Chair of a Committee/ Annual Retainer	Boards/ Committees Meeting Fees	Travel Fees	Total
Cheryl Barker	$150,000	–	–	$9,000	$159,000
Diane Bean	$30,000	$6,196	$31,500	–	$67,696
Micheline Bouchard	$30,000	–	$26,000	–	$56,000
Léon Courville	$30,000	–	$29,000	–	$59,000
Anthony R. Gage	$30,000	$10,000	$33,000	$9,000	$82,000
Garnet Garven	$30,000	–	$35,000	$10,500	$75,500
Martin J. Glynn	$5,083	–	$4,500	$1,500	$11,083
Lynn Haight	$30,000	–	$29,000	–	$59,000
Timothy E. Hodgson	$8,723	–	$8,000	–	$16,723
William A. MacKinnon	$30,000	$10,000	$27,500	–	$67,500
Michael P. Mueller	$30,000	$10,000	$38,000	–	$78,000

1 In FY2014, in addition to their total remuneration, Directors received an allowance of $2,000 to cover computer and office supply related expenses as meeting materials are delivered electronically only. The allowance has been reduced to $1,000 for FY2015.

INVESTMENT GOVERNANCE OVERSIGHT

As a long-term investor, PSP Investments believes in the importance of establishing strong governance oversight of its investments. PSP Investments uses its ownership positions to promote good corporate governance practices by exercising its proxy voting rights and actively engaging with companies through service providers, 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. 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.

As part of the active management of its proxy voting, PSP Investments reviews proxy circulars and research from service providers when voting the equities held in accounts managed internally as well as those in segregated accounts managed by external managers.

PSP Investments amended the Guidelines in fiscal year 2014, primarily to further articulate our expectations of issuers regarding the shareholder democratic process.

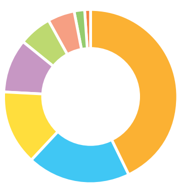
The Guidelines may be viewed on PSP Investments' website **www.investpsp.ca**.

PROXY VOTING ACTIVITIES

Most proposals at shareholder meetings are submitted by the company's management and relate to the election of directors, the appointment of auditors and other matters that arise in the normal course of business.

In fiscal year 2014, PSP Investments exercised its voting rights at 2,981 meetings, voting against or abstaining from management's recommendations on 9.3% of the 32,018 proposed resolutions.

The issues on which PSP Investments voted against management's recommendation or abstained on such resolutions are shown below followed by a description of each category:



Issue
Fiscal Year 2014

Board Independence and Effectiveness	**43%**
Compensation	**19%**
Shareholder Proposals	**14%**
Capital Structure	**10%**
Other	**6%**
Auditors Irregularities	**5%**
Amendments to Articles	**2%**
Anti-takeover Protection	**1%**

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 selected 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.

SHAREHOLDER PROPOSALS

Shareholder-initiated proxy proposals can be a useful and relevant means of addressing concerns and effecting change at companies that underperform or have poor environmental, social and governance practices. PSP Investments reviews all shareholder proposals on a case-by-case basis. PSP Investments generally supports shareholder proposals that increase the board of directors' level of accountability to shareholders and serve the company's 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 compensation, majority voting for the election of directors, and additional disclosure with respect to risks. Examples of shareholder proposals supported are provided on page 53.

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.

AUDITORS 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, in the opinion of PSP Investments, did not meet these standards.

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 jurisdiction 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.

ANTI-TAKEOVER 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.

EXAMPLES OF SHAREHOLDER PROPOSALS SUPPORTED

In fiscal year 2014, PSP Investments voted on 858 shareholder proposals, and supported 44% of these proposals.

Shareholder proposals	For votes	Rationale
Political contributions and expenditures report	51 proposals	We encourage the full and transparent disclosure of company practices regarding political contributions. When this disclosure is not found, we will support shareholder proposals requesting greater disclosure.
Majority vote for the election of directors	32 proposals	Electing directors is the most fundamental right for shareholders and thus we should have the opportunity to vote for or withhold from a director candidate.
Independent Board Chair and separation of Chair and CEO	30 proposals	We believe that the Chair of the Board should be an independent director.
Proxy access and right to call a special meeting	19 proposals	We support proposals that remove restrictions on the right of shareholders to nominate candidates for directors, subject to sufficient requirement regarding share ownership.
Report on sustainability and other environmental matters	16 proposals	We support proposals that seek to increase Board of Directors' level of accountability to shareholders on sustainability and environmental matters.

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 has adopted a Responsible Investment Policy which embodies its 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. Consideration of ESG risks is part of the due diligence process with respect to potential investments and the assessment of the practices of external managers. The integration of ESG factors is well established across asset classes and these risks are discussed in the business plans of the asset classes and are addressed in each investment recommendation submitted to the Investment Committee or to the President and Chief Executive Officer or other approving officer. The monitoring of ESG 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.

In fiscal year 2014, PSP Investments further amended its Responsible Investment Policy and related procedures to describe more fully its ESG investment due diligence and monitoring processes.

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

DIRECT ENGAGEMENT ACTIVITIES

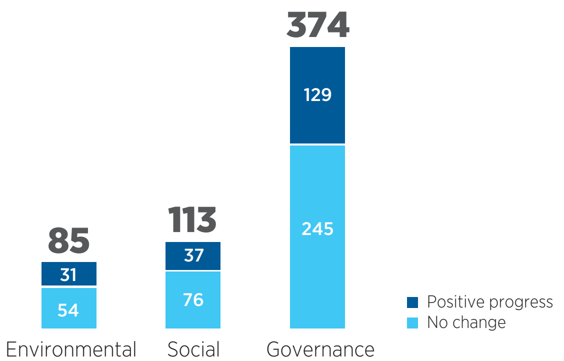
With the assistance of a service provider, PSP Investments actively engages in dialogue with public companies with a view to improving their ESG practices. Public companies are selected for engagement based on a process that takes into account elements such as a company's ability to create shareholder 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 entail 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 tracks its engagement objectives primarily in the context of issues where it feels changes in behavior are warranted. Often there are multiple ESG issues to be addressed within the same company, each of which may require different levels of effort and engagement approaches as well as different contact points.

When undertaking extensive engagements, a five-step milestone approach is used to guide the engagement process and assess the success of the engagements:

Milestone 0	Milestone 1	Milestone 2	Milestone 3	Milestone 4
New Objective	Raised Concerns	Acknowledgement of Issue	Develop Credible Strategy/ Set Stretching Targets	Strategy Implemented

In fiscal year 2014, PSP Investments made progress in delivering engagement objectives across regions and themes. The following graph depicts the progress that has been made through the achievement of new milestones for the respective objectives:

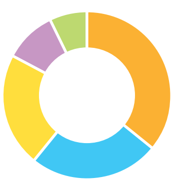
Engagement Objectives
Fiscal year 2014 (number)



In fiscal year 2014, PSP Investments directly engaged with 302 public companies held in PSP Investments' portfolios. The engagements are done globally.

PSP Investments engages with public companies on a range of ESG issues. Below is a breakdown of PSP Investments' engagement activities by issue followed by a description of each category on the next page:

Engagement by Country or Region
Fiscal Year 2014



Europe	36%
Asia Pacific, Australia and New Zealand	25%
United States	22%
Emerging Markets	10%
Canada	7%

Engagements
Fiscal Year 2014

Governance	64%
Social	22%
Environmental	14%

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, majority voting, separation of Chair and CEO roles, succession planning, committee structures, performance-linked compensation, risk management and disclosure quality.

Example of an Engagement with an Asian Company Operating in the Machinery and Equipment Sector

Engagement objective

- Encourage the company to refine its compensation programs by clarifying pay for performance.
- Encourage integrated thinking and reporting on environmental, social and governance ("ESG") factors.

What we achieved

Following PSP Investments' engagement with this global company headquartered in Asia, it adopted a new executive compensation program that increases the proportion of performance-linked compensation. The company also agreed to integrate ESG factors into its main operations and undertook to publish an integrated report in 2014.

SOCIAL

PSP Investments engaged public companies on a variety of social issues, including labour and community relations particularly in troubled regions, health and safety concerns, and bribery and corruption risk management.

Example of an Engagement with a Canadian Oil and Gas Company

Engagement objective

- Improve health and safety record in the company's Canadian and international operations.

What we achieved

We had several meetings to discuss concerns with the health and safety record of the company, particularly in relation to contractors in its international operations. Since the commencement of our engagement, the health and safety record has improved significantly and the company now discloses detailed data on injury rates and fatalities. Furthermore, higher safety standards are now imposed on contractors.

ENVIRONMENTAL

PSP Investments met with a significant number of public companies on environmental-related issues in fiscal year 2014. These engagements focused mainly on climate change, water stress, oil and gas and mineral and metals extraction, forestry and biodiversity.

Example of an Engagement with a South American Mining Company

Engagement objective

- Ensure the development of a credible environmental strategy throughout the company's operations

What we achieved

We engaged with the company to raise concerns about environmental risk management and the standards applied across the company's operations and international joint ventures. We were able to test the company's management of environmental issues through mine visits. The company has committed to improving its environmental disclosure and has provided forward-looking targets regarding carbon, waste and water. We will continue to monitor progress on this issue.

Collaborative Initiatives

In addition to its direct-engagement efforts with public companies, PSP Investments participates in collaborative governance initiatives and engagements with other like-minded institutional investors to strengthen its voice with regard to corporate governance issues.

CANADIAN COALITION FOR GOOD GOVERNANCE

For instance, PSP Investments is an active member of the Canadian Coalition for Good Governance ("CCGG"), which represents 47 institutional investors managing assets of nearly $2 trillion. CCGG, on behalf of its members, engages with the boards of directors of approximately 50 Canadian issuers each year. Discussion topics include all aspects of corporate governance. The CCGG engagements are in addition to PSP Investments' direct engagement activities discussed above.

CDP

PSP Investments is a signatory of the CDP, formerly known as the Carbon Disclosure Project. The CDP acts on behalf of 767 institutional investors representing over US$92 trillion in assets under management, to encourage public companies to disclose how they are managing climate-change risks and opportunities that may be affecting their businesses. In 2013, the CDP sent questionnaires to over 5,000 of the world's largest companies, including 200 Canadian companies. Approximately 63% of the Canadian companies in PSP Investments' portfolio that received questionnaires returned them completed. We are encouraged by the growing number of respondents to the CDP questionnaires in Canada and invite companies to continue to improve their climate disclosure scores and performance.

Since fiscal year 2010, PSP Investments is also a signatory of the CDP Water program, which enables 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. In 2013, more than 1,000 companies from all over the world were asked to report water-related information to CDP. Close to 60% of these companies engaged with CDP to enable effective measurement, management and reduction of corporate water-related issues.

OTHER COLLABORATIVE INITIATIVES

PSP Investments is an active member of a group of seven Canadian pension funds which decided in 2012 to join forces to engage on initiatives for greater transparency of the Canadian proxy-voting system and formed a Peer Proxy Voting Working Group. The Proxy Voting Working Group has informed the CSA, securities regulators, the TSX and other market participants of its concerns and called for improvement. The Proxy Voting Working Group responded to CSA Consultation Paper 54-401 on the review of the proxy-voting infrastructure. PSP Investments represented the group at the OSC roundtable on proxy-voting infrastructure on January 29, 2014, in Toronto. Industry experts were invited to explore the problems, challenges and possible solutions to improve the transparency and reliability of the proxy-voting system in Canada.

The Corporation 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.

Additionally, PSP Investments has long been an active participant in collaborative initiatives by groups of limited partners to facilitate improvement with respect to the consistency of reporting, the uniformity of information made available and governance best practices. In March 2013, the Corporation was part of a group of more than 40 limited partners that developed an ESG disclosure framework for Private Equity investments. The framework is designed to help limited partners and general partners work together to define reasonable expectations and set appropriate standards for ESG disclosure.

Public Consultations

During fiscal year 2014, PSP Investments responded to over 25 public requests in Canada and abroad to consultations on governance-related topics. Examples of public consultations in Canada to which PSP Investments responded are found below.

– Submission to Canadian Securities Administrators on proposed amendments to early reporting regime

On March 13, 2013, the Canadian Securities Administrators (CSA) published for comment proposed amendments to the early-warning reporting regime in Canada. PSP Investments submitted a comment letter to the CSA on July 12, 2013, in which it stated its support of the amendments to the early-warning requirements proposed, including reduction of the reporting share ownership levels from 10% to 5%. However, PSP Investments did express concerns with certain elements of the proposals that relate to reporting of equity equivalent derivatives and inclusion thereof in the calculation of the share ownership level.

– Submission to Canadian Securities Administrators and the AMF on proposed amendments to shareholder rights plans

On March 14, 2013, the CSA published for comment National Instrument 62-105 Security Holder Rights Plans. If adopted, the instrument would establish a national framework for shareholder rights plans and generally provide a target company greater flexibility in using such a plan. Concurrently, the Autorité des marchés financiers (AMF) published for comment a consultation paper that provides an alternative approach to defensive tactics for companies that are the targets of takeover attempts.

PSP Investments submitted a comment letter to the AMF and CSA on July 12, 2013. PSP Investments generally supported the proposed CSA rule, because it believed that it is better than the status quo in that it reduces regulatory intervention and clarifies the weight that will be given to a shareholder vote with regard to a rights plan. PSP Investments also supported two of the proposals in the AMF Consultation Paper dealing with changes to the regulatory regime applicable to take-over bids (i) to require a minimum tender condition of 50% +1 and (ii) to extend the bid period by 10 days after reaching the mandatory minimum tender condition.

HUMAN RESOURCES AND COMPENSATION COMMITTEE CHAIR'S REPORT

During fiscal year 2014, the Human Resources and Compensation Committee (HRCC) oversaw the implementation of changes to key compensation, benefits and talent-management policies.

EXECUTIVE COMPENSATION

PSP Investments' pay-for-performance approach to compensation is designed to reward outstanding performance while discouraging undue risk-taking. Incentive compensation is factored into compensation packages at all levels of the Corporation and forms the largest component of total target remuneration for PSP Investments executives.

Following an in-depth review carried out by the HRCC with the support of an independent compensation consultant, modifications to executive compensation programs were introduced effective April 1, 2013. A new Corporate Objectives component was introduced for the senior management team, along with a reduction in weighting of the formulaic-based component tied solely to investment performance to ensure an appropriate balance of metrics used to determine payments. The modifications were intended to effectively reduce potential maximum payouts, while ensuring that PSP Investments maintains a balanced pay-for-performance structure which will enable us to continue attracting, retaining and motivating outstanding executive talent by offering competitive remuneration packages in line with those of peer organizations. Both the Short-Term and Long-Term Incentive Plans are based on rolling four-year periods. Given the continuing strong relative investment performance over the latest four years, during which PSP Investments realized some $4.9 billion of value-added returns, the incentive plans generated maximum or close to maximum payouts for many executives for fiscal year 2014. Remuneration awarded to members of the senior management team for the latest fiscal year reflects the recent changes to the executive compensation programs.

PENSIONS

Pension and retirement plans represent another key element of total compensation. Several changes to pension arrangements for PSP Investments employees, approved by the Board at the Committee's recommendation, have been implemented. As of January 1, 2014, all new hires are enrolled in a newly established defined-contribution pension plan that provides the Corporation with more control over the risks associated with employee benefits. As well, amendments to cost-sharing arrangements for PSP Investments' pre-existing defined-benefit plan will see contributions move to a 50/50 ratio by January 1, 2017, thereby aligning it with pension plans covering federal government employees.

SUCCESSION PLANNING AND TALENT MANAGEMENT

In today's highly competitive market for qualified personnel, the recruitment, retention and development of high-performing employees is essential for PSP Investments' continued success. Succession planning, another important responsibility of the HRCC, is crucial in that respect. It entails not only making certain that comprehensive succession plans are in place for the CEO and other senior corporate officers, but also ensuring there is a strong focus on leadership-development programs that will enable us to identify and nurture up-and-coming talent. Accordingly, the Committee supported the introduction by Human Resources of new career-development and succession-planning initiatives that reach much deeper into the organization than was previously the case, in order to foster a culture of continuous learning and maximize opportunities for next-generation leadership candidates. As well, we continue to encourage measures designed to foster increased diversity in the workplace. The implementation of a diversity action plan which has resulted, among other advances, in an increase in the proportion of women in management continued during fiscal year 2014.

Michael P. Mueller
Chair, Human Resources and Compensation Committee

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 responsible 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 stipulated in its Act, PSP Investments is subject to a Special Examination at least once every 10 years. In the course of the latest Special Examination, performed by the Office of the Auditor General of Canada and Deloitte LLP in fiscal year 2011, 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. PSP Investments' compensation programs and policies are also consistent with the G20 Working Group recommendations that are based on the Financial Stability Forum Principles for Sound Compensation Practices.

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 2014 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 the 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.

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 and Private Equity Surveys, Towers Watson's Investment Management Compensation Survey, Mercer's Canadian Investment Management Compensation Survey and Canadian Benchmark Database.

To remain competitive, PSP Investments strives to offer:

1. Base salaries around 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 are competitive.

The Board of Directors continually ensures that PSP Investments' executive compensation is consistent with PSP Investments' Compensation Policy. For this purpose, the services of independent compensation consulting firms were retained in fiscal year 2014 to assist the HRCC in its review of executive compensation. These compensation consulting firms report solely to the HRCC when executing their mandates.

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

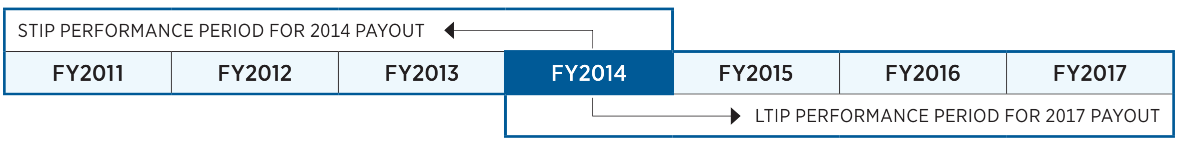


Figure B: Compensation Mix of Total Compensation for Fiscal Year 2014 (Target Awards)

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

The following tables present the compensation mix for the President and CEO and for the Senior Vice President positions (Investment):

President and Chief Executive Officer

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

Senior Vice President Positions – Investment

Long-term Incentive Compensation	**41%**
Base Salary	**31%**
Short-term Incentive Compensation	**28%**

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 2014 was consistent with PSP Investments' comparator group and in accordance with the Compensation Policy.

INCENTIVE PLANS

Annually, PSP Investments reviews its incentive plans to ensure that total compensation remains competitive with the main comparator group and reflects PSP Investments' principles and objectives of attracting, retaining and motivating employees to achieve sustained high performance.

A review conducted in the course of fiscal year 2013 led to the addition in fiscal year 2014 of a new Corporate Objectives component in the STIP for executives, along with a reduction of the maximum payout opportunity for the Total Fund performance component under both the STIP and LTIP for executives and investment professionals.

These measures aim to ensure that compensation payouts will remain in line with those of peer organizations, even in periods of sustained superior performance.

The following plans comprise incentive compensation at PSP Investments:

1) A STIP, to recognize performance results for the current year and the previous three years;
2) A 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 support retention of key employees.

SHORT-TERM INCENTIVE PLAN

PSP Investments' 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.

The STIP provides that the investment performance of each year is independently weighted. A greater weight is given to performance of the current year in order to more closely link shorter-term contribution and rewards, while still taking into account the investment performance of the previous three years. Investment performance floors and maximum levels are applied 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 2014 Performance

For fiscal year 2014, investment performance by asset class for STIP purposes has been summarized in the table below:

Asset Class	1-year[1]	4-year[1]
Private Equity	Exceeded target	Exceeded target
Real Estate	Exceeded target	Exceeded target
Infrastructure	Exceeded target	Exceeded target
Renewable Resources	Exceeded target	Not applicable
Public Markets	Achieved target	Exceeded target
Total Fund	Exceeded target	Exceeded target

[1] For the purpose of describing the performance level, a multiplier of targets ranging between 0.95 and 1.05 shall be considered as achieving target.

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 $36.5 million in fiscal year 2014 (465 employees), $29.9 million in fiscal year 2013 (404 employees) and $23.1 million in fiscal year 2012 (362 employees).

LONG-TERM INCENTIVE PLAN

PSP Investments' 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, the 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 either increased or decreased based on the total fund rate of return over the four-year performance 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 PLAN PAYMENTS

In fiscal year 2014, the four-year total fund investment performance of PSP Investments as well as that of the various asset classes was above the incentive threshold and therefore, payouts were earned for those components of the LTIP for eligible participants.

Asset Class	4-year[1]
Public Markets	Exceeded target
Private Equity	Exceeded target
Real Estate	Exceeded target
Infrastructure	Below target but above threshold
Renewable Resources	Not applicable
Total Fund	Exceeded target

[1] For the purpose of describing the performance level, a multiplier of targets ranging between 0.95 and 1.05 shall be considered as achieving target.

The total incentive amount paid under the LTIP was $17.5 million in fiscal year 2014 (73 employees), $15.2 million in fiscal year 2013 (55 employees) and $6.7 million in fiscal year 2012 (42 employees).

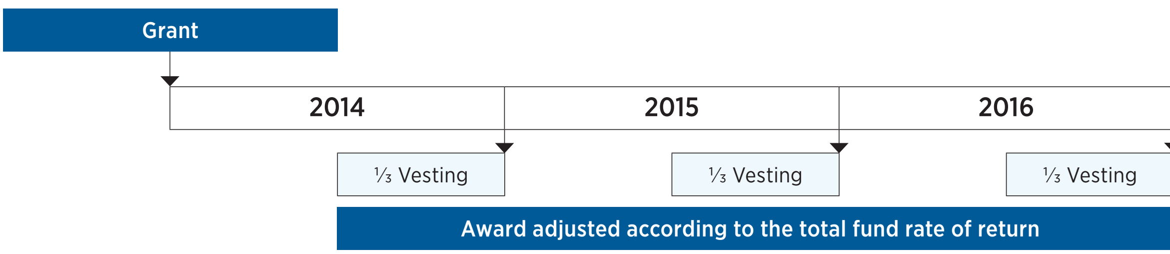
RESTRICTED FUND UNIT PLAN

PSP Investments' RFU Plan is an incentive component of total compensation to retain key individuals in the organization.

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.

Restricted fund units are a nominal investment whose value fluctuates in accordance with the total fund performance over a three-year period. One third of the award vests and is paid each year over this period, unless the participants elected to defer payment. Participants may elect to defer payment of RFUs until the end of the third year following the grant, as long as their election is made prior to the end of the fiscal year of the year of grant (see *Figure C* below).

Figure C: Restricted Fund Unit Framework



The total incentive amount paid under the RFU in fiscal year 2014 to recognize the contributions of key individuals to the performance of PSP Investments was $2.7 million. The amount paid in fiscal year 2013 was $4.5 million and in fiscal year 2012 $4.0 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 eligible PSP Investments employees participate in one of the Public Sector Pension Investment Board Pension Plans (the "Employee Pension Plans") and, as applicable, to one of the Supplemental Employee Retirement Plans (the "SERPs").

The Employee Defined Benefit ("DB") Pension Plan provides partially indexed post-retirement pension benefits for each year of participation, calculated on the basis of 2% of the participant's average of the best consecutive three years of salary. Benefits payable under the DB Pension Plan are limited by the *Income Tax Act* (Canada). The DB SERP has been established for all eligible employees enrolled in the DB Pension Plan, as an unfunded arrangement, to provide defined benefits in excess of the Employee DB Pension Plan, where such benefits are so limited. Employees participating in the DB Pension Plan and the DB SERP contribute 5% of their base salary, up to the maximum contribution allowable under the *Income Tax Act* (Canada). This contribution was increased from 4.25% on January 1, 2014 and will represent a 50/50 ratio in cost-sharing by January 1, 2017.

PSP Investments implemented the Employee Defined Contribution ("DC") Pension Plan on January 1, 2014, as a means to provide the Corporation with more control over its long-term pension costs while remaining competitive and offering flexibility to participants.

All eligible employees hired on or after January 1, 2014 are automatically enrolled in the new DC Pension Plan, to which they can contribute between 5% and 7% of base salary. All employee contributions are fully matched by PSP Investments.

Eligible participants in the DB Pension Plan were offered the opportunity to join the new DC plan on January 1, 2014, on a voluntary and irrevocable basis.

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	10.5	$104,700	$195,300	$1,560,700	$82,300	($124,300)	$1,518,700
Cunningham, Neil	6.4	$40,300	$101,400	$564,100	$65,800	($44,900)	$585,000
Garant, Daniel	5.6	$35,700	$145,400	$451,900	$64,200	($66,200)	$449,900
Murphy, Derek	10.1	$64,400	$117,700	$955,000	$52,500	($74,100)	$933,400
Guilmette, Bruno	8.4	$51,400	$154,300	$679,200	$50,200	($99,900)	$629,500

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

2 Sum of benefits accrued under the Employee DB Pension Plan and the DB 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, 2014.

4 Accrued obligation using a discount rate of 4.10%. The obligations are calculated as at March 31, 2013 using the assumptions and methods that were used for the accounting disclosures as at December 31, 2012.

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 5.10%. The obligations are calculated as at March 31, 2014 using the assumptions and methods that were used for the accounting disclosures as at December 31, 2013.

Summary Compensation Table

Name	Fiscal Year	Base Salary	Short-term Incentive Plan	Long-Term Incentive Plan	Restricted Fund Units	Benefits and Other Compensation	Pension and SERP Plans	Total Compensation
Gordon J. Fyfe President and Chief Executive Officer	2014 2013 2012	$500,000 $500,000 $500,000	$1,430,000 $1,755,000 $1,285,656	$1,940,000 $2,425,000 $1,010,092	$218,689 $519,582 $471,020	$35,994 $35,759 $35,678	$82,300 $72,200 $102,300	$4,206,983 $5,307,541 $3,404,746
Neil Cunningham Senior Vice President, Real Estate Investments[1]	2014 2013 2012	$320,000 $320,000 $306,000	$889,392 $1,074,608 $789,693	$1,215,000 $1,170,000 $363,594	$181,816 $343,344 $274,321	$25,971 $25,736 $25,654	$65,800 $81,800 $58,500	$2,697,979 $3,015,488 $1,817,762
Daniel Garant Senior Vice President, Public Markets Investments[1]	2014 2013 2012	$330,000 $330,000 $306,000	$718,922 $1,035,237 $822,578	$1,213,144 $1,192,500 $349,674	$247,014 $431,682 $320,533	$23,722 $23,636 $23,604	$64,200 $83,500 $47,200	$2,597,002 $3,096,555 $1,869,589
Derek Murphy Senior Vice President, Private Equity Investments[1]	2014 2013 2012	$320,000 $320,000 $320,000	$775,568 $675,993 $487,213	$965,084 $1,284,925 $662,516	$156,646 $388,497 $348,235	$25,971 $25,736 $25,656	$52,500 $47,600 $59,200	$2,295,769 $2,742,751 $1,902,820
Bruno Guilmette Senior Vice President, Infrastructure Investments[1]	2014 2013 2012	$306,000 $306,000 $306,000	$718,259 $663,096 $370,908	$671,395 $824,305 $246,484	$90,340 $249,314 $242,804	$25,970 $25,734 $25,654	$50,200 $41,500 $44,100	$1,862,164 $2,109,949 $1,235,950
Jeff Lozon[2] President and Chief Executive Officer of Revera Inc.	2013 2012 2011	$683,400 $670,000 $625,000	$187,600 $483,325 $510,224	$1,465,985 $703,114 $0	$0 $0 $0	$25,845 $25,659 $26,213	$10,660 $2,500 $20,000	$2,373,490 $1,884,598 $1,181,437

[1] Further to a market study, the Senior Vice President title was introduced in fiscal year 2013 for positions formerly known as First Vice President.

[2] Mr. Lozon is not an employee of PSP Investments, but was employed by Revera Inc., a wholly-owned subsidiary of PSP Investments. Revera Inc.'s fiscal year ends on December 31.

Long-Term Incentive Plan Awards Granted for Fiscal Year 2014

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

Name	Award Type	Fiscal Year 2014 Grant	Vesting Period	Estimated Future Payouts[1]		
				Threshold[2]	Target	Maximum
Gordon J. Fyfe	LTIP RFU	$500,000 $0	4 years 3 years	$0 n/a	$500,000 $0	$2,000,000 $0
Neil Cunningham	LTIP RFU	$288,000 $0	4 years 3 years	$0 n/a	$288,000 $0	$1,296,000 $0
Daniel Garant	LTIP RFU	$297,000 $0	4 years 3 years	$0 n/a	$297,000 $0	$1,336,500 $0
Derek Murphy	LTIP RFU	$288,000 $0	4 years 3 years	$0 n/a	$288,000 $0	$1,296,000 $0
Bruno Guilmette	LTIP RFU	$275,400 $0	4 years 3 years	$0 n/a	$275,400 $0	$1,239,300 $0

[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, 2014 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
		2015	2016	2017	
Gordon J. Fyfe	LTIP RFU	$1,725,000 $0	$1,495,000 $0	$1,000,000 $0	$4,220,000 $0
Neil Cunningham	LTIP RFU	$1,025,865 $61,362	$862,560 $0	$576,000 $0	$2,464,425 $61,362
Daniel Garant	LTIP RFU	$820,692 $126,560	$694,980 $0	$445,500 $0	$1,961,172 $126,560
Derek Murphy	LTIP RFU	$748,800 $30,681	$720,000 $0	$573,120 $0	$2,041,920 $30,681
Bruno Guilmette	LTIP RFU	$702,270 $0	$776,628 $0	$550,800 $0	$2,029,698 $0

[1] LTIPs' accumulated values are estimated using actual total fund and asset class performance for those years where performance is known, and a multiplier of one (1.0x) is applied for future years. RFUs' accumulated values reflect PSP Investments' total fund rate of return for fiscal years 2013 and 2014, where applicable, 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 Senior Vice Presidents, the severance pay is set at 12 months of base salary and target STIP award, plus 1 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, excluding any amounts that would become payable as per applicable incentive plan provisions.

Name	Years of Service[1]	Severance	Resignation
Gordon J. Fyfe	10.5	$6,491,625	$0
Neil Cunningham	9.8	$912,000	$0
Daniel Garant	5.6	$888,250	$0
Derek Murphy	10.1	$912,000	$0
Bruno Guilmette	8.4	$872,100	$0

[1] Assumes a notional termination as at March 31, 2014.

DIRECTORS' BIOGRAPHIES

CHERYL BARKER *Interim Chair, PSP Investments* **Member:** Investment Committee / Audit Committee / Governance Committee – Chair 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. She 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 Bachelor of Science degree as well as a Certificate in Education from the University of Manitoba.
DIANE BEAN *Corporate Director* **Member:** Investment Committee / Human Resources and Compensation Committee / Risk Committee – Chair Board member since June 18, 2010	Ms. Bean is a member of the Boards of Directors of Manulife International Ltd (Asia), The Insurance Company of the West Indies and Roy Thomson Hall/ Massey Hall, and was founding Co-Chair of the Toronto Region Immigrant Employment Council. Until her retirement in 2011, she was Executive Vice President of Manulife Financial where, over 30 years, she also served as its Regional Executive in Canada, the United States, Asia and Europe, and held senior positions in IT, Business Development, Corporate Communications and, most recently, as head of Global HR. Ms. Bean holds a Bachelor of Commerce degree from the University of Toronto.
MICHELINE BOUCHARD *Corporate Director* **Member:** Investment Committee / Human Resources and Compensation Committee Board member since September 29, 2011	Ms. Bouchard is a member of the Board of Directors of Telus. She has extensive experience as a director with public and private companies and volunteer boards. Past Board memberships include Harry Winston Diamond Corp., Banque Nationale de Paris, Ford Motor Canada, London Insurance Group and Home Capital/Home Trust. Ms. Bouchard was Global Corporate Vice President of Motorola Inc. in the U.S., after having served as President and CEO of Motorola Canada Inc. She holds a Bachelor's degree in Applied Sciences (Engineering Physics) and a Master's degree in Applied Sciences (Electrical Engineering) from École Polytechnique. Ms. Bouchard is a Member of the Order of Canada, a Member of the National Order of Quebec and a Certified Member of the Institute of Corporate Directors.

DIRECTORS' BIOGRAPHIES

LÉON COURVILLE *Corporate Director* **Member:** Investment Committee/ Governance Committee/ Human Resources and Compensation Committee Board member since March 5, 2007	Mr. Courville has devoted his entire career to the sciences of management and finance, serving 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 the Institut de tourisme et d'hôtellerie du Québec and the Institut économique de Montréal, and Chairman of the Institute of Structured Finance and Derivative Instruments. 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:** Investment Committee – Chair/ Audit Committee/ Risk Committee Board member since June 27, 2006	Mr. Gage is Chairman of Sky Investment Counsel, Head of the Management Committee of JEA Pension System Solutions and Chairman of the University of Victoria Properties Investments Inc. He is a past member of the Board of Governors of the University of Victoria and 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 Bachelor of Arts (Economics) from the University of Victoria, an MBA (Finance) from the University of British Columbia and a Chartered Director designation from McMaster University. He is also a Chartered Financial Analyst (CFA).
GARNET GARVEN *Corporate Director* **Member:** Investment Committee/ Audit Committee/ Governance Committee Board member since September 29, 2011	Mr. Garven is a professor and former dean of the Paul J. Hill School of Business and the Kenneth Levene Graduate School of Business at the University of Regina. Most recently he served as Senior Fellow at Canada's Public Policy Forum, a national think tank based in Ottawa. He previously served as Deputy Minister to the Premier and Saskatchewan Cabinet Secretary. He holds a Bachelor of Administration from the University of Regina, an MBA in Finance from the University of Saskatchewan and an Honourary CMA from the Society of Management Accountants. Mr. Garven was a Research Fellow in corporate governance at the Richard Ivey School of Business – University of Western Ontario. A founding director of the Investment Corporation of Saskatchewan (now Greystone Managed Investments Inc.) and former Chairman and CEO of the Saskatchewan Workers' Compensation Board, he has served on a variety of other public, private and not-for-profit boards. He is a recipient of the Queen Elizabeth II Diamond Jubilee Medal for leadership in business education and public policy.

MARTIN J. GLYNN *Corporate Director* **Member:** Investment Committee / Human Resources and Compensation Committee Board member since January 30, 2014	Mr. Glynn is a member of the Boards of three public companies, Sun Life Financial Inc., Husky Energy Inc. and VinaCapital Vietnam Opportunity Fund Ltd. He also serves as Chairman of UBC Investment Management Trust Inc. and is on the Boards of the Vancouver General Hospital & UBC Hospital Foundation. Until his retirement in 2006, Mr. Glynn held progressively senior positions with HSBC Bank, including President and CEO of HSBC Bank Canada from 1999 to 2003, and President and CEO of HSBC Bank USA from 2003 to 2006. He remains active in professional and community circles throughout Asia, the U.K. and North America. Mr. Glynn holds a BA Honours in Economics from Carleton University and an MBA (Finance and International Business) from the University of British Columbia. From 2009 to 2010, he was the Jarislowsky Fellow in Business Management at the Haskayne School of Business, University of Calgary.
LYNN HAIGHT *Corporate Director* **Member:** Investment Committee / Audit Committee / Risk Committee Board member since January 14, 2010	Ms. Haight is a member of the Board of Directors and Chair of the Audit Committee of the World Bank's Consultative Group on International Agricultural Research (CGIAR) and Green Shield Canada. She is a member of the Independent Audit and Oversight Panel of the United Nations High Commission for Refugees. She also sits on the Boards of the Bank of India (Canada) and the Somerville College Foundation at Oxford University. Ms. Haight retired in 2009 as Chief Operating Officer and Chief Financial Officer of the Foresters International Insurance Organization. She previously served as Vice President, U.S. Fixed Annuities, and Chief Accountant of Manulife Financial. She has also served as a Trustee and Chair of the Audit Committee of the Ontario Arts Council, Chair of Foresters Holdings Europe, Chair of Tafelmusik Baroque Orchestra, 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 Institute of Chartered Accountants in England and Wales, a Fellow of the Canadian Association of Management Consultants and a Certified Corporate Director.

DIRECTORS' BIOGRAPHIES

TIMOTHY HODGSON *Corporate Director* **Member:** Investment Committee / Audit Committee Board member since December 17, 2013	Mr. Hodgson is Managing Partner of Alignvest Management Corporation. From 2010 to 2012, he was Special Advisor to Governor Mark Carney at the Bank of Canada. Previously, Mr. Hodgson was at Goldman Sachs, where he served as Chief Executive Officer of its Canadian subsidiary, Goldman Sachs Canada, Inc. from 2005 to 2010. Mr. Hodgson currently sits on the Boards of KGS-Alpha Capital Markets, the Global Risk Institute, the Bridgepoint Health Corporation, the Ivey Business School and The Next36. He is a past member of the Board of Goldman Sachs Canada, Inc. Mr. Hodgson holds an MBA from the Ivey Business School at Western University in London, Ontario, and a Bachelor of Commerce from the University of Manitoba. He is a Chartered Accountant and a member of the Institute of Corporate Directors.
WILLIAM A. MACKINNON *Corporate Director* **Member:** Investment Committee / Audit Committee – Chair Board member since January 14, 2010	Mr. MacKinnon is a member of the Boards of Telus, Pioneer Petroleum, Osisko Mining Corporation and Novadaq Technologies. Very active in professional and community circles, he is also a member of the Boards of the Toronto Community Foundation, the Roy Thomson Hall, the Toronto East General Hospital Foundation and the St. Stephen's Community House. 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. As well, he served on the KPMG International Board of Directors. Mr. MacKinnon holds a Bachelor of Commerce degree 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:** Investment Committee / Governance Committee / Human Resources and Compensation Committee – Chair / Risk Committee Board member since December 18, 2006	Mr. Mueller is Chairman of Annidis Corporation and a member of the Boards of Canadian Tire Bank, Magor Communications Corp., Pediapharm and Emily's House. 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 the Scarborough Hospital (past Chair), the Scarborough Hospital Foundation, AIM Therapeutics Inc., Biovest Corp. 1, Budco, TM BioScience, MDS Capital and the Canadian Medical Discoveries Funds I and II. Mr. Mueller holds a Bachelor of Science degree from Western University and an MBA from York University.

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
Senior Vice President, Human Resources

NEIL CUNNINGHAM
Senior Vice President, Real Estate Investments

DANIEL GARANT
Senior Vice President, Public Market Investments

BRUNO GUILMETTE
Senior Vice President, Infrastructure Investments

DEREK MURPHY
Senior Vice President, Private Equity

MARC LACOURCIÈRE
Senior Vice President and Chief Legal Officer

STÉPHANIE LACHANCE
Vice President, Responsible Investment and Corporate Secretary

Consolidated Ten Year Financial Review

($ millions)	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
CHANGE IN NET ASSETS										
Investment income (loss)	**$12,793**	$ 7,194	$ 1,888	$ 7,043	$ 7,605	$ (9,493)	$ (197)	$ 3,414	$ 4,097	$ 1,334
Operating expenses	**216**	184	148	114	92	86	77	52	39	21
Net income (loss) from operations and comprehensive income	**$12,577**	$ 7,010	$ 1,740	$ 6,929	$ 7,513	$ (9,579)	$ (274)	$ 3,362	$ 4,058	$ 1,313
Fund transfers	**$ 4,997**	$ 4,635	$ 4,733	$ 4,814	$ 4,980	$ 4,431	$ 4,237	$ 3,990	$ 4,197	$ 3,816
Increase/(decrease) in net assets	**$17,574**	$11,645	$ 6,473	$11,743	$12,493	$ (5,148)	$ 3,963	$ 7,352	$ 8,255	$ 5,129
NET INVESTMENT ASSETS										
Investments										
World Equity										
Canadian Equity	**$16,731**	$15,425	$14,464	$18,665	$13,547	$ 8,815	$11,538	$10,328	$ 9,346	$ 7,758
Foreign Equity:										
US Large Cap Equity	**9,097**	7,163	5,294	3,829	2,111	926	1,763	2,498	2,618	2,314
EAFE Large Cap Equity	**9,000**	6,745	4,760	3,052	2,043	1,043	1,831	1,720	3,217	2,506
Small Cap Equity	**6,535**	4,738	3,641	3,221	1,977	781	1,930	2,936	2,006	105
Emerging Markets Equity	**8,116**	6,163	4,787	4,062	2,987	2,122	2,726	2,501	1,943	354
Private Equity	**8,425**	6,924	6,444	5,582	5,426	4,191	3,972	1,669	301	3
Nominal Fixed Income										
Cash & Cash Equivalents [1,2]	**1,756**	1,456	1,597	1,254	1,892	73	533	468	967	537
Fixed Income	**11,578**	9,481	8,569	7,685	6,958	6,358	7,097	7,089	5,243	5,143
Real Return Assets										
World Inflation-Linked Bonds	**5,036**	4,427	3,982	3,022	2,145	2,389	2,211	1,714	421	219
Real Estate [2]	**10,650**	9,427	7,055	5,312	5,118	4,653	4,029	3,596	1,584	429
Infrastructure	**6,011**	3,854	3,607	2,356	2,073	2,446	1,343	479	–	–
Renewable Resources	**795**	382	325	–	–	–	–	–	–	–
Net investments	**$93,730**	**$76,185**	**$64,525**	**$58,040**	**$46,277**	**$33,797**	**$38,973**	**$34,998**	**$27,646**	**$19,368**
PERFORMANCE (%)										
Annual rate of return	**16.3**	10.7	3.0	14.5	21.5	(22.7)	(0.3)	11.3	19.1	7.9
Benchmark	**13.9**	8.6	1.6	12.7	19.8	(17.6)	1.2	10.1	18.0	7.2

The ten year annualized net return is 7.0% (or 5.2% after inflation) exceeding the return objective of 6.1% (or 4.3% after inflation) for the period.

1 Includes amounts related to absolute return strategies.

2 Since 2013, amounts related to real estate debt strategies are reported under Real Estate.

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 (the "SIP&P").

In this regard, investments of PSP Investments held during the year ended March 31, 2014 were in accordance with the Act and the SIP&P.

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

PSP Investments' external "joint" auditors, the Office of the Auditor General of Canada and Deloitte LLP (the "External Auditors"), have conducted an independent examination of the financial statements in accordance with Canadian generally accepted auditing standards, performing such tests and other procedures as they consider necessary to express an opinion in their Auditors' Report. The External Auditors have full and unrestricted access to management and the 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 15, 2014

John Valentini
Executive Vice President,
Chief Operating Officer and Chief Financial Officer
May 15, 2014

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, 2014 were in accordance with the Act and PSP Investments’ Statement of Investment Policies, Standards and Procedures”.

Cheryl Barker
Interim Chair of the Board
May 15, 2014

PUBLIC SECTOR PENSION INVESTMENT BOARD

CONSOLIDATED FINANCIAL STATEMENTS

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), which comprise the consolidated balance sheet as at March 31, 2014, and the consolidated statement of net income from operations and comprehensive income and 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.

Auditor's 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 auditor's 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 auditor considers 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 as at March 31, 2014, 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 PSP Investments and 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 LLP[1]

[1] CPA auditor, CA, public accountancy permit No. A116129

May 15, 2014
Montréal, Canada

Clyde M. MacLellan, FCPA, FCA
Assistant Auditor General for the Auditor General of Canada

May 15, 2014
Ottawa, Canada

Consolidated Balance Sheet

As at March 31

($ millions)	2014	2013
ASSETS		
Investments (Note 3 (A))	**$101,570**	$ 81,808
Investment-related assets (Note 3 (A))	**1,935**	2,211
Cash	**2**	2
Other assets	**125**	81
	$103,632	$ 84,102
LIABILITIES		
Investment-related liabilities (Note 3 (A))	**$ 9,775**	$ 7,834
Accounts payable and other liabilities	**152**	137
	$ 9,927	$ 7,971
NET ASSETS	**$ 93,705**	$ 76,131
Share capital (Note 5)	**$ –**	$ –
Public Service Pension Plan Account	**68,168**	55,483
Canadian Forces Pension Plan Account	**18,352**	14,872
Royal Canadian Mounted Police Pension Plan Account	**6,720**	5,374
Reserve Force Pension Plan Account	**465**	402
NET ASSETS	**$ 93,705**	$ 76,131

Commitments (Note 13)

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

On behalf of the Board of Directors:

Cheryl Barker
Interim 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)	2014	2013
INVESTMENT INCOME (NOTE 7)	**$ 12,793**	$ 7,194
OPERATING EXPENSES (NOTE 8)	**$ 216**	$ 184
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME (NOTE 9)	**$ 12,577**	$ 7,010

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)	2014	2013
NET ASSETS, BEGINNING OF YEAR	**$ 76,131**	$ 64,486
Fund transfers (Note 6)	**4,997**	4,635
Net income from operations and comprehensive income	**12,577**	7,010
Increase in net assets for the year	**17,574**	11,645
NET ASSETS, END OF YEAR	**$ 93,705**	$ 76,131

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

Notes to the Consolidated Financial Statements

For the year ended March 31, 2014

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 pursuant to the *Superannuation Act*s (defined below), for 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 Act*s"), and certain regulations under the CFSA (the "CFSA Regulations"). The pension plans established under the *Superannuation Act*s consist of the Public Service pension plan, the Canadian Forces pension plan, and the Royal Canadian Mounted Police pension plan, and the pension plan established under the CFSA Regulations is the Reserve Force pension plan. They are herein referred to individually as a "Plan" and collectively as the "Plans".

The funds for which amounts are currently transferred to PSP Investments by the Government of Canada (individually a "Fund" and collectively the "Funds") relate to pension obligations under the Plans for service on or after April 1, 2000, and in the case of the Reserve Force Plan, for service on or after March 1, 2007 (collectively "Post-2000 Service"). The accounts managed by PSP Investments for the Funds are herein referred to individually as a "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 Act*s. 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.

Pursuant to the *Superannuation Act*s, the Government of Canada, which administers the Plans and their respective Funds, may at any time call upon the net assets of PSP Investments allocated to each Fund's Plan Account for amounts required for the purpose of paying benefits under the relevant Plan in respect of Post-2000 Service or for the purpose of reducing any non-permitted surplus in the Fund of such Plan.

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 for the Funds. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities under the Plans. 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, including those that meet the definition of a subsidiary and those over which PSP Investments exercises significant influence, 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 net contributions for each Fund, 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 at the date upon which PSP Investments becomes a party to the associated contractual provisions, and are carried at fair value. Purchases and sales are recorded as of the trade date. Fair value is 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 year-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.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

Valuation techniques are generally applied to investments in real estate, private equity, infrastructure and renewable resources, over-the-counter (OTC) derivatives and certain fixed income securities. 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 the investments are described in Notes 3 (A) and 3 (B).

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 directly attributable to the external management of assets on behalf of PSP Investments. Management fees incurred for investments in private markets and certain private debt portfolios are paid by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment. Management fees are also incurred for certain public markets and alternative investments and 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 classified as dividend income. Private markets distributions from pooled funds, limited partnerships or from direct investments and co-investments are recognized as interest income, dividend income or realized gains (losses) as appropriate. Co-investments are investments in private entities where the investment is made in conjunction with an external manager with whom PSP Investments already has committed and delegated funds. Dividend expense related to securities sold short and securities lending income (net of fees on securities borrowed) are classified as other (net).

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

Amounts received for 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 paragraphs 149(1)*(d)* and 149(1)*(d.2)* of the *Income Tax Act* (Canada), respectively.

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. This is principally reflected in the valuation of private markets investments, valuation of certain fixed income securities, related income and expenses as well as note disclosures. Although estimates and assumptions reflect management's best judgment, actual results may differ from these estimates.

2 FUTURE CHANGES IN ACCOUNTING POLICIES

In 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 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, 2014.

In October 2012, the International Accounting Standards Board (IASB) issued "Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)". Such amendments require qualifying investment entities to measure particular subsidiaries at fair value through profit or loss instead of consolidating them. The amendments are effective for annual periods beginning on or after January 1, 2014.

In December 2012, the AcSB approved the incorporation of the above amendments to IFRS into Part I of the *CPA Canada Handbook – Accounting* released by the Chartered Professional Accountants of Canada (CPA Canada). The AcSB also confirmed the previously announced IFRS adoption date for Canadian investment companies applying AcG-18.

The first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015. Consequently, PSP Investments' transition date is April 1, 2013 – the first day of the earliest comparative period required to be presented under IFRS.

Management is at an advanced stage in its analysis of the impact of adopting IFRS on PSP Investments' consolidated financial statements. To date, the impact on PSP Investments' opening consolidated statement of financial position as at April 1, 2013 is not expected to be significant. Other anticipated impacts include presenting a statement of cash flows as well as additional note disclosures.

3 INVESTMENTS

(A) INVESTMENT PORTFOLIO

The investment portfolio is organized according to the nature and common characteristics associated with the investments held. The following table presents the investment portfolio as at March 31:

	2014		2013	
($ millions)	**Fair Value**	**Cost**	Fair Value	Cost
INVESTMENTS				
Public markets				
Canadian equity	**$ 9,118**	**$ 7,667**	$ 9,224	$ 8,822
Foreign equity	**27,728**	**20,987**	20,949	18,452
Private markets				
Real estate	**12,777**	**10,543**	10,896	9,379
Private equity	**8,077**	**5,273**	7,020	5,414
Infrastructure	**6,534**	**6,144**	4,458	4,622
Renewable resources	**1,185**	**1,040**	420	376
Fixed income				
Cash and money market securities	**3,866**	**3,866**	3,604	3,604
Government and corporate bonds	**17,080**	**16,584**	11,211	10,993
Inflation-linked bonds	**4,991**	**4,190**	4,377	3,818
Other fixed income securities	**7,202**	**6,203**	7,857	7,033
Alternative investments	**3,012**	**2,552**	1,792	1,503
	$101,570	**$ 85,049**	$ 81,808	$ 74,016
INVESTMENT-RELATED ASSETS				
Amounts receivable from pending trades	**$ 734**	**$ 734**	$ 1,121	$ 1,121
Interest receivable	**218**	**218**	152	152
Dividends receivable	**83**	**83**	67	67
Derivative-related receivables	**900**	**687**	871	284
	$ 1,935	**$ 1,722**	$ 2,211	$ 1,624
INVESTMENT-RELATED LIABILITIES				
Amounts payable from pending trades	**$ (948)**	**$ (948)**	$ (1,104)	$ (1,104)
Interest payable	**(27)**	**(27)**	(24)	(24)
Securities sold short	**(715)**	**(687)**	(468)	(465)
Securities sold under repurchase agreements	**(632)**	**(635)**	(609)	(609)
Derivative-related payables	**(1,211)**	**(574)**	(734)	(246)
Capital market debt financing (Note 10)	**(6,242)**	**(6,159)**	(4,895)	(4,834)
	$ (9,775)	**$ (9,030)**	$ (7,834)	$ (7,282)
NET INVESTMENTS	**$ 93,730**	**$ 77,741**	$ 76,185	$ 68,358

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Public Markets

Public markets consist of Canadian and foreign investments in the following securities: common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds units, pooled funds units, 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 using unit values obtained from each of the funds' administrators, which are derived from the fair value of the underlying investments in each pooled fund. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

(ii) Private Markets

Private markets consist of investments in real estate, private equity, infrastructure and renewable resources.

Real estate investments are comprised of direct equity positions in various private entities, fund investments, as well as properties in the real estate sector. Real estate investments focus on partnerships, companies and properties operating mainly in the retirement and residential, office, retail and industrial sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of real estate contracted by direct investments controlled by PSP Investments was $4,050 million (2013 – $3,599 million).

Private equity investments are comprised of fund investments with similar objectives, co-investments in private entities as well as direct equity positions.

Infrastructure investments are comprised of direct equity positions, fund investments and co-investments in various private entities. Infrastructure investments focus on entities engaged in the management, ownership or operation of assets in energy, transportation and other regulated businesses. Infrastructure investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSP Investments was $1,644 million (2013 – $277 million).

Renewable resources investments are comprised of direct investments in properties involved in the production and harvesting of timber and farmland.

Valuation Techniques

The fair value of private markets 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 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 discount rates, capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

For direct investments in private equity, direct investments and co-investments in infrastructure and in renewable resources, 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.

In the case of private equity, real estate and 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.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Fixed Income

Fixed income consists of cash and money market securities, government and corporate bonds, inflation-linked bonds and other fixed income securities.

Cash and money market securities include instruments having a maximum term to maturity of one year, such as treasury bills, certificates of deposit and bankers' acceptances.

Government and corporate bonds include Canadian and foreign, federal, provincial, territorial and municipal bonds. Inflation-linked bonds are fixed income securities that earn inflation adjusted returns.

Other fixed income securities consist of asset-backed securities, floating rate notes as well as private debt portfolios.

Asset-backed securities consist mainly of asset-backed term notes (ABTNs) and mortgage-backed securities. 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. Potential margin calls on the ABTNs are supported by funding facilities, as described in Note 12.

Private debt portfolios consist mainly of investments in the real estate sector in the form of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, as well as other structured finance products. They also include real estate debt funds where significant portions of the value are attributed to the underlying real estate assets.

Private debt portfolios also include debt securities of private companies or other entities such as venture capital organizations, held mainly through private funds. Such debt securities take the form of senior debt, mezzanine and distressed debt.

Valuation Techniques

Cash and money market securities include short-term instruments that are recorded at cost plus accrued interest, which approximates fair value.

Fair values of government and corporate bonds, inflation-linked bonds, floating rate notes and mortgage-backed securities are based on prices obtained from third-party pricing sources. Such prices 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 whereby management relies on the valuation work performed by a recognized third-party expert. Management ensures that the valuation conducted by such expert uses acceptable industry methods. Financial information used in the valuation of ABTNs includes interest rates, credit spreads and the underlying investments' terms to maturity. In addition to the values determined by the expert, management integrated certain assumptions in the fair value of ABTNs that are not fully supported by market observable data, such as liquidity estimates and the impact of the funding facilities described in Note 12.

The fair value of private debt portfolios in the real estate sector is obtained from third-party appraisers and 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.

The fair value of fund investments included as part of private debt portfolios is determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

(iv) Alternative Investments

Alternative investments consist mainly of units of funds that hold a mix of equity, fixed income and derivative instruments as well as hedge funds.

Valuation Techniques

The fair value of these investments is obtained from each of the funds' administrators and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(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 and Dividends Receivable

Interest and dividends are recorded at the amounts expected to be received as at the reporting date, which approximates fair value.

(vii) Interest Payable

Interest is accrued at the amount expected to be paid as at the reporting date, which approximates fair value.

(viii) Securities Sold Short

Securities sold short reflect PSP Investments' obligation to purchase securities pursuant to short selling transactions. In such transactions, PSP Investments sells securities it does not own with an obligation to purchase 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 within public markets and fixed income.

(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 at a 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 approximates fair value.

(x) Derivative-Related Receivables and Payables

The description and valuation of derivative-related receivables and payables are described in Note 3 (B).

(xi) Capital Market Debt Financing

PSP Investments' capital market debt program is described in Note 10. Short-term promissory notes are recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' medium-term notes is based on prices that are obtained from third-party pricing sources. Such prices are determined using an interest rate curve with a spread consistent with PSP Investments' credit quality.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date. The value of such instruments is derived from changes in the value of the 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. Derivative financial instruments can be listed or traded OTC. OTC instruments consist of those that are bilaterally negotiated and settled, and those that are cleared (OTC-cleared) by a central clearing party (CCP).

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.

(ii) Futures

Futures are standardized contracts to take or make delivery of an asset (buy or sell) at a predefined price and predefined future date. 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 at a predefined date in the future. Forwards are used to adjust exposures to specified assets without directly purchasing or selling the underlying assets.

(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

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-cleared derivatives are recorded at fair value using prices obtained from the CCP. 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 collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behavior of the default correlation. Such assumptions are not observable in the market.

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, 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:

	2014				2013			
	Notional Value	Fair Value			Notional Value	Fair Value		
($ millions)		Assets	Liabilities	Net		Assets	Liabilities	Net
Equity and commodity derivatives								
Futures	$ 1,401	$ –	$ –	$ –	$ 846	$ –	$ –	$ –
Total return swaps	13,555	212	(22)	190	9,935	166	(50)	116
Warrants and rights	5	5	–	5	2	–	–	–
Options:								
Listed-purchased	689	20	–	20	2,570	27	–	27
Listed-written	414	–	(17)	(17)	1,002	–	(15)	(15)
OTC-purchased	5,486	308	–	308	1,257	164	–	164
OTC-written	6,091	–	(352)	(352)	1,237	–	(145)	(145)
Currency derivatives								
Forwards	31,004	153	(452)	(299)	34,291	342	(334)	8
Futures	70	–	–	–	42	–	–	–
Swaps	3,554	9	(125)	(116)	1,063	24	(29)	(5)
Options:								
OTC-purchased	4,021	33	–	33	5,199	78	–	78
OTC-written	3,505	–	(16)	(16)	4,850	–	(67)	(67)
Interest rate derivatives								
Bond forwards	701	–	–	–	846	5	(6)	(1)
Futures	2,432	–	–	–	1,330	–	–	–
Interest rate swaps:								
OTC	11,853	40	(86)	(46)	11,562	23	(39)	(16)
OTC-cleared	8,370	–	–	–	–	–	–	–
Total return swaps	–	–	–	–	2	–	–	–
Swaptions	31,545	82	(70)	12	2,811	7	(5)	2
Options:								
Listed-purchased	26,476	18	–	18	5,055	4	–	4
Listed-written	27,766	–	(9)	(9)	4,967	–	(3)	(3)
OTC-purchased	10,160	15	–	15	1,761	10	–	10
OTC-written	15,038	–	(15)	(15)	2,784	–	(10)	(10)
Credit derivatives[1]								
OTC-purchased	2,134	1	(46)	(45)	1,914	17	(17)	–
OTC-sold	548	4	(1)	3	934	4	(14)	(10)
OTC-cleared-purchased	851	–	–	–	–	–	–	–
OTC-cleared-sold	1,284	–	–	–	–	–	–	–
Total	$ 208,953	$ 900	$ (1,211)	$ (311)	$ 96,260	$ 871	$ (734)	$ 137

[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.

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, 2014:

($ millions)

Less than 3 months	**$ 92,888**
3 to 12 months	**77,491**
Over 1 year	**38,574**
Total	**$208,953**

(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 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.

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, 2014:

($ millions)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 8,459	$ 659	$ –	$ –	$ 9,118
Foreign equity	23,461	4,267	–	–	27,728
Private markets					
Real estate	–	–	12,777	–	12,777
Private equity	–	–	8,077	–	8,077
Infrastructure	–	–	6,534	–	6,534
Renewable resources	–	–	1,185	–	1,185
Fixed income					
Cash and money market securities	811	3,055	–	–	3,866
Government and corporate bonds	–	17,080	–	–	17,080
Inflation-linked bonds	–	4,991	–	–	4,991
Other fixed income securities	–	3,063	4,139	–	7,202
Alternative investments	–	1,125	1,887	–	3,012
	$ 32,731	$ 34,240	$ 34,599	$ –	$101,570
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 734	$ 734
Interest receivable	–	–	–	218	218
Dividends receivable	–	–	–	83	83
Derivative-related receivables	43	857	–	–	900
	$ 43	$ 857	$ –	$ 1,035	$ 1,935
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (948)	$ (948)
Interest payable	–	–	–	(27)	(27)
Securities sold short	(715)	–	–	–	(715)
Securities sold under repurchase agreements	–	(632)	–	–	(632)
Derivative-related payables	(26)	(1,185)	–	–	(1,211)
Capital market debt financing	–	(6,242)	–	–	(6,242)
	$ (741)	$ (8,059)	$ –	$ (975)	$ (9,775)
NET INVESTMENTS	$ 32,033	$ 27,038	$ 34,599	$ 60	$ 93,730

[1] With respect to the amounts reflected in this column, cost approximates fair value. Consequently, no fair value hierarchy classification is required for such amounts.

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, 2013:

($ millions)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 9,224	$ –	$ –	$ –	$ 9,224
Foreign equity	17,217	3,732	–	–	20,949
Private markets					
Real estate	–	–	10,896	–	10,896
Private equity	–	–	7,020	–	7,020
Infrastructure	–	–	4,458	–	4,458
Renewable resources	–	–	420	–	420
Fixed income					
Cash and money market securities	629	2,975	–	–	3,604
Government and corporate bonds	–	11,211	–	–	11,211
Inflation-linked bonds	–	4,377	–	–	4,377
Other fixed income securities	–	3,398	4,459	–	7,857
Alternative investments	–	885	907	–	1,792
	$ 27,070	$ 26,578	$ 28,160	$ –	$ 81,808
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 1,121	$ 1,121
Interest receivable	–	–	–	152	152
Dividends receivable	–	–	–	67	67
Derivative-related receivables	31	839	1	–	871
	$ 31	$ 839	$ 1	$ 1,340	$ 2,211
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (1,104)	$ (1,104)
Interest payable	–	–	–	(24)	(24)
Securities sold short	(468)	–	–	–	(468)
Securities sold under repurchase agreements	–	(609)	–	–	(609)
Derivative-related payables	(18)	(712)	(4)	–	(734)
Capital market debt financing	–	(4,895)	–	–	(4,895)
	$ (486)	$ (6,216)	$ (4)	$ (1,128)	$ (7,834)
NET INVESTMENTS	$ 26,615	$ 21,201	$ 28,157	$ 212	$ 76,185

[1] With respect to the amounts reflected in this column, cost approximates fair value. Consequently, no fair value hierarchy classification is required for such amounts.

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 year-end.

During the year ended March 31, 2014, listed Canadian equity securities with a fair value of $627 million classified as Level 1 were transferred to a non-listed fund held by PSP Investments. Consequently, the securities were classified as Level 2 as at March 31, 2014 (no significant transfers during the year ended March 31, 2013).

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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, 2014:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains	Transfer out of Level 3	Closing Balance
Private markets	$ 22,794	$ 6,887	$ (4,263)	$ –	$ 752	$ 2,667	$ (264)	$ 28,573
Fixed income	4,459	724	(1,213)	(287)	305	151	–	4,139
Alternative investments	907	875	(26)	–	1	130	–	1,887
Derivative-related receivables/payables (net)	(3)	8	(10)	–	1	4	–	–
Total	**$ 28,157**	**$ 8,494**	**$ (5,512)**	**$ (287)**	**$ 1,059**	**$ 2,952**	**$ (264)**	**$ 34,599**

As at March 31, 2013, two private markets investments were classified under Level 3 as their fair values were determined based on significant unobservable inputs. During the year ended March 31, 2014, such investments were transferred to Level 2 as the underlying investees indirectly held by PSP Investments became publicly traded. In the case of one of the two private markets investments, the instruments held by PSP Investments are subject to restrictions as at March 31, 2014 and may only be resold upon registration.

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, 2013:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)	Transfer out of Level 3	Closing Balance
Public markets	$ 168	$ 1	$ (6)	$ –	$ 1	$ (14)	$ (150)	$ –
Private markets	18,278	4,835	(1,844)	–	212	1,313	–	22,794
Fixed income	3,986	1,355	(1,174)	(65)	200	157	–	4,459
Alternative investments	304	576	–	–	–	27	–	907
Derivative-related receivables/payables (net)	(10)	8	(10)	–	2	7	–	(3)
Total	$ 22,726	$ 6,775	$ (3,034)	$ (65)	$ 415	$ 1,490	$ (150)	$ 28,157

As at March 31, 2012, an investment in a non-listed fund that held listed securities was classified under Level 3 due to the nature of the contractual restrictions on the redemption of the fund units. During the year ended March 31, 2013, the listed securities held by the fund were transferred to PSP Investments and were classified as Level 1 as at March 31, 2013.

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 7% increase and 5% decrease (2013 – 4% increase and 4% decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios and fund investments of $13,120 million (2013 – $10,178 million), where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of 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 private debt portfolios, the fair value is obtained from third-party appraisers as described in Note 3 (A).

(D) SECURITIES LENDING AND 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, 2014, PSP Investments has re-invested $2,412 million of collateral held (2013 – $2,217 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)	2014	2013
Securities lending		
Securities lent	$ 9,622	$ 7,395
Collateral held[1]	10,242	7,789
Securities borrowing		
Securities borrowed	715	468
Collateral pledged[2]	750	470

[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.

(E) SECURITIES SOLD AND 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 relevant 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 relevant 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 $631 million as at March 31, 2014 (2013 – $609 million).

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 reporting 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 Statement of Investment Policies, Standards and Procedures (SIP&P). The objective of this policy is to provide a framework to manage the investment risks that PSP Investments is exposed to, namely market, credit and liquidity risks.

(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 funding risk. Funding risk is the risk that the assets under management will be insufficient to meet the relevant pension liabilities of the Plans, which may require the contributions to the Funds of the Plans to be increased. 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. For investments that are not actively traded, the calculation of VaR uses securities with similar risk attributes as a proxy.

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.

	2014	2013
Policy Portfolio VaR	**20.3 %**	20.2 %
Active VaR	**2.8**	2.6
Total VaR (undiversified)	**23.1**	22.8
Diversification effect	**(0.1)**	(1.3)
Total VaR	**23.0 %**	21.5 %

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 terms to maturity of the investments with the most significant exposure to interest rate risk were as follows as at March 31, 2014:

($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Other	Total
Government bonds	$ 1,781	$ 5,342	$ 1,813	$ 2,663	$ –	$ 11,599
Corporate bonds	668	3,032	1,405	376	–	5,481
Inflation-linked bonds	3	1,220	1,398	2,370	–	4,991
Asset-backed securities	11	1,612	25	–	–	1,648
Private debt portfolios:						
Directly held	175	484	–	–	–	659
Held through funds [1]	–	–	–	–	1,965	1,965
Total investments with significant exposure to interest rate risk	$ 2,638	$ 11,690	$ 4,641	$ 5,409	$ 1,965	$ 26,343
Other investments [2]	$ –	$ –	$ –	$ –	$ 6,796	$ 6,796
Total fixed income	$ 2,638	$ 11,690	$ 4,641	$ 5,409	$ 8,761	$ 33,139

[1] Due to their nature, information in connection with the terms to maturity of fund investments included in the private debt portfolios is not available.

[2] Consists of $3,866 million in cash and money market securities and $2,930 million in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

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

Alternative investments as well as derivative contracts described in Notes 3(A) (iv) and 3 (B), respectively, are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 4 (A).

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. In October 2013, PSP Investments amended its policy to fully hedge foreign currency investments in government and corporate bonds, inflation-linked bonds, certain other fixed income securities, as well as investments in real estate, infrastructure and renewable resources. PSP Investments' previous policy was to hedge a target of 50% of its foreign currency investments in non-emerging countries. 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:

(in millions of Canadian $)	2014		2013	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 24,588**	**61.0 %**	$ 15,290	53.3 %
Euro	**3,465**	**8.6**	2,573	9.0
British Pound	**1,857**	**4.6**	2,128	7.4
Japanese Yen	**1,571**	**3.9**	1,143	4.0
Hong Kong Dollar	**1,311**	**3.3**	1,034	3.6
Korean Won	**1,308**	**3.2**	775	2.7
Brazilian Real	**1,263**	**3.1**	1,205	4.2
Swiss Franc	**796**	**2.0**	382	1.3
Taiwanese New Dollar	**612**	**1.5**	468	1.6
Australian Dollar	**507**	**1.3**	943	3.3
Indian Rupee	**470**	**1.2**	353	1.2
South African Rand	**392**	**1.0**	304	1.1
Swedish Krona	**264**	**0.6**	72	0.3
Colombian Peso	**245**	**0.6**	174	0.6
Mexican Peso	**211**	**0.5**	242	0.9
Others	**1,441**	**3.6**	1,578	5.5
Total	**$ 40,301**	**100.0 %**	$ 28,664	100.0 %

As at March 31, 2014, PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $12,004 million (US$10,063 million, €259 million, £29 million, R22 million South African Rands, R$283 million Brazilian Reals, $61,524 million Colombian pesos and ₹14,898 million Indian Rupees) which were not included in the foreign currency exposure table.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

PSP Investments is exposed to credit risk, that is, the risk that the issuer of a debt security or 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 relevant 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.

As at March 31, 2014, PSP Investments' maximum exposure to credit risk amounted to approximately $30 billion (2013 – approximately $24 billion). This amount excludes investments in distressed debt in the amount of approximately $1.6 billion as at March 31, 2014 (2013 – approximately $1.4 billion). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 3 (D), 3 (E) and 4 (B) and the impact of guarantees and indemnities disclosed in Note 12.

As at March 31, 2014, PSP Investments had a net notional exposure of $55 million (2013 – $120 million) to various tranches of collateralized debt obligations, of which approximately 53% (2013 – approximately 67%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 12, to support potential margin calls on the ABTNs.

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 markets investments.

PSP Investments' concentration of credit risk by credit rating, excluding the items described above and any other credit enhancement was as follows as at March 31:

	2014	2013
Investment grade (AAA to BBB–)	**97.4 %**	97.9 %
Below investment grade (BB+ and below)	**1.0**	1.0
Not rated:		
Rated by a single credit rating agency	**0.5**	0.1
Not rated by credit rating agencies	**1.1**	1.0
Total	**100.0 %**	100.0 %

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 requires that counterparties provide adequate collateral and meet its credit rating requirements. PSP Investments frequently monitors the credit rating of its counterparties as determined by recognized credit rating agencies. With respect to derivative contracts, PSP Investments has the ability to terminate all trades with most counterparties whose credit rating is downgraded below its requirements.

For OTC derivatives, 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. In the case of OTC-cleared derivatives, the CCP regulates trading activities between parties under terms that are customary to such transactions.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master Agreement contractually binds counterparties to close-out netting provisions in the case of default by one of the counterparties. 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 under the CSA 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. Similarly, in the case of OTC-cleared derivatives, the CCP requires collateral in cash, high quality debt instruments or securities and is authorized to sell, repledge or otherwise use collateral held. PSP Investments pledged securities with a fair value of $579 million as collateral with respect to derivative contracts at March 31, 2014 (2013 – $72 million), $27 million of which are with respect to OTC-cleared derivatives (2013 – nil). Securities with a fair value of $35 million were received from counterparties as collateral at March 31, 2014 (2013 – $145 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 (D) and 3 (E) 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.

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, 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, bonds and public equities are expected to be highly liquid as they will be invested in securities that are actively traded. Management utilizes appropriate measures and controls to monitor liquidity risk in order to ensure that there is sufficient liquidity to meet financial obligations as they come due. A liquidity report taking into consideration future forecasted cash flows is prepared and presented to senior management on a weekly basis. This ensures that sufficient cash reserves are available to meet forecasted cash outflows. Additionally, sufficient sources of liquidity are maintained for deployment in case of market disruption.

PSP Investments has the ability to raise additional capital through the use of its capital market 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 market debt program.

The terms to maturity of the notional amount of derivatives are disclosed in Note 3 (B).

4 INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial instruments, aggregated according to their maturities as at March 31, 2014:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities [1]				
Amounts payable from pending trades	$ (948)	$ –	$ –	$ (948)
Interest payable	(25)	(2)	–	(27)
Securities sold short	(715)	–	–	(715)
Securities sold under repurchase agreements	(632)	–	–	(632)
Capital market debt financing	(3,299)	(792)	(2,151)	(6,242)
Accounts payable and other liabilities	(102)	–	(50)	(152)
Total	$ (5,721)	$ (794)	$ (2,201)	$ (8,716)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial instruments				
Derivative-related receivables	$ 414	$ 316	$ 170	$ 900
Derivative-related payables [1]	(465)	(437)	(309)	(1,211)
Total	$ (51)	$ (121)	$ (139)	$ (311)

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

5 SHARE CAPITAL

Pursuant to the Act, PSP Investments' share capital consists of 10 shares having a par value of $10 each that were issued to the President of the Treasury Board, to be held on behalf of Her Majesty in Right of Canada. The Act does not attribute any voting, dividend, residual or other rights to these shares.

6 FUND TRANSFERS

PSP Investments received fund transfers from the Government of Canada of $4,997 million for the year ended March 31, 2014 ($4,635 million for the year ended March 31, 2013) for the Funds, recorded in their respective Plan Accounts.

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

($ millions)	**2014**	2013
Public Service Pension Fund	**$ 3,535**	$ 3,258
Canadian Forces Pension Fund	**1,010**	1,055
Royal Canadian Mounted Police Pension Fund	**452**	322
Reserve Force Pension Fund	**–**	–
Total	**$ 4,997**	$ 4,635

7 INVESTMENT INCOME

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

($ millions)	2014	2013
Interest income	$ 1,083	$ 804
Dividend income	1,377	1,179
Interest expense (Note 10)	(99)	(102)
Transaction costs	(94)	(50)
External investment management fees[1]	(31)	(37)
Other (net)	(33)	(18)
	2,203	1,776
Net realized gains[2]	2,428	2,246
Net unrealized gains[3]	8,162	3,172
Investment income	**$ 12,793**	$ 7,194

[1] Consists of amounts incurred for investments in public markets that are paid directly by PSP Investments. This excludes fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of $55 million for the year ended March 31, 2014 (2013 - $21 million).

This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSP Investments. Such fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, totalled $151 million for the year ended March 31, 2014 (2013 - $127 million).

[2] Includes realized foreign currency losses of $1,509 million for the year ended March 31, 2014 (2013 - realized foreign currency losses of $203 million).

[3] Includes unrealized foreign currency gains of $4,146 million for the year ended March 31, 2014 (2013 - unrealized foreign currency gains $200 million).

8 OPERATING EXPENSES

Operating expenses for the years ended March 31 were as follows:

($ thousands)	2014	2013
Salaries and benefits	$137,316	$122,178
Professional and consulting fees	23,977	11,848
Office supplies and equipment	21,376	18,704
Other operating expenses	8,288	7,895
Depreciation of fixed assets	13,740	13,018
Occupancy costs	6,790	6,284
Custodial fees	2,854	2,803
Remuneration earned by Directors	808	765
Travel and related expenses for Directors	223	210
Communication expenses	185	146
Total	**$215,557**	$183,851

Professional and consulting fees paid or accrued to the external auditors include audit fees of $633 thousand (2013 – $498 thousand), audit-related fees of $730 thousand (2013 – $579 thousand) and non-audit fees of $122 thousand (2013 – $352 thousand).

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

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

(A) INVESTMENT INCOME (LOSS)

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

(B) EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the 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:

	2014	2013
Public Service Pension Plan Account	72.9 %	73.0 %
Canadian Forces Pension Plan Account	19.5	19.3
Royal Canadian Mounted Police Pension Plan Account	7.1	7.1
Reserve Force Pension Plan Account	0.5	0.6
Total	**100.0 %**	100.0 %

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

10 CAPITAL MARKET DEBT FINANCING

PSP Investments' capital market debt 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 private market investments. It is unconditionally and irrevocably guaranteed by PSP Investments in accordance with its corporate leverage policy.

The maximum amount authorized by the Board of Directors for the capital market debt program is 10% of the net investments plus all recourse debt outstanding of PSP Investments at the time of commitment to issuance. Under this limit, the short-term promissory note component cannot exceed $3 billion for issuances in Canada and US$3 billion for issuances in the United States.

PSP Investments' capital market debt financing was in compliance with the limits authorized by the Board of Directors during the period ended March 31, 2014.

The following outlines the terms as well as the fair value of the notes issued under the capital market debt program as at March 31:

($ millions)	**2014** Capital amounts payable at maturity	**2014** Fair Value	2013 Capital amounts payable at maturity	2013 Fair Value
Short-term Canadian Dollar promissory notes, bearing interest between 0.99% and 1.19% and maturing within 7 and 364 days of issuance (March 31, 2013 – 31 and 191 days)	**$ 1,436**	**$ 1,434**	$ 863	$ 861
Short-term US Dollar promissory notes, bearing interest between 0.11% and 0.30% and maturing within 35 and 365 days of issuance (March 31, 2013 – 29 and 189 days)	**2,307**	**2,306**	1,016	1,016
Medium-term notes Series 1, bearing interest of 4.57% per annum and matured on December 9, 2013	**–**	**–**	1,000	1,023
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**700**	**719**	700	726
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on February 16, 2015	**350**	**351**	350	352
Medium-term notes Series 4, bearing interest of 2.26% per annum and maturing on February 16, 2017	**900**	**918**	900	917
Medium-term notes Series 5, bearing interest of 3.03% per annum and maturing on October 22, 2020	**500**	**514**	–	–
Total	**$ 6,193**	**$ 6,242**	$ 4,829	$ 4,895

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

($ thousands)	**2014**	2013
Short-term promissory notes	**$ 14,268**	$ 10,660
Medium-term notes	**85,040**	90,859
Total	**$ 99,308**	$101,519

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 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 market debt financing and Note 4 (C) provides information on PSP Investments' liquidity.

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

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 indemnities.

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.

PSP Investments unconditionally and irrevocably guarantees all credit facilities, as well as short-term promissory notes and medium-term notes issued by PSP Capital Inc., as described in Note 10.

PSP Capital Inc. provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs. As at March 31, 2014, the margin funding facilities have not been drawn upon since inception.

In certain investment transactions, PSP Investments provided guarantees, indemnifications or issued letters of credit to third parties, the most significant of which are as follows:

As at March 31, 2014, PSP Investments agreed to guarantee and, in some cases, provide indemnification for the performance of certain investees under contractual agreements. The majority of these agreements are borrowing arrangements. In the event a default occurs under such agreements, which is of limited recourse in certain cases, PSP Investments could assume obligations of up to $1,223 million (2013 – $999 million) plus applicable interest and other related costs. The arrangements mature between January 2014 and September 2028.

Additionally, PSP Investments and its subsidiaries issued letters of credit totalling $82 million as at March 31, 2014 (2013 – $41 million) in relation to investment transactions.

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, 2014:

($ millions)	
Real estate	$ 1,196
Private equity	4,072
Infrastructure	2,533
Renewable resources	800
Other fixed income securities	2,080
Alternative investments	1,825
Total	**$ 12,506**

PUBLIC SERVICE PENSION PLAN ACCOUNT
FINANCIAL STATEMENTS

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, 2014, and the statement of net income from operations and comprehensive income and 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.

Auditor's 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 auditor's 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 auditor considers 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, 2014, 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 the Public Sector Pension Investment Board and its wholly-owned subsidiaries.

Deloitte LLP[1]

[1] CPA auditor, CA, public accountancy permit No. A116129

May 15, 2014
Montréal, Canada

Clyde M. MacLellan, FCPA, FCA
Assistant Auditor General for the Auditor General of Canada

May 15, 2014
Ottawa, Canada

Balance Sheet

As at March 31

($ millions)	2014	2013
ASSETS		
Investments (Note 3 (A))	$ 73,869	$ 59,610
Investment-related assets (Note 3 (A))	1,408	1,612
Other assets	92	60
Due from the Canadian Forces Pension Plan Account	14	7
Due from the Royal Canadian Mounted Police Pension Plan Account	5	3
	$ 75,388	$ 61,292
LIABILITIES		
Investment-related liabilities (Note 3 (A))	$ 7,110	$ 5,709
Accounts payable and other liabilities	110	100
	$ 7,220	$ 5,809
NET ASSETS	$ 68,168	$ 55,483
Accumulated net income from operations and comprehensive income	$ 26,209	$ 17,059
Accumulated fund transfers	41,959	38,424
NET ASSETS	$ 68,168	$ 55,483

Commitments (Note 11)

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

On behalf of the Board of Directors:

Cheryl Barker
Interim 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)	2014	2013
INVESTMENT INCOME (NOTE 6)	**$ 9,307**	$ 5,231
OPERATING EXPENSES (NOTE 7)	**$ 157**	$ 134
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ 9,150**	$ 5,097

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

Statement of Changes in Net Assets

For the years ended March 31

($ millions)	2014	2013
NET ASSETS, BEGINNING OF YEAR	**$ 55,483**	$ 47,128
Fund transfers (Note 5)	**3,535**	3,258
Net income from operations and comprehensive income	**9,150**	5,097
Increase in net assets for the year	**12,685**	8,355
NET ASSETS, END OF YEAR	**$ 68,168**	$ 55,483

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

Notes to the Financial Statements

For the year ended March 31, 2014

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 pursuant to the *Superannuation Act*s (defined below), for 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 Act*s"), and certain regulations under the CFSA (the "CFSA Regulations"). The pension plans established under the *Superannuation Act*s consist of the Public Service pension plan (the "Plan"), the Canadian Forces pension plan, and the Royal Canadian Mounted Police pension plan, and the pension plan established under the CFSA Regulations is the Reserve Force pension plan. The Plan and the other pension plans are herein referred to collectively as the "Plans".

The fund for which amounts are currently transferred to PSP Investments by the Government of Canada (the "Fund") relates to pension obligations under the Plan for service on or after April 1, 2000 ("Post-2000 Service"). The account managed by PSP Investments for the Fund is herein referred to as the "Plan Account". PSP Investments maintains records of the net contributions for the Fund, as well as the allocation of its investments and the results of its operations for the Fund in the Plan Account.

PSP Investments is responsible for managing amounts that are transferred to it for 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 Plan and the Plan's ability to meet its financial obligations.

Pursuant to the *Public Service Superannuation Act*, the Government of Canada, which administers the Plan and the Fund, may at any time call upon the net assets of PSP Investments allocated to the Fund's Plan Account for amounts required for the purpose of paying benefits under the Plan in respect of Post-2000 Service or for the purpose of reducing any non-permitted surplus in the Fund.

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 for the Fund in respect of Post-2000 Service. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities under the Plan. 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, including those that meet the definition of a subsidiary and those over which PSP Investments exercises significant influence, 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 at the date upon which PSP Investments becomes a party to the associated contractual provisions, and are carried at fair value. Purchases and sales are recorded as of the trade date. Fair value is 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 year-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.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

Valuation techniques are generally applied to investments in real estate, private equity, infrastructure and renewable resources, over-the-counter (OTC) derivatives and certain fixed income securities. 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 the investments are described in Notes 3 (A) and 3 (B).

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 directly attributable to the external management of assets on behalf of PSP Investments. Management fees incurred for investments in private markets and certain private debt portfolios are paid by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment. Management fees are also incurred for certain public markets and alternative investments and 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 classified as dividend income. Private markets distributions from pooled funds, limited partnerships or from direct investments and co-investments are recognized as interest income, dividend income or realized gains (losses) as appropriate. Co-investments are investments in private entities where the investment is made in conjunction with an external manager with whom PSP Investments already has committed and delegated funds. Dividend expense related to securities sold short and securities lending income (net of fees on securities borrowed) are classified as other (net).

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

Amounts received for 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 paragraphs 149(1)*(d)* and 149(1)*(d.2)* of the *Income Tax Act* (Canada), respectively.

USE OF ESTIMATES

In preparing these financial statements, management makes certain estimates and assumptions which can affect the reported values of assets and liabilities. This is principally reflected in the valuation of private markets investments, valuation of certain fixed income securities, related income and expenses as well as note disclosures. Although estimates and assumptions reflect management's best judgment, actual results may differ from these estimates.

2 FUTURE CHANGES IN ACCOUNTING POLICIES

In 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 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, 2014.

In October 2012, the International Accounting Standards Board (IASB) issued "Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)". Such amendments require qualifying investment entities to measure particular subsidiaries at fair value through profit or loss instead of consolidating them. The amendments are effective for annual periods beginning on or after January 1, 2014.

In December 2012, the AcSB approved the incorporation of the above amendments to IFRS into Part I of the *CPA Canada Handbook – Accounting* released by the Chartered Professional Accountants of Canada (CPA Canada). The AcSB also confirmed the previously announced IFRS adoption date for Canadian investment companies applying AcG-18.

The first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015. Consequently, PSP Investments' transition date is April 1, 2013 – the first day of the earliest comparative period required to be presented under IFRS.

Management is at an advanced stage in its analysis of the impact of adopting IFRS on PSP Investments' consolidated financial statements. To date, the impact on PSP Investments' opening consolidated statement of financial position as at April 1, 2013 is not expected to be significant. Other anticipated impacts include presenting a statement of cash flows as well as additional note disclosures.

3 INVESTMENTS

(A) INVESTMENT PORTFOLIO

The investment portfolio is organized according to the nature and common characteristics associated with the investments held. The following table presents the investment portfolio as at March 31:

	2014		2013	
($ millions)	Fair Value	Cost	Fair Value	Cost
INVESTMENTS				
Public markets				
Canadian equity	$ 6,631	$ 5,588	$ 6,721	$ 6,439
Foreign equity	20,166	15,264	15,265	13,452
Private markets				
Real estate	9,292	7,664	7,939	6,833
Private equity	5,874	3,830	5,115	3,943
Infrastructure	4,752	4,469	3,248	3,368
Renewable resources	862	756	306	274
Fixed income				
Cash and money market securities	2,812	2,812	2,626	2,626
Government and corporate bonds	12,421	12,060	8,169	8,009
Inflation-linked bonds	3,630	3,046	3,190	2,782
Other fixed income securities	5,238	4,511	5,725	5,125
Alternative investments	2,191	1,854	1,306	1,094
	$ 73,869	$ 61,854	$ 59,610	$ 53,945
INVESTMENT-RELATED ASSETS				
Amounts receivable from pending trades	$ 534	$ 534	$ 817	$ 817
Interest receivable	159	159	111	111
Dividends receivable	60	60	49	49
Derivative-related receivables	655	500	635	207
	$ 1,408	$ 1,253	$ 1,612	$ 1,184
INVESTMENT-RELATED LIABILITIES				
Amounts payable from pending trades	$ (689)	$ (689)	$ (805)	$ (805)
Interest payable	(20)	(20)	(18)	(18)
Securities sold short	(520)	(500)	(341)	(339)
Securities sold under repurchase agreements	(460)	(462)	(444)	(444)
Derivative-related payables	(881)	(418)	(535)	(179)
Capital market debt financing (Note 8)	(4,540)	(4,479)	(3,566)	(3,522)
	$ (7,110)	$ (6,568)	$ (5,709)	$ (5,307)
NET INVESTMENTS	$ 68,167	$ 56,539	$ 55,513	$ 49,822

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Public Markets

Public markets consist of Canadian and foreign investments in the following securities: common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds units, pooled funds units, 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 using unit values obtained from each of the funds' administrators, which are derived from the fair value of the underlying investments in each pooled fund. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

(ii) Private Markets

Private markets consist of investments in real estate, private equity, infrastructure and renewable resources.

Real estate investments are comprised of direct equity positions in various private entities, fund investments, as well as properties in the real estate sector. Real estate investments focus on partnerships, companies and properties operating mainly in the retirement and residential, office, retail and industrial sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of real estate contracted by direct investments controlled by PSP Investments for the Plan Account was $2,945 million (2013 – $2,623 million).

Private equity investments are comprised of fund investments with similar objectives, co-investments in private entities as well as direct equity positions.

Infrastructure investments are comprised of direct equity positions, fund investments and co-investments in various private entities. Infrastructure investments focus on entities engaged in the management, ownership or operation of assets in energy, transportation and other regulated businesses. Infrastructure investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSP Investments for the Plan Account was $1,196 million (2013 – $202 million).

Renewable resources investments are comprised of direct investments in properties involved in the production and harvesting of timber and farmland.

Valuation Techniques

The fair value of private markets 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 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 discount rates, capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

For direct investments in private equity, direct investments and co-investments in infrastructure and in renewable resources, 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.

In the case of private equity, real estate and 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.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Fixed Income

Fixed income consists of cash and money market securities, government and corporate bonds, inflation-linked bonds and other fixed income securities.

Cash and money market securities include instruments having a maximum term to maturity of one year, such as treasury bills, certificates of deposit and bankers' acceptances.

Government and corporate bonds include Canadian and foreign, federal, provincial, territorial and municipal bonds. Inflation-linked bonds are fixed income securities that earn inflation adjusted returns.

Other fixed income securities consist of asset-backed securities, floating rate notes as well as private debt portfolios.

Asset-backed securities consist mainly of asset-backed term notes (ABTNs) and mortgage-backed securities. 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. Potential margin calls on the ABTNs are supported by funding facilities, as described in Note 10.

Private debt portfolios consist mainly of investments in the real estate sector in the form of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, as well as other structured finance products. They also include real estate debt funds where significant portions of the value are attributed to the underlying real estate assets.

Private debt portfolios also include debt securities of private companies or other entities such as venture capital organizations, held mainly through private funds. Such debt securities take the form of senior debt, mezzanine and distressed debt.

Valuation Techniques

Cash and money market securities include short-term instruments that are recorded at cost plus accrued interest, which approximates fair value.

Fair values of government and corporate bonds, inflation-linked bonds, floating rate notes and mortgage-backed securities are based on prices obtained from third-party pricing sources. Such prices 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 whereby management relies on the valuation work performed by a recognized third-party expert. Management ensures that the valuation conducted by such expert uses acceptable industry methods. Financial information used in the valuation of ABTNs includes interest rates, credit spreads and the underlying investments' terms to maturity. In addition to the values determined by the expert, management integrated certain assumptions in the fair value of ABTNs that are not fully supported by market observable data, such as liquidity estimates and the impact of the funding facilities described in Note 10.

The fair value of private debt portfolios in the real estate sector is obtained from third-party appraisers and 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.

The fair value of fund investments included as part of private debt portfolios is determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

(iv) Alternative Investments

Alternative investments consist mainly of units of funds that hold a mix of equity, fixed income and derivative instruments as well as hedge funds.

Valuation Techniques

The fair value of these investments is obtained from each of the funds' administrators and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(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 and Dividends Receivable

Interest and dividends are recorded at the amounts expected to be received as at the reporting date, which approximates fair value.

(vii) Interest Payable

Interest is accrued at the amount expected to be paid as at the reporting date, which approximates fair value.

(viii) Securities Sold Short

Securities sold short reflect PSP Investments' obligation to purchase securities pursuant to short selling transactions. In such transactions, PSP Investments sells securities it does not own with an obligation to purchase 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 within public markets and fixed income.

(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 at a 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 approximates fair value.

(x) Derivative-Related Receivables and Payables

The description and valuation of derivative-related receivables and payables are described in Note 3 (B).

(xi) Capital Market Debt Financing

PSP Investments' capital market debt program is described in Note 8. Short-term promissory notes are recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' medium-term notes is based on prices that are obtained from third-party pricing sources. Such prices are determined using an interest rate curve with a spread consistent with PSP Investments' credit quality.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date. The value of such instruments is derived from changes in the value of the 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. Derivative financial instruments can be listed or traded OTC. OTC instruments consist of those that are bilaterally negotiated and settled, and those that are cleared (OTC-cleared) by a central clearing party (CCP).

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.

(ii) Futures

Futures are standardized contracts to take or make delivery of an asset (buy or sell) at a predefined price and predefined future date. 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 at a predefined date in the future. Forwards are used to adjust exposures to specified assets without directly purchasing or selling the underlying assets.

(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

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-cleared derivatives are recorded at fair value using prices obtained from the CCP. 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 collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behavior of the default correlation. Such assumptions are not observable in the market.

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, 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:

	2014				2013			
		Fair Value				Fair Value		
($ millions)	Notional Value	Assets	Liabilities	Net	Notional Value	Assets	Liabilities	Net
Equity and commodity derivatives								
Futures	$ 1,019	$ –	$ –	$ –	$ 616	$ –	$ –	$ –
Total return swaps	9,858	155	(16)	139	7,240	121	(36)	85
Warrants and rights	4	4	–	4	2	–	–	–
Options:								
Listed-purchased	501	14	–	14	1,872	20	–	20
Listed-written	301	–	(13)	(13)	730	–	(11)	(11)
OTC-purchased	3,990	224	–	224	916	119	–	119
OTC-written	4,430	–	(256)	(256)	901	–	(106)	(106)
Currency derivatives								
Forwards	22,549	110	(328)	(218)	24,986	249	(243)	6
Futures	51	–	–	–	31	–	–	–
Swaps	2,584	7	(91)	(84)	774	17	(21)	(4)
Options:								
OTC-purchased	2,924	24	–	24	3,789	57	–	57
OTC-written	2,549	–	(12)	(12)	3,534	–	(49)	(49)
Interest rate derivatives								
Bond forwards	510	–	–	–	617	4	(5)	(1)
Futures	1,768	–	–	–	969	–	–	–
Interest rate swaps:								
OTC	8,620	29	(63)	(34)	8,425	17	(29)	(12)
OTC-cleared	6,087	–	–	–	–	–	–	–
Total return swaps	–	–	–	–	2	–	–	–
Swaptions	22,942	60	(51)	9	2,048	6	(4)	2
Options:								
Listed-purchased	19,255	13	–	13	3,683	3	–	3
Listed-written	20,193	–	(6)	(6)	3,619	–	(2)	(2)
OTC-purchased	7,389	11	–	11	1,283	7	–	7
OTC-written	10,937	–	(11)	(11)	2,028	–	(7)	(7)
Credit derivatives [1]								
OTC-purchased	1,552	1	(33)	(32)	1,395	12	(12)	–
OTC-sold	399	3	(1)	2	681	3	(10)	(7)
OTC-cleared-purchased	619	–	–	–	–	–	–	–
OTC-cleared-sold	934	–	–	–	–	–	–	–
Total	$ 151,965	$ 655	$ (881)	$ (226)	$ 70,141	$ 635	$ (535)	$ 100

[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.

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, 2014:

($ millions)

Less than 3 months	**$ 67,555**
3 to 12 months	**56,357**
Over 1 year	**28,053**
Total	**$151,965**

(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 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.

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, 2014:

($ millions)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 6,152	$ 479	$ –	$ –	$ 6,631
Foreign equity	17,063	3,103	–	–	20,166
Private markets					
Real estate	–	–	9,292	–	9,292
Private equity	–	–	5,874	–	5,874
Infrastructure	–	–	4,752	–	4,752
Renewable resources	–	–	862	–	862
Fixed income					
Cash and money market securities	590	2,222	–	–	2,812
Government and corporate bonds	–	12,421	–	–	12,421
Inflation-linked bonds	–	3,630	–	–	3,630
Other fixed income securities	–	2,228	3,010	–	5,238
Alternative investments	–	818	1,373	–	2,191
	$ 23,805	$ 24,901	$ 25,163	$ –	$ 73,869
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 534	$ 534
Interest receivable	–	–	–	159	159
Dividends receivable	–	–	–	60	60
Derivative-related receivables	31	624	–	–	655
	$ 31	$ 624	$ –	$ 753	$ 1,408
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (689)	$ (689)
Interest payable	–	–	–	(20)	(20)
Securities sold short	(520)	–	–	–	(520)
Securities sold under repurchase agreements	–	(460)	–	–	(460)
Derivative-related payables	(19)	(862)	–	–	(881)
Capital market debt financing	–	(4,540)	–	–	(4,540)
	$ (539)	$ (5,862)	$ –	$ (709)	$ (7,110)
NET INVESTMENTS	$ 23,297	$ 19,663	$ 25,163	$ 44	$ 68,167

[1] With respect to the amounts reflected in this column, cost approximates fair value. Consequently, no fair value hierarchy classification is required for such amounts.

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, 2013:

($ millions)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 6,721	$ –	$ –	$ –	$ 6,721
Foreign equity	12,546	2,719	–	–	15,265
Private markets					
Real estate	–	–	7,939	–	7,939
Private equity	–	–	5,115	–	5,115
Infrastructure	–	–	3,248	–	3,248
Renewable resources	–	–	306	–	306
Fixed income					
Cash and money market securities	458	2,168	–	–	2,626
Government and corporate bonds	–	8,169	–	–	8,169
Inflation-linked bonds	–	3,190	–	–	3,190
Other fixed income securities	–	2,476	3,249	–	5,725
Alternative investments	–	644	662	–	1,306
	$ 19,725	$ 19,366	$ 20,519	$ –	$ 59,610
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 817	$ 817
Interest receivable	–	–	–	111	111
Dividends receivable	–	–	–	49	49
Derivative-related receivables	23	611	1	–	635
	$ 23	$ 611	$ 1	$ 977	$ 1,612
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (805)	$ (805)
Interest payable	–	–	–	(18)	(18)
Securities sold short	(341)	–	–	–	(341)
Securities sold under repurchase agreements	–	(444)	–	–	(444)
Derivative-related payables	(13)	(519)	(3)	–	(535)
Capital market debt financing	–	(3,566)	–	–	(3,566)
	$ (354)	$ (4,529)	$ (3)	$ (823)	$ (5,709)
NET INVESTMENTS	$ 19,394	$ 15,448	$ 20,517	$ 154	$ 55,513

[1] With respect to the amounts reflected in this column, cost approximates fair value. Consequently, no fair value hierarchy classification is required for such amounts.

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 year-end.

During the year ended March 31, 2014, listed Canadian equity securities with a fair value of $456 million classified as Level 1 were transferred to a non-listed fund held by PSP Investments. Consequently, the securities were classified as Level 2 as at March 31, 2014 (no significant transfers during the year ended March 31, 2013).

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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, 2014:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains [1]	Transfer out of Level 3	Closing Balance
Private markets	$ 16,608	$ 5,013	$ (3,102)	$ –	$ 547	$ 1,906	$ (192)	$ 20,780
Fixed income	3,249	527	(883)	(211)	223	105	–	3,010
Alternative investments	662	637	(19)	–	1	92	–	1,373
Derivative-related receivables/payables (net)	(2)	5	(7)	–	1	3	–	–
Total	**$ 20,517**	**$ 6,182**	**$ (4,011)**	**$ (211)**	**$ 772**	**$ 2,106**	**$ (192)**	**$ 25,163**

As at March 31, 2013, two private markets investments were classified under Level 3 as their fair values were determined based on significant unobservable inputs. During the year ended March 31, 2014, such investments were transferred to Level 2 as the underlying investees indirectly held by PSP Investments became publicly traded. In the case of one of the two private markets investments, the instruments held by PSP Investments are subject to restrictions as at March 31, 2014 and may only be resold upon registration.

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, 2013:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Public markets	$ 123	$ 1	$ (5)	$ –	$ 1	$ (11)	$ (109)	$ –
Private markets	13,355	3,520	(1,343)	–	154	922	–	16,608
Fixed income	2,912	987	(855)	(47)	146	106	–	3,249
Alternative investments	222	420	–	–	–	20	–	662
Derivative-related receivables/payables (net)	(7)	5	(7)	–	2	5	–	(2)
Total	$ 16,605	$ 4,933	$ (2,210)	$ (47)	$ 303	$ 1,042	$ (109)	$ 20,517

[1] Includes Plan Account allocation adjustments.

As at March 31, 2012, an investment in a non-listed fund that held listed securities was classified under Level 3 due to the nature of the contractual restrictions on the redemption of the fund units. During the year ended March 31, 2013, the listed securities held by the fund were transferred to PSP Investments and were classified as Level 1 as at March 31, 2013.

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 7% increase and 5% decrease (2013 – 4% increase and 4% decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios and fund investments of $9,542 million allocated to the Plan Account (2013 – $7,416 million), where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of 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 private debt portfolios, the fair value is obtained from third-party appraisers as described in Note 3 (A).

(D) SECURITIES LENDING AND 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, 2014, PSP Investments, on behalf of the Plan Account, has re-invested $1,754 million of collateral held (2013 – $1,615 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)	2014	2013
Securities lending		
Securities lent	$ 6,998	$ 5,389
Collateral held [1]	7,449	5,676
Securities borrowing		
Securities borrowed	520	341
Collateral pledged [2]	545	343

[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.

(E) SECURITIES SOLD AND 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 relevant 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 relevant 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 $459 million as at March 31, 2014 (2013 – $444 million).

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 reporting 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 Statement of Investment Policies, Standards and Procedures (SIP&P). The objective of this policy is to provide a framework to manage the investment risks that PSP Investments is exposed to, namely market, credit and liquidity risks.

(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 funding risk. Funding risk is the risk that the assets under management will be insufficient to meet the relevant pension liabilities of the Plans, which may require the contributions to the Funds of the Plans to be increased. 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. For investments that are not actively traded, the calculation of VaR uses securities with similar risk attributes as a proxy.

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.

	2014	2013
Policy Portfolio VaR	**20.3 %**	20.2 %
Active VaR	**2.8**	2.6
Total VaR (undiversified)	**23.1**	22.8
Diversification effect	**(0.1)**	(1.3)
Total VaR	**23.0 %**	21.5 %

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 terms to maturity of the investments with the most significant exposure to interest rate risk were as follows as at March 31, 2014:

($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Other	Total
Government bonds	$ 1,295	$ 3,885	$ 1,319	$ 1,937	$ –	$ 8,436
Corporate bonds	486	2,205	1,021	273	–	3,985
Inflation-linked bonds	2	887	1,017	1,724	–	3,630
Asset-backed securities	8	1,173	18	–	–	1,199
Private debt portfolios:						
Directly held	127	352	–	–	–	479
Held through funds [1]	–	–	–	–	1,429	1,429
Total investments with significant exposure to interest rate risk	**$ 1,918**	**$ 8,502**	**$ 3,375**	**$ 3,934**	**$ 1,429**	**$ 19,158**
Other investments [2]	**$ –**	**$ –**	**$ –**	**$ –**	**$ 4,943**	**$ 4,943**
Total fixed income	**$ 1,918**	**$ 8,502**	**$ 3,375**	**$ 3,934**	**$ 6,372**	**$ 24,101**

[1] Due to their nature, information in connection with the terms to maturity of fund investments included in the private debt portfolios is not available.

[2] Consists of $2,812 million in cash and money market securities and $2,131 million in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

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

Alternative investments as well as derivative contracts described in Notes 3(A) (iv) and 3 (B), respectively, are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 4 (A).

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. In October 2013, PSP Investments amended its policy to fully hedge foreign currency investments in government and corporate bonds, inflation-linked bonds, certain other fixed income securities, as well as investments in real estate, infrastructure and renewable resources. PSP Investments' previous policy was to hedge a target of 50% of its foreign currency investments in non-emerging countries. 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:

(in millions of Canadian $)	2014		2013	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 17,882**	**61.0 %**	$ 11,141	53.3 %
Euro	**2,520**	**8.6**	1,875	9.0
British Pound	**1,350**	**4.6**	1,550	7.4
Japanese Yen	**1,143**	**3.9**	833	4.0
Hong Kong Dollar	**953**	**3.3**	754	3.6
Korean Won	**952**	**3.2**	565	2.7
Brazilian Real	**918**	**3.1**	878	4.2
Swiss Franc	**579**	**2.0**	278	1.3
Taiwanese New Dollar	**445**	**1.5**	341	1.6
Australian Dollar	**369**	**1.3**	687	3.3
Indian Rupee	**342**	**1.2**	257	1.2
South African Rand	**285**	**1.0**	221	1.1
Swedish Krona	**192**	**0.6**	53	0.3
Colombian Peso	**178**	**0.6**	127	0.6
Mexican Peso	**153**	**0.5**	177	0.9
Others	**1,049**	**3.6**	1,149	5.5
Total	**$ 29,310**	**100.0 %**	$ 20,886	100.0 %

As at March 31, 2014, PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $8,730 million (US$7,319 million, €188 million, £21 million, R16 million South African Rands, R$206 million Brazilian Reals, $44,745 million Colombian pesos and ₹10,835 million Indian Rupees) for the Plan Account which were not included in the foreign currency exposure table.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

PSP Investments is exposed to credit risk, that is, the risk that the issuer of a debt security or 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 relevant 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.

As at March 31, 2014, the Plan Account's maximum exposure to credit risk amounted to approximately $22 billion (2013 – approximately $17 billion). This amount excludes investments in distressed debt in the amount of approximately $1.2 billion as at March 31, 2014 (2013 – approximately $1 billion). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 3 (D), 3 (E) and 4 (B) and the impact of guarantees and indemnities disclosed in Note 10.

As at March 31, 2014, the Plan Account had a net notional exposure of $40 million (2013 – $87 million) to various tranches of collateralized debt obligations, of which approximately 53% (2013 – approximately 67%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 10, to support potential margin calls on the ABTNs.

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 markets investments.

PSP Investments' concentration of credit risk by credit rating, excluding the items described above and any other credit enhancement, for the Plan Account was as follows as at March 31:

	2014	2013
Investment grade (AAA to BBB–)	**97.4 %**	97.9 %
Below investment grade (BB+ and below)	**1.0**	1.0
Not rated:		
Rated by a single credit rating agency	**0.5**	0.1
Not rated by credit rating agencies	**1.1**	1.0
Total	**100.0 %**	100.0 %

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 requires that counterparties provide adequate collateral and meet its credit rating requirements. PSP Investments frequently monitors the credit rating of its counterparties as determined by recognized credit rating agencies. With respect to derivative contracts, PSP Investments has the ability to terminate all trades with most counterparties whose credit rating is downgraded below its requirements.

For OTC derivatives, 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. In the case of OTC-cleared derivatives, the CCP regulates trading activities between parties under terms that are customary to such transactions.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master Agreement contractually binds counterparties to close-out netting provisions in the case of default by one of the counterparties. 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 under the CSA 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. Similarly, in the case of OTC-cleared derivatives, the CCP requires collateral in cash, high quality debt instruments or securities and is authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments pledged securities with a fair value of $421 million as collateral with respect to derivative contracts at March 31, 2014 (2013 – $53 million), $20 million of which are with respect to OTC-cleared derivatives (2013 – nil). Securities with a fair value of $25 million were received from counterparties as collateral at March 31, 2014 (2013 – $106 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 (D) and 3 (E) 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.

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, 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, bonds and public equities are expected to be highly liquid as they will be invested in securities that are actively traded. Management utilizes appropriate measures and controls to monitor liquidity risk in order to ensure that there is sufficient liquidity to meet financial obligations as they come due. A liquidity report taking into consideration future forecasted cash flows is prepared and presented to senior management on a weekly basis. This ensures that sufficient cash reserves are available to meet forecasted cash outflows. Additionally, sufficient sources of liquidity are maintained for deployment in case of market disruption.

PSP Investments has the ability to raise additional capital through the use of its capital market 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 market debt program.

The terms to maturity of the notional amount of derivatives are disclosed in Note 3 (B).

4 INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial instruments, aggregated according to their maturities as at March 31, 2014:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities [1]				
Amounts payable from pending trades	$ (689)	$ –	$ –	$ (689)
Interest payable	(18)	(2)	–	(20)
Securities sold short	(520)	–	–	(520)
Securities sold under repurchase agreements	(460)	–	–	(460)
Capital market debt financing	(2,399)	(576)	(1,565)	(4,540)
Accounts payable and other liabilities	(74)	–	(36)	(110)
Total	$ (4,160)	$ (578)	$ (1,601)	$ (6,339)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial instruments				
Derivative-related receivables	$ 301	$ 230	$ 124	$ 655
Derivative-related payables [1]	(339)	(318)	(224)	(881)
Total	$ (38)	$ (88)	$ (100)	$ (226)

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

5 FUND TRANSFERS

PSP Investments received fund transfers from the Government of Canada of $3,535 million for the year ended March 31, 2014 (2013 – $3,258 million) for the Fund, recorded in the Plan Account.

6 INVESTMENT INCOME

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

($ millions)	2014	2013
Interest income	$ 788	$ 585
Dividend income	1,002	858
Interest expense (Note 8)	(72)	(74)
Transaction costs	(69)	(36)
External investment management fees [1]	(22)	(27)
Other (net)	(24)	(13)
	1,603	1,293
Net realized gains [2]	1,767	1,634
Net unrealized gains [3]	5,937	2,304
Investment income	$ 9,307	$ 5,231

[1] Consists of amounts incurred for investments in public markets that are paid directly by PSP Investments. This excludes fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of $40 million for the year ended March 31, 2014 (2013 - $16 million).

This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSP Investments. Such fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, totalled $110 million for the year ended March 31, 2014 (2013 - $92 million).

[2] Includes realized foreign currency losses of $1,098 million for the year ended March 31, 2014 (2013 - realized foreign currency losses of $148 million).

[3] Includes unrealized foreign currency gains of $3,015 million for the year ended March 31, 2014 (2013 - unrealized foreign currency gains of $145 million).

7 EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the plan accounts ("Plan Accounts") for the Plans for which it provides investment services. Under section 4(3) of the Act, the President of the Treasury Board shall determine to which Plan Account these costs will be charged, in consultation with the Minister of National Defence and the Minister of Public Safety. An allocation policy 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:

	2014	2013
Public Service Pension Plan Account	72.9 %	73.0 %
Canadian Forces Pension Plan Account	19.5	19.3
Royal Canadian Mounted Police Pension Plan Account	7.1	7.1
Reserve Force Pension Plan Account	0.5	0.6
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)	2014	2013
Salaries and benefits	$100,062	$ 89,276
Professional and consulting fees	17,472	8,657
Office supplies and equipment	15,576	13,667
Other operating expenses	6,036	5,769
Depreciation of fixed assets	10,012	9,512
Occupancy costs	4,948	4,592
Custodial fees	2,080	2,040
Remuneration earned by Directors	589	559
Travel and related expenses for Directors	162	154
Communication expenses	135	107
Total	$157,072	$134,333

8 CAPITAL MARKET DEBT FINANCING

PSP Investments' capital market debt 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 private market investments. It is unconditionally and irrevocably guaranteed by PSP Investments in accordance with its corporate leverage policy.

The maximum amount authorized by the Board of Directors for the capital market debt program is 10% of the net investments plus all recourse debt outstanding of PSP Investments at the time of commitment to issuance. Under this limit, the short-term promissory note component cannot exceed $3 billion for issuances in Canada and US$3 billion for issuances in the United States.

PSP Investments' capital market debt financing was in compliance with the limits authorized by the Board of Directors during the year ended March 31, 2014.

The following outlines the terms as well as the fair value of the notes issued under the capital market debt program allocated to the Plan Account as at March 31:

	2014		2013	
($ millions)	**Capital amounts payable at maturity**	**Fair Value**	Capital amounts payable at maturity	Fair Value
Short-term Canadian Dollar promissory notes, bearing interest between 0.99% and 1.19% and maturing within 7 and 364 days of issuance (March 31, 2013 – 31 and 191 days)	**$ 1,044**	**$ 1,043**	$ 629	$ 627
Short-term US Dollar promissory notes, bearing interest between 0.11% and 0.30% and maturing within 35 and 365 days of issuance (March 31, 2013 – 29 and 189 days)	**1,678**	**1,677**	740	740
Medium-term notes Series 1, bearing interest of 4.57% per annum and matured on December 9, 2013	**–**	**–**	729	746
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**509**	**523**	510	529
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on February 16, 2015	**254**	**255**	255	256
Medium-term notes Series 4, bearing interest of 2.26% per annum and maturing on February 16, 2017	**655**	**668**	656	668
Medium-term notes Series 5, bearing interest of 3.03% per annum and maturing on October 22, 2020	**364**	**374**	–	–
Total	**$ 4,504**	**$ 4,540**	$ 3,519	$ 3,566

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)	**2014**	2013
Short-term promissory notes	**$ 10,377**	$ 7,761
Medium-term notes	**61,848**	66,139
Total	**$ 72,225**	$ 73,900

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 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 market debt financing and Note 4 (C) provides information on PSP Investments' liquidity.

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

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 indemnities.

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.

PSP Investments unconditionally and irrevocably guarantees all credit facilities, as well as short-term promissory notes and medium-term notes issued by PSP Capital Inc., as described in Note 8.

PSP Capital Inc. provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $705 million has been allocated to the Plan Account. As at March 31, 2014, the margin funding facilities have not been drawn upon since inception.

In certain investment transactions, PSP Investments provided guarantees, indemnifications or issued letters of credit to third parties, the most significant of which are as follows:

As at March 31, 2014, PSP Investments agreed to guarantee and, in some cases, provide indemnification for the performance of certain investees under contractual agreements. The majority of these agreements are borrowing arrangements. In the event a default occurs under such agreements, which is of limited recourse in certain cases, the Plan Account could assume obligations of up to $889 million (2013 – $728 million) plus applicable interest and other related costs. The arrangements mature between January 2014 and September 2028.

Additionally, PSP Investments and its subsidiaries issued letters of credit totalling $82 million as at March 31, 2014 (2013 – $41 million), of which $60 million has been allocated to the Plan Account (2013 – $30 million) in relation to investment transactions.

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, 2014:

($ millions)

Real estate	$ 870
Private equity	2,962
Infrastructure	1,842
Renewable resources	582
Other fixed income securities	1,513
Alternative investments	1,327
Total	**$ 9,096**

CANADIAN FORCES PENSION PLAN ACCOUNT
FINANCIAL STATEMENTS

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, 2014, and the statement of net income from operations and comprehensive income and 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.

Auditor's 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 auditor's 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 auditor considers 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, 2014, 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 the Public Sector Pension Investment Board and its wholly-owned subsidiaries.

Deloitte LLP[1]

[1] CPA auditor, CA, public accountancy permit No. A116129

May 15, 2014
Montréal, Canada

Clyde M. MacLellan, FCPA, FCA
Assistant Auditor General for the Auditor General of Canada

May 15, 2014
Ottawa, Canada

Balance Sheet

As at March 31

($ millions)	2014	2013
ASSETS		
Investments (Note 3 (A))	**$ 19,907**	$ 15,989
Investment-related assets (Note 3 (A))	**379**	432
Other assets	**25**	16
	$ 20,311	$ 16,437
LIABILITIES		
Investment-related liabilities (Note 3 (A))	**$ 1,915**	$ 1,531
Accounts payable and other liabilities	**30**	27
Due to the Public Service Pension Plan Account	**14**	7
	$ 1,959	$ 1,565
NET ASSETS	**$ 18,352**	$ 14,872
Accumulated net income from operations and comprehensive income	**$ 7,124**	$ 4,654
Accumulated fund transfers	**11,228**	10,218
NET ASSETS	**$ 18,352**	$ 14,872

Commitments (Note 11)

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

On behalf of the Board of Directors:

Cheryl Barker
Interim 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)	2014	2013
INVESTMENT INCOME (NOTE 6)	**$ 2,512**	$ 1,414
OPERATING EXPENSES (NOTE 7)	**$ 42**	$ 35
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ 2,470**	$ 1,379

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

Statement of Changes in Net Assets

For the years ended March 31

($ millions)	2014	2013
NET ASSETS, BEGINNING OF YEAR	**$ 14,872**	$ 12,438
Fund transfers (Note 5)	**1,010**	1,055
Net income from operations and comprehensive income	**2,470**	1,379
Increase in net assets for the year	**3,480**	2,434
NET ASSETS, END OF YEAR	**$ 18,352**	$ 14,872

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

Notes to the Financial Statements

For the year ended March 31, 2014

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 pursuant to the *Superannuation Act*s (defined below), for 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 Act*s consist of the Public Service pension plan, the Canadian Forces pension plan (the "Plan"), and the Royal Canadian Mounted Police pension plan, and the pension plan established under the CFSA Regulations is the Reserve Force pension plan. The Plan and the other pension plans are herein referred to collectively as the "Plans".

The fund for which amounts are currently transferred to PSP Investments by the Government of Canada (the "Fund") relates to pension obligations under the Plan for service on or after April 1, 2000 ("Post-2000 Service"). The account managed by PSP Investments for the Fund is herein referred to as the "Plan Account". PSP Investments maintains records of the net contributions for the Fund, as well as the allocation of its investments and the results of its operations for the Fund in the Plan Account.

PSP Investments is responsible for managing amounts that are transferred to it for 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 Plan and the Plan's ability to meet its financial obligations.

Pursuant to the *Canadian Forces Superannuation Act*, the Government of Canada, which administers the Plan and the Fund, may at any time call upon the net assets of PSP Investments allocated to the Fund's Plan Account for amounts required for the purpose of paying benefits under the Plan in respect of Post-2000 Service or for the purpose of reducing any non-permitted surplus in the Fund.

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 for the Fund in respect of Post-2000 Service. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities under the Plan. 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, including those that meet the definition of a subsidiary and those over which PSP Investments exercises significant influence, 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 at the date upon which PSP Investments becomes a party to the associated contractual provisions, and are carried at fair value. Purchases and sales are recorded as of the trade date. Fair value is 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 year-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.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

Valuation techniques are generally applied to investments in real estate, private equity, infrastructure and renewable resources, over-the-counter (OTC) derivatives and certain fixed income securities. 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 the investments are described in Notes 3 (A) and 3 (B).

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 directly attributable to the external management of assets on behalf of PSP Investments. Management fees incurred for investments in private markets and certain private debt portfolios are paid by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment. Management fees are also incurred for certain public markets and alternative investments and 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 classified as dividend income. Private markets distributions from pooled funds, limited partnerships or from direct investments and co-investments are recognized as interest income, dividend income or realized gains (losses) as appropriate. Co-investments are investments in private entities where the investment is made in conjunction with an external manager with whom PSP Investments already has committed and delegated funds. Dividend expense related to securities sold short and securities lending income (net of fees on securities borrowed) are classified as other (net).

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

Amounts received for 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 paragraphs 149(1)*(d)* and 149(1)*(d.2)* of the *Income Tax Act* (Canada), respectively.

USE OF ESTIMATES

In preparing these financial statements, management makes certain estimates and assumptions which can affect the reported values of assets and liabilities. This is principally reflected in the valuation of private markets investments, valuation of certain fixed income securities, related income and expenses as well as note disclosures. Although estimates and assumptions reflect management's best judgment, actual results may differ from these estimates.

2 FUTURE CHANGES IN ACCOUNTING POLICIES

In 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 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, 2014.

In October 2012, the International Accounting Standards Board (IASB) issued "Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)". Such amendments require qualifying investment entities to measure particular subsidiaries at fair value through profit or loss instead of consolidating them. The amendments are effective for annual periods beginning on or after January 1, 2014.

In December 2012, the AcSB approved the incorporation of the above amendments to IFRS into Part I of the *CPA Canada Handbook – Accounting* released by the Chartered Professional Accountants of Canada (CPA Canada). The AcSB also confirmed the previously announced IFRS adoption date for Canadian investment companies applying AcG-18.

The first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015. Consequently, PSP Investments' transition date is April 1, 2013 – the first day of the earliest comparative period required to be presented under IFRS.

Management is at an advanced stage in its analysis of the impact of adopting IFRS on PSP Investments' consolidated financial statements. To date, the impact on PSP Investments' opening consolidated statement of financial position as at April 1, 2013 is not expected to be significant. Other anticipated impacts include presenting a statement of cash flows as well as additional note disclosures.

3 INVESTMENTS

(A) INVESTMENT PORTFOLIO

The investment portfolio is organized according to the nature and common characteristics associated with the investments held. The following table presents the investment portfolio as at March 31:

	2014		2013	
($ millions)	**Fair Value**	**Cost**	Fair Value	Cost
INVESTMENTS				
Public markets				
Canadian equity	**$ 1,787**	**$ 1,494**	$ 1,803	$ 1,718
Foreign equity	**5,435**	**4,112**	4,094	3,605
Private markets				
Real estate	**2,504**	**2,065**	2,130	1,831
Private equity	**1,583**	**1,036**	1,373	1,059
Infrastructure	**1,281**	**1,203**	871	903
Renewable resources	**232**	**204**	82	73
Fixed income				
Cash and money market securities	**758**	**758**	704	704
Government and corporate bonds	**3,348**	**3,250**	2,191	2,148
Inflation-linked bonds	**978**	**822**	855	747
Other fixed income securities	**1,411**	**1,216**	1,536	1,375
Alternative investments	**590**	**506**	350	300
	$ 19,907	**$ 16,666**	$ 15,989	$ 14,463
INVESTMENT-RELATED ASSETS				
Amounts receivable from pending trades	**$ 144**	**$ 144**	$ 219	$ 219
Interest receivable	**43**	**43**	30	30
Dividends receivable	**16**	**16**	13	13
Derivative-related receivables	**176**	**135**	170	55
	$ 379	**$ 338**	$ 432	$ 317
INVESTMENT-RELATED LIABILITIES				
Amounts payable from pending trades	**$ (186)**	**$ (186)**	$ (216)	$ (216)
Interest payable	**(5)**	**(5)**	(4)	(4)
Securities sold short	**(140)**	**(135)**	(92)	(91)
Securities sold under repurchase agreements	**(124)**	**(124)**	(119)	(119)
Derivative-related payables	**(237)**	**(112)**	(143)	(48)
Capital market debt financing (Note 8)	**(1,223)**	**(1,208)**	(957)	(945)
	$ (1,915)	**$ (1,770)**	$ (1,531)	$ (1,423)
NET INVESTMENTS	**$ 18,371**	**$ 15,234**	$ 14,890	$ 13,357

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Public Markets

Public markets consist of Canadian and foreign investments in the following securities: common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds units, pooled funds units, 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 using unit values obtained from each of the funds' administrators, which are derived from the fair value of the underlying investments in each pooled fund. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

(ii) Private Markets

Private markets consist of investments in real estate, private equity, infrastructure and renewable resources.

Real estate investments are comprised of direct equity positions in various private entities, fund investments, as well as properties in the real estate sector. Real estate investments focus on partnerships, companies and properties operating mainly in the retirement and residential, office, retail and industrial sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of real estate contracted by direct investments controlled by PSP Investments for the Plan Account was $794 million (2013 – $703 million).

Private equity investments are comprised of fund investments with similar objectives, co-investments in private entities as well as direct equity positions.

Infrastructure investments are comprised of direct equity positions, fund investments and co-investments in various private entities. Infrastructure investments focus on entities engaged in the management, ownership or operation of assets in energy, transportation and other regulated businesses. Infrastructure investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSP Investments for the Plan Account was $322 million (2013 – $54 million).

Renewable resources investments are comprised of direct investments in properties involved in the production and harvesting of timber and farmland.

Valuation Techniques

The fair value of private markets 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 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 discount rates, capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

For direct investments in private equity, direct investments and co-investments in infrastructure and in renewable resources, 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.

In the case of private equity, real estate and 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.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Fixed Income

Fixed income consists of cash and money market securities, government and corporate bonds, inflation-linked bonds and other fixed income securities.

Cash and money market securities include instruments having a maximum term to maturity of one year, such as treasury bills, certificates of deposit and bankers' acceptances.

Government and corporate bonds include Canadian and foreign, federal, provincial, territorial and municipal bonds. Inflation-linked bonds are fixed income securities that earn inflation adjusted returns.

Other fixed income securities consist of asset-backed securities, floating rate notes as well as private debt portfolios.

Asset-backed securities consist mainly of asset-backed term notes (ABTNs) and mortgage-backed securities. 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. Potential margin calls on the ABTNs are supported by funding facilities, as described in Note 10.

Private debt portfolios consist mainly of investments in the real estate sector in the form of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, as well as other structured finance products. They also include real estate debt funds where significant portions of the value are attributed to the underlying real estate assets.

Private debt portfolios also include debt securities of private companies or other entities such as venture capital organizations, held mainly through private funds. Such debt securities take the form of senior debt, mezzanine and distressed debt.

Valuation Techniques

Cash and money market securities include short-term instruments that are recorded at cost plus accrued interest, which approximates fair value.

Fair values of government and corporate bonds, inflation-linked bonds, floating rate notes and mortgage-backed securities are based on prices obtained from third-party pricing sources. Such prices 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 whereby management relies on the valuation work performed by a recognized third-party expert. Management ensures that the valuation conducted by such expert uses acceptable industry methods. Financial information used in the valuation of ABTNs includes interest rates, credit spreads and the underlying investments' terms to maturity. In addition to the values determined by the expert, management integrated certain assumptions in the fair value of ABTNs that are not fully supported by market observable data, such as liquidity estimates and the impact of the funding facilities described in Note 10.

The fair value of private debt portfolios in the real estate sector is obtained from third-party appraisers and 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.

The fair value of fund investments included as part of private debt portfolios is determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

(iv) Alternative Investments

Alternative investments consist mainly of units of funds that hold a mix of equity, fixed income and derivative instruments as well as hedge funds.

Valuation Techniques

The fair value of these investments is obtained from each of the funds' administrators and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(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 and Dividends Receivable

Interest and dividends are recorded at the amounts expected to be received as at the reporting date, which approximates fair value.

(vii) Interest Payable

Interest is accrued at the amount expected to be paid as at the reporting date, which approximates fair value.

(viii) Securities Sold Short

Securities sold short reflect PSP Investments' obligation to purchase securities pursuant to short selling transactions. In such transactions, PSP Investments sells securities it does not own with an obligation to purchase 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 within public markets and fixed income.

(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 at a 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 approximates fair value.

(x) Derivative-Related Receivables and Payables

The description and valuation of derivative-related receivables and payables are described in Note 3 (B).

(xi) Capital Market Debt Financing

PSP Investments' capital market debt program is described in Note 8. Short-term promissory notes are recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' medium-term notes is based on prices that are obtained from third-party pricing sources. Such prices are determined using an interest rate curve with a spread consistent with PSP Investments' credit quality.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date. The value of such instruments is derived from changes in the value of the 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. Derivative financial instruments can be listed or traded OTC. OTC instruments consist of those that are bilaterally negotiated and settled, and those that are cleared (OTC-cleared) by a central clearing party (CCP).

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.

(ii) Futures

Futures are standardized contracts to take or make delivery of an asset (buy or sell) at a predefined price and predefined future date. 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 at a predefined date in the future. Forwards are used to adjust exposures to specified assets without directly purchasing or selling the underlying assets.

(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

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-cleared derivatives are recorded at fair value using prices obtained from the CCP. 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 collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behavior of the default correlation. Such assumptions are not observable in the market.

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, 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:

	2014				2013			
		Fair Value				Fair Value		
($ millions)	**Notional Value**	**Assets**	**Liabilities**	**Net**	Notional Value	Assets	Liabilities	Net
Equity and commodity derivatives								
Futures	**$ 275**	**$ –**	**$ –**	**$ –**	$ 166	$ –	$ –	$ –
Total return swaps	**2,657**	**41**	**(4)**	**37**	1,942	32	(10)	22
Warrants and rights	**1**	**1**	**–**	**1**	–	–	–	–
Options:								
Listed-purchased	**135**	**4**	**–**	**4**	502	6	–	6
Listed-written	**81**	**–**	**(3)**	**(3)**	196	–	(3)	(3)
OTC-purchased	**1,075**	**60**	**–**	**60**	245	32	–	32
OTC-written	**1,194**	**–**	**(69)**	**(69)**	242	–	(28)	(28)
Currency derivatives								
Forwards	**6,076**	**30**	**(89)**	**(59)**	6,702	67	(65)	2
Futures	**14**	**–**	**–**	**–**	8	–	–	–
Swaps	**697**	**1**	**(24)**	**(23)**	208	5	(6)	(1)
Options:								
OTC-purchased	**788**	**7**	**–**	**7**	1,016	15	–	15
OTC-written	**687**	**–**	**(3)**	**(3)**	948	–	(13)	(13)
Interest rate derivatives								
Bond forwards	**138**	**–**	**–**	**–**	165	1	(1)	–
Futures	**477**	**–**	**–**	**–**	260	–	–	–
Interest rate swaps:								
OTC	**2,323**	**8**	**(17)**	**(9)**	2,260	4	(7)	(3)
OTC-cleared	**1,640**	**–**	**–**	**–**	–	–	–	–
Swaptions	**6,183**	**16**	**(14)**	**2**	550	1	(1)	–
Options:								
Listed-purchased	**5,189**	**4**	**–**	**4**	988	1	–	1
Listed-written	**5,442**	**–**	**(2)**	**(2)**	971	–	(1)	(1)
OTC-purchased	**1,991**	**3**	**–**	**3**	344	2	–	2
OTC-written	**2,947**	**–**	**(3)**	**(3)**	544	–	(2)	(2)
Credit derivatives [1]								
OTC-purchased	**418**	**–**	**(9)**	**(9)**	374	3	(3)	–
OTC-sold	**107**	**1**	**–**	**1**	182	1	(3)	(2)
OTC-cleared-purchased	**167**	**–**	**–**	**–**	–	–	–	–
OTC-cleared-sold	**252**	**–**	**–**	**–**	–	–	–	–
Total	**$ 40,954**	**$ 176**	**$ (237)**	**$ (61)**	$ 18,813	$ 170	$ (143)	$ 27

[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.

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, 2014:

($ millions)

Less than 3 months	$ 18,206
3 to 12 months	15,188
Over 1 year	7,560
Total	**$ 40,954**

(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 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.

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, 2014:

($ millions)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 1,658	$ 129	$ –	$ –	$ 1,787
Foreign equity	4,598	837	–	–	5,435
Private markets					
Real estate	–	–	2,504	–	2,504
Private equity	–	–	1,583	–	1,583
Infrastructure	–	–	1,281	–	1,281
Renewable resources	–	–	232	–	232
Fixed income					
Cash and money market securities	159	599	–	–	758
Government and corporate bonds	–	3,348	–	–	3,348
Inflation-linked bonds	–	978	–	–	978
Other fixed income securities	–	600	811	–	1,411
Alternative investments	–	220	370	–	590
	$ 6,415	$ 6,711	$ 6,781	$ –	$ 19,907
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 144	$ 144
Interest receivable	–	–	–	43	43
Dividends receivable	–	–	–	16	16
Derivative-related receivables	8	168	–	–	176
	$ 8	$ 168	$ –	$ 203	$ 379
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (186)	$ (186)
Interest payable	–	–	–	(5)	(5)
Securities sold short	(140)	–	–	–	(140)
Securities sold under repurchase agreements	–	(124)	–	–	(124)
Derivative-related payables	(5)	(232)	–	–	(237)
Capital market debt financing	–	(1,223)	–	–	(1,223)
	$ (145)	$ (1,579)	$ –	$ (191)	$ (1,915)
NET INVESTMENTS	$ 6,278	$ 5,300	$ 6,781	$ 12	$ 18,371

[1] With respect to the amounts reflected in this column, cost approximates fair value. Consequently, no fair value hierarchy classification is required for such amounts.

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, 2013:

($ millions)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 1,803	$ –	$ –	$ –	$ 1,803
Foreign equity	3,364	730	–	–	4,094
Private markets					
Real estate	–	–	2,130	–	2,130
Private equity	–	–	1,373	–	1,373
Infrastructure	–	–	871	–	871
Renewable resources	–	–	82	–	82
Fixed income					
Cash and money market securities	123	581	–	–	704
Government and corporate bonds	–	2,191	–	–	2,191
Inflation-linked bonds	–	855	–	–	855
Other fixed income securities	–	665	871	–	1,536
Alternative investments	–	173	177	–	350
	$ 5,290	$ 5,195	$ 5,504	$ –	$ 15,989
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 219	$ 219
Interest receivable	–	–	–	30	30
Dividends receivable	–	–	–	13	13
Derivative-related receivables	6	164	–	–	170
	$ 6	$ 164	$ –	$ 262	$ 432
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (216)	$ (216)
Interest payable	–	–	–	(4)	(4)
Securities sold short	(92)	–	–	–	(92)
Securities sold under repurchase agreements	–	(119)	–	–	(119)
Derivative-related payables	(3)	(139)	(1)	–	(143)
Capital market debt financing	–	(957)	–	–	(957)
	$ (95)	$ (1,215)	$ (1)	$ (220)	$ (1,531)
NET INVESTMENTS	$ 5,201	$ 4,144	$ 5,503	$ 42	$ 14,890

[1] With respect to the amounts reflected in this column, cost approximates fair value. Consequently, no fair value hierarchy classification is required for such amounts.

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 year-end.

During the year ended March 31, 2014, listed Canadian equity securities with a fair value of $123 million classified as Level 1 were transferred to a non-listed fund held by PSP Investments. Consequently, the securities were classified as Level 2 as at March 31, 2014 (no significant transfers during the year ended March 31, 2013).

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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, 2014:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains [1]	Transfer out of Level 3	Closing Balance
Private markets	$ 4,456	$ 1,350	$ (837)	$ –	$ 147	$ 536	$ (52)	$ 5,600
Fixed income	871	142	(238)	(55)	60	31	–	811
Alternative investments	177	172	(5)	–	–	26	–	370
Derivative-related receivables/payables (net)	(1)	2	(2)	–	–	1	–	–
Total	$ 5,503	$ 1,666	$ (1,082)	$ (55)	$ 207	$ 594	$ (52)	$ 6,781

As at March 31, 2013, two private markets investments were classified under Level 3 as their fair values were determined based on significant unobservable inputs. During the year ended March 31, 2014, such investments were transferred to Level 2 as the underlying investees indirectly held by PSP Investments became publicly traded. In the case of one of the two private markets investments, the instruments held by PSP Investments are subject to restrictions as at March 31, 2014 and may only be resold upon registration.

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, 2013:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Public markets	$ 32	$ –	$ (1)	$ –	$ –	$ (2)	$ (29)	$ –
Private markets	3,527	947	(361)	–	42	301	–	4,456
Fixed income	770	265	(230)	(13)	39	40	–	871
Alternative investments	59	112	–	–	–	6	–	177
Derivative-related receivables/payables (net)	(2)	2	(2)	–	–	1	–	(1)
Total	$ 4,386	$ 1,326	$ (594)	$ (13)	$ 81	$ 346	$ (29)	$ 5,503

[1] Includes Plan Account allocation adjustments.

As at March 31, 2012, an investment in a non-listed fund that held listed securities was classified under Level 3 due to the nature of the contractual restrictions on the redemption of the fund units. During the year ended March 31, 2013, the listed securities held by the fund were transferred to PSP Investments and were classified as Level 1 as at March 31, 2013.

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 7% increase and 5% decrease (2013 – 4% increase and 4% decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios and fund investments of $2,571 million allocated to the Plan Account (2013 – $1,989 million), where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of 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 private debt portfolios, the fair value is obtained from third-party appraisers as described in Note 3 (A).

(D) SECURITIES LENDING AND 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, 2014, PSP Investments, on behalf of the Plan Account, has re-invested $473 million of collateral held (2013 – $433 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)	2014	2013
Securities lending		
Securities lent	$ 1,886	$ 1,445
Collateral held[1]	2,007	1,522
Securities borrowing		
Securities borrowed	140	92
Collateral pledged[2]	147	92

[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.

(E) SECURITIES SOLD AND 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 relevant 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 relevant 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 $124 million as at March 31, 2014 (2013 – $119 million).

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 reporting 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 Statement of Investment Policies, Standards and Procedures (SIP&P). The objective of this policy is to provide a framework to manage the investment risks that PSP Investments is exposed to, namely market, credit and liquidity risks.

(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 funding risk. Funding risk is the risk that the assets under management will be insufficient to meet the relevant pension liabilities of the Plans, which may require the contributions to the Funds of the Plans to be increased. 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. For investments that are not actively traded, the calculation of VaR uses securities with similar risk attributes as a proxy.

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.

	2014	2013
Policy Portfolio VaR	**20.3 %**	20.2 %
Active VaR	**2.8**	2.6
Total VaR (undiversified)	**23.1**	22.8
Diversification effect	**(0.1)**	(1.3)
Total VaR	**23.0 %**	21.5 %

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 terms to maturity of the investments with the most significant exposure to interest rate risk were as follows as at March 31, 2014:

($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Other	Total
Government bonds	$ 349	$ 1,047	$ 355	$ 522	$ –	$ 2,273
Corporate bonds	131	594	276	74	–	1,075
Inflation-linked bonds	1	239	274	464	–	978
Asset-backed securities	2	316	5	–	–	323
Private debt portfolios:						
Directly held	34	95	–	–	–	129
Held through funds [1]	–	–	–	–	385	385
Total investments with significant exposure to interest rate risk	$ 517	$ 2,291	$ 910	$ 1,060	$ 385	$ 5,163
Other investments [2]	$ –	$ –	$ –	$ –	$ 1,332	$ 1,332
Total fixed income	$ 517	$ 2,291	$ 910	$ 1,060	$ 1,717	$ 6,495

[1] Due to their nature, information in connection with the terms to maturity of fund investments included in the private debt portfolios is not available.

[2] Consists of $758 million in cash and money market securities and $574 million in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

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

Alternative investments as well as derivative contracts described in Notes 3(A) (iv) and 3 (B), respectively, are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 4 (A).

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. In October 2013, PSP Investments amended its policy to fully hedge foreign currency investments in government and corporate bonds, inflation-linked bonds, certain other fixed income securities, as well as investments in real estate, infrastructure and renewable resources. PSP Investments' previous policy was to hedge a target of 50% of its foreign currency investments in non-emerging countries. 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:

(in millions of Canadian $)	2014		2013	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	$ 4,819	61.0 %	$ 2,988	53.3 %
Euro	679	8.6	503	9.0
British Pound	364	4.6	416	7.4
Japanese Yen	308	3.9	223	4.0
Hong Kong Dollar	257	3.3	202	3.6
Korean Won	256	3.2	151	2.7
Brazilian Real	248	3.1	236	4.2
Swiss Franc	156	2.0	75	1.3
Taiwanese New Dollar	120	1.5	92	1.6
Australian Dollar	99	1.3	184	3.3
Indian Rupee	92	1.2	69	1.2
South African Rand	77	1.0	59	1.1
Swedish Krona	52	0.6	14	0.3
Colombian Peso	48	0.6	34	0.6
Mexican Peso	42	0.5	47	0.9
Others	282	3.6	309	5.5
Total	**$ 7,899**	**100.0 %**	$ 5,602	100.0 %

As at March 31, 2014, PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $2,353 million (US$1,972 million, €51 million, £6 million, R4 million South African Rands, R$56 million Brazilian Reals, $12,058 million Colombian pesos and ₹2,920 million Indian Rupees) for the Plan Account which were not included in the foreign currency exposure table.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

PSP Investments is exposed to credit risk, that is, the risk that the issuer of a debt security or 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 relevant 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.

As at March 31, 2014, the Plan Account's maximum exposure to credit risk amounted to approximately $6 billion (2013 – approximately $5 billion). This amount excludes investments in distressed debt in the amount of approximately $0.3 billion as at March 31, 2014 (2013 – approximately $0.3 billion). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 3 (D), 3 (E) and 4 (B) and the impact of guarantees and indemnities disclosed in Note 10.

As at March 31, 2014, the Plan Account had a net notional exposure of $11 million (2013 – $24 million) to various tranches of collateralized debt obligations, of which approximately 53% (2013 – approximately 67%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 10, to support potential margin calls on the ABTNs.

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 markets investments.

PSP Investments' concentration of credit risk by credit rating, excluding the items described above and any other credit enhancement, for the Plan Account was as follows as at March 31:

	2014	2013
Investment grade (AAA to BBB–)	**97.4 %**	97.9 %
Below investment grade (BB+ and below)	**1.0**	1.0
Not rated:		
Rated by a single credit rating agency	**0.5**	0.1
Not rated by credit rating agencies	**1.1**	1.0
Total	**100.0 %**	100.0 %

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 requires that counterparties provide adequate collateral and meet its credit rating requirements. PSP Investments frequently monitors the credit rating of its counterparties as determined by recognized credit rating agencies. With respect to derivative contracts, PSP Investments has the ability to terminate all trades with most counterparties whose credit rating is downgraded below its requirements.

For OTC derivatives, 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. In the case of OTC-cleared derivatives, the CCP regulates trading activities between parties under terms that are customary to such transactions.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master Agreement contractually binds counterparties to close-out netting provisions in the case of default by one of the counterparties. 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 under the CSA 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. Similarly, in the case of OTC-cleared derivatives, the CCP requires collateral in cash, high quality debt instruments or securities and is authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments pledged securities with a fair value of $113 million as collateral with respect to derivative contracts at March 31, 2014 (2013 – $14 million), $5 million of which are with respect to OTC-cleared derivatives (2013 – nil). Securities with a fair value of $7 million were received from counterparties as collateral at March 31, 2014 (2013 – $28 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 (D) and 3 (E) 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.

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, 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, bonds and public equities are expected to be highly liquid as they will be invested in securities that are actively traded. Management utilizes appropriate measures and controls to monitor liquidity risk in order to ensure that there is sufficient liquidity to meet financial obligations as they come due. A liquidity report taking into consideration future forecasted cash flows is prepared and presented to senior management on a weekly basis. This ensures that sufficient cash reserves are available to meet forecasted cash outflows. Additionally, sufficient sources of liquidity are maintained for deployment in case of market disruption.

PSP Investments has the ability to raise additional capital through the use of its capital market 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 market debt program.

The terms to maturity of the notional amount of derivatives are disclosed in Note 3 (B).

4 INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial instruments, aggregated according to their maturities as at March 31, 2014:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities [1]				
Amounts payable from pending trades	$ (186)	$ –	$ –	$ (186)
Interest payable	(5)	–	–	(5)
Securities sold short	(140)	–	–	(140)
Securities sold under repurchase agreements	(124)	–	–	(124)
Capital market debt financing	(647)	(155)	(421)	(1,223)
Accounts payable and other liabilities	(20)	–	(10)	(30)
Total	$ (1,122)	$ (155)	$ (431)	$ (1,708)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial instruments				
Derivative-related receivables	$ 81	$ 62	$ 33	$ 176
Derivative-related payables [1]	(91)	(85)	(61)	(237)
Total	$ (10)	$ (23)	$ (28)	$ (61)

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

5 FUND TRANSFERS

PSP Investments received fund transfers from the Government of Canada of $1,010 million for the year ended March 31, 2014 (2013 – $1,055 million) for the Fund, recorded in the Plan Account.

6 INVESTMENT INCOME

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

($ millions)	2014	2013
Interest income	$ 213	$ 157
Dividend income	270	231
Interest expense (Note 8)	(20)	(20)
Transaction costs	(19)	(10)
External investment management fees [1]	(6)	(7)
Other (net)	(6)	(4)
	432	347
Net realized gains [2]	476	440
Net unrealized gains [3]	1,604	627
Investment income	**$ 2,512**	$ 1,414

[1] Consists of amounts incurred for investments in public markets that are paid directly by PSP Investments. This excludes fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of $11 million for the year ended March 31, 2014 (2013 – $4 million).

This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSP Investments. Such fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, totalled $29 million for the year ended March 31, 2014 (2013 – $25 million).

[2] Includes realized foreign currency losses of $296 million for the year ended March 31, 2014 (2013 – realized foreign currency losses of $40 million).

[3] Includes unrealized foreign currency gains of $816 million for the year ended March 31, 2014 (2013 – unrealized foreign currency gains of $40 million).

7 EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the plan accounts ("Plan Accounts") for the Plans for which it provides investment services. Under section 4(3) of the Act, the President of the Treasury Board shall determine to which Plan Account these costs will be charged, in consultation with the Minister of National Defence and the Minister of Public Safety. An allocation policy 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:

	2014	2013
Public Service Pension Plan Account	72.9 %	73.0 %
Canadian Forces Pension Plan Account	19.5	19.3
Royal Canadian Mounted Police Pension Plan Account	7.1	7.1
Reserve Force Pension Plan Account	0.5	0.6
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)	2014	2013
Salaries and benefits	$ 26,831	$ 23,580
Professional and consulting fees	4,685	2,287
Office supplies and equipment	4,177	3,610
Other operating expenses	1,623	1,524
Depreciation of fixed assets	2,685	2,512
Occupancy costs	1,327	1,213
Custodial fees	557	549
Remuneration earned by Directors	158	148
Travel and related expenses for Directors	44	40
Communication expenses	36	28
Total	**$ 42,123**	$ 35,491

8 CAPITAL MARKET DEBT FINANCING

PSP Investments' capital market debt 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 private market investments. It is unconditionally and irrevocably guaranteed by PSP Investments in accordance with its corporate leverage policy.

The maximum amount authorized by the Board of Directors for the capital market debt program is 10% of the net investments plus all recourse debt outstanding of PSP Investments at the time of commitment to issuance. Under this limit, the short-term promissory note component cannot exceed $3 billion for issuances in Canada and US$3 billion for issuances in the United States.

PSP Investments' capital market debt financing was in compliance with the limits authorized by the Board of Directors during the year ended March 31, 2014.

The following outlines the terms as well as the fair value of the notes issued under the capital market debt program allocated to the Plan Account as at March 31:

	2014		2013	
($ millions)	**Capital amounts payable at maturity**	**Fair Value**	Capital amounts payable at maturity	Fair Value
Short-term Canadian Dollar promissory notes, bearing interest between 0.99% and 1.19% and maturing within 7 and 364 days of issuance (March 31, 2013 – 31 and 191 days)	**$ 282**	**$ 281**	$ 169	$ 168
Short-term US Dollar promissory notes, bearing interest between 0.11% and 0.30% and maturing within 35 and 365 days of issuance (March 31, 2013 – 29 and 189 days)	**452**	**452**	199	199
Medium-term notes Series 1, bearing interest of 4.57% per annum and matured on December 9, 2013	**–**	**–**	195	200
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**137**	**141**	137	142
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on February 16, 2015	**69**	**69**	68	69
Medium-term notes Series 4, bearing interest of 2.26% per annum and maturing on February 16, 2017	**176**	**180**	176	179
Medium-term notes Series 5, bearing interest of 3.03% per annum and maturing on October 22, 2020	**98**	**100**	–	–
Total	**$ 1,214**	**$ 1,223**	$ 944	$ 957

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)	**2014**	2013
Short-term promissory notes	**$ 2,802**	$ 2,089
Medium-term notes	**16,710**	17,809
Total	**$ 19,512**	$ 19,898

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 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 market debt financing and Note 4 (C) provides information on PSP Investments' liquidity.

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

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 indemnities.

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.

PSP Investments unconditionally and irrevocably guarantees all credit facilities, as well as short-term promissory notes and medium-term notes issued by PSP Capital Inc., as described in Note 8.

PSP Capital Inc. provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $190 million has been allocated to the Plan Account. As at March 31, 2014, the margin funding facilities have not been drawn upon since inception.

In certain investment transactions, PSP Investments provided guarantees, indemnifications or issued letters of credit to third parties, the most significant of which are as follows:

As at March 31, 2014, PSP Investments agreed to guarantee and, in some cases, provide indemnification for the performance of certain investees under contractual agreements. The majority of these agreements are borrowing arrangements. In the event a default occurs under such agreements, which is of limited recourse in certain cases, the Plan Account could assume obligations of up to $240 million (2013 – $195 million) plus applicable interest and other related costs. The arrangements mature between January 2014 and September 2028.

Additionally, PSP Investments and its subsidiaries issued letters of credit totalling $82 million as at March 31, 2014 (2013 – $41 million), of which $16 million has been allocated to the Plan Account (2013 – $8 million) in relation to investment transactions.

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, 2014:

($ millions)	
Real estate	$ 234
Private equity	798
Infrastructure	496
Renewable resources	157
Other fixed income securities	408
Alternative investments	358
Total	**$ 2,451**

ROYAL CANADIAN MOUNTED POLICE PENSION PLAN ACCOUNT
FINANCIAL STATEMENTS

Independent Auditors' Report

To the Minister of Public Safety and Emergency Preparedness

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, 2014, and the statement of net income from operations and comprehensive income and 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.

Auditor's 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 auditor's 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 auditor considers 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, 2014, 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 the Public Sector Pension Investment Board and its wholly-owned subsidiaries.

Deloitte LLP[1]

[1] CPA auditor, CA, public accountancy permit No. A116129

May 15, 2014
Montréal, Canada

Clyde M. MacLellan, FCPA, FCA
Assistant Auditor General for the Auditor General of Canada

May 15, 2014
Ottawa, Canada

Balance Sheet

As at March 31

($ millions)	2014	2013
ASSETS		
Investments (Note 3 (A))	**$ 7,289**	$ 5,777
Investment-related assets (Note 3 (A))	**138**	156
Other assets	**10**	6
	$ 7,437	$ 5,939
LIABILITIES		
Investment-related liabilities (Note 3 (A))	**$ 701**	$ 553
Accounts payable and other liabilities	**11**	9
Due to the Public Service Pension Plan Account	**5**	3
	$ 717	$ 565
NET ASSETS	**$ 6,720**	$ 5,374
Accumulated net income from operations and comprehensive income	**$ 2,571**	$ 1,677
Accumulated fund transfers	**4,149**	3,697
NET ASSETS	**$ 6,720**	$ 5,374

Commitments (Note 11)

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

On behalf of the Board of Directors:

Cheryl Barker
Interim 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)	2014	2013
INVESTMENT INCOME (NOTE 6)	**$ 909**	$ 509
OPERATING EXPENSES (NOTE 7)	**$ 15**	$ 13
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ 894**	$ 496

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

Statement of Changes in Net Assets

For the years ended March 31

($ millions)	2014	2013
NET ASSETS, BEGINNING OF YEAR	**$ 5,374**	$ 4,556
Fund transfers (Note 5)	**452**	322
Net income from operations and comprehensive income	**894**	496
Increase in net assets for the year	**1,346**	818
NET ASSETS, END OF YEAR	**$ 6,720**	$ 5,374

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

Notes to the Financial Statements

For the year ended March 31, 2014

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 pursuant to the *Superannuation Act*s (defined below), for 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 Act*s"), and certain regulations under the CFSA (the "CFSA Regulations"). The pension plans established under the *Superannuation Act*s consist of the Public Service pension plan, the Canadian Forces pension plan, and the Royal Canadian Mounted Police pension plan (the "Plan"), and the pension plan established under the CFSA Regulations is the Reserve Force pension plan. The Plan and the other pension plans are herein referred to collectively as the "Plans".

The fund for which amounts are currently transferred to PSP Investments by the Government of Canada (the "Fund") relates to pension obligations under the Plan for service on or after April 1, 2000 ("Post-2000 Service"). The account managed by PSP Investments for the Fund is herein referred to as the "Plan Account". PSP Investments maintains records of the net contributions for the Fund, as well as the allocation of its investments and the results of its operations for the Fund in the Plan Account.

PSP Investments is responsible for managing amounts that are transferred to it for 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 Plan and the Plan's ability to meet its financial obligations.

Pursuant to the *Royal Canadian Mounted Police Superannuation Act*, the Government of Canada, which administers the Plan and the Fund, may at any time call upon the net assets of PSP Investments allocated to the Fund's Plan Account for amounts required for the purpose of paying benefits under the Plan in respect of Post-2000 Service or for the purpose of reducing any non-permitted surplus in the Fund.

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 for the Fund in respect of Post-2000 Service. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities under the Plan. 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, including those that meet the definition of a subsidiary and those over which PSP Investments exercises significant influence, 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 at the date upon which PSP Investments becomes a party to the associated contractual provisions, and are carried at fair value. Purchases and sales are recorded as of the trade date. Fair value is 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 year-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.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

Valuation techniques are generally applied to investments in real estate, private equity, infrastructure and renewable resources, over-the-counter (OTC) derivatives and certain fixed income securities. 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 the investments are described in Notes 3 (A) and 3 (B).

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 directly attributable to the external management of assets on behalf of PSP Investments. Management fees incurred for investments in private markets and certain private debt portfolios are paid by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment. Management fees are also incurred for certain public markets and alternative investments and 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 classified as dividend income. Private markets distributions from pooled funds, limited partnerships or from direct investments and co-investments are recognized as interest income, dividend income or realized gains (losses) as appropriate. Co-investments are investments in private entities where the investment is made in conjunction with an external manager with whom PSP Investments already has committed and delegated funds. Dividend expense related to securities sold short and securities lending income (net of fees on securities borrowed) are classified as other (net).

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

Amounts received for 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 paragraphs 149(1)*(d)* and 149(1)*(d.2)* of the *Income Tax Act* (Canada), respectively.

USE OF ESTIMATES

In preparing these financial statements, management makes certain estimates and assumptions which can affect the reported values of assets and liabilities. This is principally reflected in the valuation of private markets investments, valuation of certain fixed income securities, related income and expenses as well as note disclosures. Although estimates and assumptions reflect management's best judgment, actual results may differ from these estimates.

2 FUTURE CHANGES IN ACCOUNTING POLICIES

In 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 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, 2014.

In October 2012, the International Accounting Standards Board (IASB) issued "Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)". Such amendments require qualifying investment entities to measure particular subsidiaries at fair value through profit or loss instead of consolidating them. The amendments are effective for annual periods beginning on or after January 1, 2014.

In December 2012, the AcSB approved the incorporation of the above amendments to IFRS into Part I of the *CPA Canada Handbook – Accounting* released by the Chartered Professional Accountants of Canada (CPA Canada). The AcSB also confirmed the previously announced IFRS adoption date for Canadian investment companies applying AcG-18.

The first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015. Consequently, PSP Investments' transition date is April 1, 2013 – the first day of the earliest comparative period required to be presented under IFRS.

Management is at an advanced stage in its analysis of the impact of adopting IFRS on PSP Investments' consolidated financial statements. To date, the impact on PSP Investments' opening consolidated statement of financial position as at April 1, 2013 is not expected to be significant. Other anticipated impacts include presenting a statement of cash flows as well as additional note disclosures.

3 INVESTMENTS

(A) INVESTMENT PORTFOLIO

The investment portfolio is organized according to the nature and common characteristics associated with the investments held. The following table presents the investment portfolio as at March 31:

	2014		2013	
($ millions)	**Fair Value**	**Cost**	Fair Value	Cost
INVESTMENTS				
Public markets				
Canadian equity	**$ 655**	**$ 545**	$ 651	$ 616
Foreign equity	**1,989**	**1,510**	1,479	1,300
Private markets				
Real estate	**917**	**759**	769	662
Private equity	**580**	**383**	495	385
Infrastructure	**469**	**441**	315	326
Renewable resources	**85**	**75**	30	27
Fixed income				
Cash and money market securities	**277**	**277**	255	255
Government and corporate bonds	**1,226**	**1,192**	792	778
Inflation-linked bonds	**358**	**302**	309	270
Other fixed income securities	**517**	**445**	555	496
Alternative investments	**216**	**184**	127	106
	$ 7,289	**$ 6,113**	$ 5,777	$ 5,221
INVESTMENT-RELATED ASSETS				
Amounts receivable from pending trades	**$ 52**	**$ 52**	$ 79	$ 79
Interest receivable	**15**	**15**	10	10
Dividends receivable	**6**	**6**	5	5
Derivative-related receivables	**65**	**49**	62	20
	$ 138	**$ 122**	$ 156	$ 114
INVESTMENT-RELATED LIABILITIES				
Amounts payable from pending trades	**$ (68)**	**$ (68)**	$ (77)	$ (77)
Interest payable	**(2)**	**(2)**	(2)	(2)
Securities sold short	**(51)**	**(49)**	(33)	(33)
Securities sold under repurchase agreements	**(45)**	**(46)**	(43)	(43)
Derivative-related payables	**(87)**	**(41)**	(52)	(18)
Capital market debt financing (Note 8)	**(448)**	**(441)**	(346)	(341)
	$ (701)	**$ (647)**	$ (553)	$ (514)
NET INVESTMENTS	**$ 6,726**	**$ 5,588**	$ 5,380	$ 4,821

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Public Markets

Public markets consist of Canadian and foreign investments in the following securities: common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds units, pooled funds units, 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 using unit values obtained from each of the funds' administrators, which are derived from the fair value of the underlying investments in each pooled fund. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

(ii) Private Markets

Private markets consist of investments in real estate, private equity, infrastructure and renewable resources.

Real estate investments are comprised of direct equity positions in various private entities, fund investments, as well as properties in the real estate sector. Real estate investments focus on partnerships, companies and properties operating mainly in the retirement and residential, office, retail and industrial sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of real estate contracted by direct investments controlled by PSP Investments for the Plan Account was $291 million (2013 – $254 million).

Private equity investments are comprised of fund investments with similar objectives, co-investments in private entities as well as direct equity positions.

Infrastructure investments are comprised of direct equity positions, fund investments and co-investments in various private entities. Infrastructure investments focus on entities engaged in the management, ownership or operation of assets in energy, transportation and other regulated businesses. Infrastructure investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSP Investments for the Plan Account was $118 million (2013 – $20 million).

Renewable resources investments are comprised of direct investments in properties involved in the production and harvesting of timber and farmland.

Valuation Techniques

The fair value of private markets 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 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 discount rates, capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

For direct investments in private equity, direct investments and co-investments in infrastructure and in renewable resources, 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.

In the case of private equity, real estate and 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.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Fixed Income

Fixed income consists of cash and money market securities, government and corporate bonds, inflation-linked bonds and other fixed income securities.

Cash and money market securities include instruments having a maximum term to maturity of one year, such as treasury bills, certificates of deposit and bankers' acceptances.

Government and corporate bonds include Canadian and foreign, federal, provincial, territorial and municipal bonds. Inflation-linked bonds are fixed income securities that earn inflation adjusted returns.

Other fixed income securities consist of asset-backed securities, floating rate notes as well as private debt portfolios.

Asset-backed securities consist mainly of asset-backed term notes (ABTNs) and mortgage-backed securities. 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. Potential margin calls on the ABTNs are supported by funding facilities, as described in Note 10.

Private debt portfolios consist mainly of investments in the real estate sector in the form of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, as well as other structured finance products. They also include real estate debt funds where significant portions of the value are attributed to the underlying real estate assets.

Private debt portfolios also include debt securities of private companies or other entities such as venture capital organizations, held mainly through private funds. Such debt securities take the form of senior debt, mezzanine and distressed debt.

Valuation Techniques

Cash and money market securities include short-term instruments that are recorded at cost plus accrued interest, which approximates fair value.

Fair values of government and corporate bonds, inflation-linked bonds, floating rate notes and mortgage-backed securities are based on prices obtained from third-party pricing sources. Such prices 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 whereby management relies on the valuation work performed by a recognized third-party expert. Management ensures that the valuation conducted by such expert uses acceptable industry methods. Financial information used in the valuation of ABTNs includes interest rates, credit spreads and the underlying investments' terms to maturity. In addition to the values determined by the expert, management integrated certain assumptions in the fair value of ABTNs that are not fully supported by market observable data, such as liquidity estimates and the impact of the funding facilities described in Note 10.

The fair value of private debt portfolios in the real estate sector is obtained from third-party appraisers and 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.

The fair value of fund investments included as part of private debt portfolios is determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

(iv) Alternative Investments

Alternative investments consist mainly of units of funds that hold a mix of equity, fixed income and derivative instruments as well as hedge funds.

Valuation Techniques

The fair value of these investments is obtained from each of the funds' administrators and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(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 and Dividends Receivable

Interest and dividends are recorded at the amounts expected to be received as at the reporting date, which approximates fair value.

(vii) Interest Payable

Interest is accrued at the amount expected to be paid as at the reporting date, which approximates fair value.

(viii) Securities Sold Short

Securities sold short reflect PSP Investments' obligation to purchase securities pursuant to short selling transactions. In such transactions, PSP Investments sells securities it does not own with an obligation to purchase 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 within public markets and fixed income.

(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 at a 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 approximates fair value.

(x) Derivative-Related Receivables and Payables

The description and valuation of derivative-related receivables and payables are described in Note 3 (B).

(xi) Capital Market Debt Financing

PSP Investments' capital market debt program is described in Note 8. Short-term promissory notes are recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' medium-term notes is based on prices that are obtained from third-party pricing sources. Such prices are determined using an interest rate curve with a spread consistent with PSP Investments' credit quality.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date. The value of such instruments is derived from changes in the value of the 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. Derivative financial instruments can be listed or traded OTC. OTC instruments consist of those that are bilaterally negotiated and settled, and those that are cleared (OTC-cleared) by a central clearing party (CCP).

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.

(ii) Futures

Futures are standardized contracts to take or make delivery of an asset (buy or sell) at a predefined price and predefined future date. 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 at a predefined date in the future. Forwards are used to adjust exposures to specified assets without directly purchasing or selling the underlying assets.

(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

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-cleared derivatives are recorded at fair value using prices obtained from the CCP. 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 collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behavior of the default correlation. Such assumptions are not observable in the market.

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, 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:

	2014				2013			
		Fair Value				Fair Value		
($ millions)	Notional Value	Assets	Liabilities	Net	Notional Value	Assets	Liabilities	Net
Equity and commodity derivatives								
Futures	$ 100	$ –	$ –	$ –	$ 60	$ –	$ –	$ –
Total return swaps	973	15	(2)	13	701	12	(4)	8
Options:								
Listed-purchased	50	2	–	2	182	2	–	2
Listed-written	30	–	(1)	(1)	71	–	(1)	(1)
OTC-purchased	394	22	–	22	89	12	–	12
OTC-written	437	–	(25)	(25)	87	–	(10)	(10)
Currency derivatives								
Forwards	2,225	12	(33)	(21)	2,422	24	(24)	–
Futures	5	–	–	–	3	–	–	–
Swaps	255	1	(9)	(8)	75	2	(2)	–
Options:								
OTC-purchased	289	2	–	2	367	6	–	6
OTC-written	252	–	(1)	(1)	342	–	(5)	(5)
Interest rate derivatives								
Bond forwards	50	–	–	–	60	–	–	–
Futures	175	–	–	–	94	–	–	–
Interest rate swaps:								
OTC	851	3	(6)	(3)	816	2	(3)	(1)
OTC-cleared	601	–	–	–	–	–	–	–
Swaptions	2,263	6	(5)	1	198	–	–	–
Options:								
Listed-purchased	1,900	1	–	1	357	–	–	–
Listed-written	1,993	–	(1)	(1)	351	–	–	–
OTC-purchased	729	1	–	1	125	1	–	1
OTC-written	1,079	–	(1)	(1)	197	–	(1)	(1)
Credit derivatives [1]								
OTC-purchased	153	–	(3)	(3)	135	1	(1)	–
OTC-sold	39	–	–	–	66	–	(1)	(1)
OTC-cleared-purchased	61	–	–	–	–	–	–	–
OTC-cleared-sold	92	–	–	–	–	–	–	–
Total	$ 14,996	$ 65	$ (87)	$ (22)	$ 6,798	$ 62	$ (52)	$ 10

[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.

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, 2014:

($ millions)

Less than 3 months	$ 6,666
3 to 12 months	5,561
Over 1 year	2,769
Total	**$ 14,996**

(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 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.

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, 2014:

($ millions)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 607	$ 48	$ –	$ –	$ 655
Foreign equity	1,683	306	–	–	1,989
Private markets					
Real estate	–	–	917	–	917
Private equity	–	–	580	–	580
Infrastructure	–	–	469	–	469
Renewable resources	–	–	85	–	85
Fixed income					
Cash and money market securities	58	219	–	–	277
Government and corporate bonds	–	1,226	–	–	1,226
Inflation-linked bonds	–	358	–	–	358
Other fixed income securities	–	220	297	–	517
Alternative investments	–	81	135	–	216
	$ 2,348	$ 2,458	$ 2,483	$ –	$ 7,289
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 52	$ 52
Interest receivable	–	–	–	15	15
Dividends receivable	–	–	–	6	6
Derivative-related receivables	4	61	–	–	65
	$ 4	$ 61	$ –	$ 73	$ 138
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (68)	$ (68)
Interest payable	–	–	–	(2)	(2)
Securities sold short	(51)	–	–	–	(51)
Securities sold under repurchase agreements	–	(45)	–	–	(45)
Derivative-related payables	(2)	(85)	–	–	(87)
Capital market debt financing	–	(448)	–	–	(448)
	$ (53)	$ (578)	$ –	$ (70)	$ (701)
NET INVESTMENTS	$ 2,299	$ 1,941	$ 2,483	$ 3	$ 6,726

[1] With respect to the amounts reflected in this column, cost approximates fair value. Consequently, no fair value hierarchy classification is required for such amounts.

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, 2013:

($ millions)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 651	$ –	$ –	$ –	$ 651
Foreign equity	1,216	263	–	–	1,479
Private markets					
Real estate	–	–	769	–	769
Private equity	–	–	495	–	495
Infrastructure	–	–	315	–	315
Renewable resources	–	–	30	–	30
Fixed income					
Cash and money market securities	45	210	–	–	255
Government and corporate bonds	–	792	–	–	792
Inflation-linked bonds	–	309	–	–	309
Other fixed income securities	–	240	315	–	555
Alternative investments	–	63	64	–	127
	$ 1,912	$ 1,877	$ 1,988	$ –	$ 5,777
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 79	$ 79
Interest receivable	–	–	–	10	10
Dividends receivable	–	–	–	5	5
Derivative-related receivables	2	60	–	–	62
	$ 2	$ 60	$ –	$ 94	$ 156
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (77)	$ (77)
Interest payable	–	–	–	(2)	(2)
Securities sold short	(33)	–	–	–	(33)
Securities sold under repurchase agreements	–	(43)	–	–	(43)
Derivative-related payables	(1)	(51)	–	–	(52)
Capital market debt financing	–	(346)	–	–	(346)
	$ (34)	$ (440)	$ –	$ (79)	$ (553)
NET INVESTMENTS	$ 1,880	$ 1,497	$ 1,988	$ 15	$ 5,380

[1] With respect to the amounts reflected in this column, cost approximates fair value. Consequently, no fair value hierarchy classification is required for such amounts.

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 year-end.

During the year ended March 31, 2014, listed Canadian equity securities with a fair value of $44 million classified as Level 1 were transferred to a non-listed fund held by PSP Investments. Consequently, the securities were classified as Level 2 as at March 31, 2014 (no significant transfers during the year ended March 31, 2013).

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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, 2014:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains [1]	Transfer out of Level 3	Closing Balance
Private markets	$ 1,609	$ 489	$ (302)	$ –	$ 54	$ 220	$ (19)	$ 2,051
Fixed income	315	51	(86)	(20)	21	16	–	297
Alternative investments	64	62	(2)	–	–	11	–	135
Derivative-related receivables/payables (net)	–	1	(1)	–	–	–	–	–
Total	$ 1,988	$ 603	$ (391)	$ (20)	$ 75	$ 247	$ (19)	$ 2,483

As at March 31, 2013, two private markets investments were classified under Level 3 as their fair values were determined based on significant unobservable inputs. During the year ended March 31, 2014, such investments were transferred to Level 2 as the underlying investees indirectly held by PSP Investments became publicly traded. In the case of one of the two private markets investments, the instruments held by PSP Investments are subject to restrictions as at March 31, 2014 and may only be resold upon registration.

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, 2013:

($ millions)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Public markets	$ 12	$ –	$ –	$ –	$ –	$ (1)	$ (11)	$ –
Private markets	1,293	341	(130)	–	15	90	–	1,609
Fixed income	282	96	(83)	(5)	14	11	–	315
Alternative investments	21	41	–	–	–	2	–	64
Derivative-related receivables/payables (net)	(1)	1	(1)	–	–	1	–	–
Total	$ 1,607	$ 479	$ (214)	$ (5)	$ 29	$ 103	$ (11)	$ 1,988

[1] Includes Plan Account allocation adjustments.

As at March 31, 2012, an investment in a non-listed fund that held listed securities was classified under Level 3 due to the nature of the contractual restrictions on the redemption of the fund units. During the year ended March 31, 2013, the listed securities held by the fund were transferred to PSP Investments and were classified as Level 1 as at March 31, 2013.

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 7% increase and 5% decrease (2013 – 4% increase and 4% decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios and fund investments of $942 million allocated to the Plan Account (2013 – $719 million), where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of 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 private debt portfolios, the fair value is obtained from third-party appraisers as described in Note 3 (A).

(D) SECURITIES LENDING AND 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, 2014, PSP Investments, on behalf of the Plan Account, has re-invested $173 million of collateral held (2013 – $157 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)	2014	2013
Securities lending		
Securities lent	$ 690	$ 522
Collateral held[1]	735	550
Securities borrowing		
Securities borrowed	51	33
Collateral pledged[2]	54	33

[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.

(E) SECURITIES SOLD AND 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 relevant 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 relevant 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 $45 million as at March 31, 2014 (2013 – $43 million).

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 reporting 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 Statement of Investment Policies, Standards and Procedures (SIP&P). The objective of this policy is to provide a framework to manage the investment risks that PSP Investments is exposed to, namely market, credit and liquidity risks.

(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 funding risk. Funding risk is the risk that the assets under management will be insufficient to meet the relevant pension liabilities of the Plans, which may require the contributions to the Funds of the Plans to be increased. 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. For investments that are not actively traded, the calculation of VaR uses securities with similar risk attributes as a proxy.

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.

	2014	2013
Policy Portfolio VaR	**20.3 %**	20.2 %
Active VaR	**2.8**	2.6
Total VaR (undiversified)	**23.1**	22.8
Diversification effect	**(0.1)**	(1.3)
Total VaR	**23.0 %**	21.5 %

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 terms to maturity of the investments with the most significant exposure to interest rate risk were as follows as at March 31, 2014:

($ millions)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Other	Total
Government bonds	$ 128	$ 383	$ 130	$ 191	$ –	$ 832
Corporate bonds	48	218	101	27	–	394
Inflation-linked bonds	–	88	100	170	–	358
Asset-backed securities	1	115	2	–	–	118
Private debt portfolios:						
Directly held	13	35	–	–	–	48
Held through funds [1]	–	–	–	–	141	141
Total investments with significant exposure to interest rate risk	**$ 190**	**$ 839**	**$ 333**	**$ 388**	**$ 141**	**$ 1,891**
Other investments [2]	**$ –**	**$ –**	**$ –**	**$ –**	**$ 487**	**$ 487**
Total fixed income	**$ 190**	**$ 839**	**$ 333**	**$ 388**	**$ 628**	**$ 2,378**

[1] Due to their nature, information in connection with the terms to maturity of fund investments included in the private debt portfolios is not available.

[2] Consists of $277 million in cash and money market securities and $210 million in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

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

Alternative investments as well as derivative contracts described in Notes 3(A) (iv) and 3 (B), respectively, are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 4 (A).

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. In October 2013, PSP Investments amended its policy to fully hedge foreign currency investments in government and corporate bonds, inflation-linked bonds, certain other fixed income securities, as well as investments in real estate, infrastructure and renewable resources. PSP Investments' previous policy was to hedge a target of 50% of its foreign currency investments in non-emerging countries. 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:

(in millions of Canadian $)	2014		2013	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 1,765**	**61.0 %**	$ 1,080	53.3 %
Euro	**249**	**8.6**	181	9.0
British Pound	**134**	**4.6**	150	7.4
Japanese Yen	**112**	**3.9**	81	4.0
Hong Kong Dollar	**94**	**3.3**	73	3.6
Korean Won	**93**	**3.2**	55	2.7
Brazilian Real	**91**	**3.1**	85	4.2
Swiss Franc	**57**	**2.0**	27	1.3
Taiwanese New Dollar	**44**	**1.5**	33	1.6
Australian Dollar	**36**	**1.3**	67	3.3
Indian Rupee	**34**	**1.2**	25	1.2
South African Rand	**28**	**1.0**	22	1.1
Swedish Krona	**19**	**0.6**	5	0.3
Colombian Peso	**18**	**0.6**	12	0.6
Mexican Peso	**15**	**0.5**	17	0.9
Others	**103**	**3.6**	112	5.5
Total	**$ 2,892**	**100.0 %**	$ 2,025	100.0 %

As at March 31, 2014, PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $861 million (US$722 million, €19 million, £2 million, R2 million South African Rands, R$20 million Brazilian Reals, $4,415 million Colombian pesos and ₹1,069 million Indian Rupees) for the Plan Account which were not included in the foreign currency exposure table.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

PSP Investments is exposed to credit risk, that is, the risk that the issuer of a debt security or 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 relevant 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.

As at March 31, 2014, the Plan Account's maximum exposure to credit risk amounted to approximately $2 billion (2013 – approximately $2 billion). This amount excludes investments in distressed debt in the amount of approximately $0.1 billion as at March 31, 2014 (2013 – approximately $0.1 billion). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 3 (D), 3 (E) and 4 (B) and the impact of guarantees and indemnities disclosed in Note 10.

As at March 31, 2014, the Plan Account had a net notional exposure of $4 million (2013 – $8 million) to various tranches of collateralized debt obligations, of which approximately 53% (2013 – approximately 67%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 10, to support potential margin calls on the ABTNs.

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 markets investments.

PSP Investments' concentration of credit risk by credit rating, excluding the items described above and any other credit enhancement, for the Plan Account was as follows as at March 31:

	2014	2013
Investment grade (AAA to BBB–)	**97.4 %**	97.9 %
Below investment grade (BB+ and below)	**1.0**	1.0
Not rated:		
Rated by a single credit rating agency	**0.5**	0.1
Not rated by credit rating agencies	**1.1**	1.0
Total	**100.0 %**	100.0 %

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 requires that counterparties provide adequate collateral and meet its credit rating requirements. PSP Investments frequently monitors the credit rating of its counterparties as determined by recognized credit rating agencies. With respect to derivative contracts, PSP Investments has the ability to terminate all trades with most counterparties whose credit rating is downgraded below its requirements.

For OTC derivatives, 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. In the case of OTC-cleared derivatives, the CCP regulates trading activities between parties under terms that are customary to such transactions.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master Agreement contractually binds counterparties to close-out netting provisions in the case of default by one of the counterparties. 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 under the CSA 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. Similarly, in the case of OTC-cleared derivatives, the CCP requires collateral in cash, high quality debt instruments or securities and is authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments pledged securities with a fair value of $42 million as collateral with respect to derivative contracts at March 31, 2014 (2013 – $5 million), $2 million of which are with respect to OTC-cleared derivatives (2013 – nil). Securities with a fair value of $3 million were received from counterparties as collateral at March 31, 2014 (2013 – $10 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 (D) and 3 (E) 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.

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, 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, bonds and public equities are expected to be highly liquid as they will be invested in securities that are actively traded. Management utilizes appropriate measures and controls to monitor liquidity risk in order to ensure that there is sufficient liquidity to meet financial obligations as they come due. A liquidity report taking into consideration future forecasted cash flows is prepared and presented to senior management on a weekly basis. This ensures that sufficient cash reserves are available to meet forecasted cash outflows. Additionally, sufficient sources of liquidity are maintained for deployment in case of market disruption.

PSP Investments has the ability to raise additional capital through the use of its capital market 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 market debt program.

The terms to maturity of the notional amount of derivatives are disclosed in Note 3 (B).

4 INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial instruments, aggregated according to their maturities as at March 31, 2014:

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities [1]				
Amounts payable from pending trades	$ (68)	$ –	$ –	$ (68)
Interest payable	(2)	–	–	(2)
Securities sold short	(51)	–	–	(51)
Securities sold under repurchase agreements	(45)	–	–	(45)
Capital market debt financing	(237)	(57)	(154)	(448)
Accounts payable and other liabilities	(8)	–	(3)	(11)
Total	$ (411)	$ (57)	$ (157)	$ (625)

($ millions)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial instruments				
Derivative-related receivables	$ 30	$ 23	$ 12	$ 65
Derivative-related payables [1]	(33)	(32)	(22)	(87)
Total	$ (3)	$ (9)	$ (10)	$ (22)

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

5 FUND TRANSFERS

PSP Investments received fund transfers from the Government of Canada of $452 million for the year ended March 31, 2014 (2013 – $322 million) for the Fund, recorded in the Plan Account.

6 INVESTMENT INCOME

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

($ millions)	2014	2013
Interest income	$ 76	$ 57
Dividend income	98	83
Interest expense (Note 8)	(7)	(7)
Transaction costs	(6)	(4)
External investment management fees [1]	(2)	(3)
Other (net)	(2)	(1)
	157	125
Net realized gains [2]	173	159
Net unrealized gains [3]	579	225
Investment income	**$ 909**	$ 509

[1] Consists of amounts incurred for investments in public markets that are paid directly by PSP Investments. This excludes fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of $4 million for the year ended March 31, 2014 (2013 – $1 million).

This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSP Investments. Such fees, which generally vary between 0.1% and 2.0% of the total invested and/or committed amount, totalled $11 million for the year ended March 31, 2014 (2013 – $9 million).

[2] Includes realized foreign currency losses of $107 million for the year ended March 31, 2014 (2013 – realized foreign currency losses of $14 million).

[3] Includes unrealized foreign currency gains of $294 million for the year ended March 31, 2014 (2013 – unrealized foreign currency gains of $14 million).

7 EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the plan accounts ("Plan Accounts") for the Plans for which it provides investment services. Under section 4(3) of the Act, the President of the Treasury Board shall determine to which Plan Account these costs will be charged, in consultation with the Minister of National Defence and the Minister of Public Safety. An allocation policy 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:

	2014	2013
Public Service Pension Plan Account	72.9 %	73.0 %
Canadian Forces Pension Plan Account	19.5	19.3
Royal Canadian Mounted Police Pension Plan Account	7.1	7.1
Reserve Force Pension Plan Account	0.5	0.6
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)	2014	2013
Salaries and benefits	$ 9,695	$ 8,638
Professional and consulting fees	1,693	838
Office supplies and equipment	1,509	1,322
Other operating expenses	586	558
Depreciation of fixed assets	970	921
Occupancy costs	479	444
Custodial fees	202	198
Remuneration earned by Directors	57	54
Travel and related expenses for Directors	16	15
Communication expenses	13	10
Total	**$ 15,220**	$ 12,998

8 CAPITAL MARKET DEBT FINANCING

PSP Investments' capital market debt 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 private market investments. It is unconditionally and irrevocably guaranteed by PSP Investments in accordance with its corporate leverage policy.

The maximum amount authorized by the Board of Directors for the capital market debt program is 10% of the net investments plus all recourse debt outstanding of PSP Investments at the time of commitment to issuance. Under this limit, the short-term promissory note component cannot exceed $3 billion for issuances in Canada and US$3 billion for issuances in the United States.

PSP Investments' capital market debt financing was in compliance with the limits authorized by the Board of Directors during the year ended March 31, 2014.

The following outlines the terms as well as the fair value of the notes issued under the capital market debt program allocated to the Plan Account as at March 31:

	2014		2013	
($ millions)	**Capital amounts payable at maturity**	**Fair Value**	Capital amounts payable at maturity	Fair Value
Short-term Canadian Dollar promissory notes, bearing interest between 0.99% and 1.19% and maturing within 7 and 364 days of issuance (March 31, 2013 – 31 and 191 days)	**$ 103**	**$ 103**	$ 61	$ 61
Short-term US Dollar promissory notes, bearing interest between 0.11% and 0.30% and maturing within 35 and 365 days of issuance (March 31, 2013 – 29 and 189 days)	**165**	**166**	72	72
Medium-term notes Series 1, bearing interest of 4.57% per annum and matured on December 9, 2013	**–**	**–**	71	72
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**50**	**51**	49	51
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on February 16, 2015	**25**	**25**	25	25
Medium-term notes Series 4, bearing interest of 2.26% per annum and maturing on February 16, 2017	**65**	**66**	63	65
Medium-term notes Series 5, bearing interest of 3.03% per annum and maturing on October 22, 2020	**36**	**37**	–	–
Total	**$ 444**	**$ 448**	$ 341	$ 346

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)	**2014**	2013
Short-term promissory notes	**$ 1,017**	$ 753
Medium-term notes	**6,050**	6,419
Total	**$ 7,067**	$ 7,172

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 Act*s. 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 Plans established under the *Superannuation Act*s 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 market debt financing and Note 4 (C) provides information on PSP Investments' liquidity.

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

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 indemnities.

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.

PSP Investments unconditionally and irrevocably guarantees all credit facilities, as well as short-term promissory notes and medium-term notes issued by PSP Capital Inc., as described in Note 8.

PSP Capital Inc. provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $69 million has been allocated to the Plan Account. As at March 31, 2014, the margin funding facilities have not been drawn upon since inception.

In certain investment transactions, PSP Investments provided guarantees, indemnifications or issued letters of credit to third parties, the most significant of which are as follows:

As at March 31, 2014, PSP Investments agreed to guarantee and, in some cases, provide indemnification for the performance of certain investees under contractual agreements. The majority of these agreements are borrowing arrangements. In the event a default occurs under such agreements, which is of limited recourse in certain cases, the Plan Account could assume obligations of up to $88 million (2013 – $71 million) plus applicable interest and other related costs. The arrangements mature between January 2014 and September 2028.

Additionally, PSP Investments and its subsidiaries issued letters of credit totalling $82 million as at March 31, 2014 (2013 – $41 million), of which $6 million has been allocated to the Plan Account (2013 – $3 million) in relation to investment transactions.

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, 2014:

($ millions)

Real estate	$ 86
Private equity	292
Infrastructure	182
Renewable resources	57
Other fixed income securities	149
Alternative investments	131
Total	**$ 897**

RESERVE FORCE PENSION PLAN ACCOUNT
FINANCIAL STATEMENTS

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, 2014, and the statement of net income from operations and comprehensive income and 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.

Auditor's 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 auditor's 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 auditor considers 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, 2014, 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 the Public Sector Pension Investment Board and its wholly-owned subsidiaries.

Deloitte LLP[1]

[1] CPA auditor, CA, public accountancy permit No. A116129

May 15, 2014
Montréal, Canada

Clyde M. MacLellan, FCPA, FCA
Assistant Auditor General for the Auditor General of Canada

May 15, 2014
Ottawa, Canada

Balance Sheet

As at March 31

($ thousands)	2014	2013
ASSETS		
Investments (Note 3 (A))	**$504,897**	$431,940
Investment-related assets (Note 3 (A))	**9,616**	11,679
Other assets	**497**	270
	$515,010	$443,889
LIABILITIES		
Investment-related liabilities (Note 3 (A))	**$ 48,589**	$ 41,370
Accounts payable and other liabilities	**645**	572
Due to the Public Service Pension Plan Account	**370**	197
	$ 49,604	$ 42,139
NET ASSETS	**$465,406**	$401,750
Accumulated net income from operations and comprehensive income	**$154,834**	$ 91,178
Accumulated fund transfers	**310,572**	310,572
NET ASSETS	**$465,406**	$401,750

Commitments (Note 11)

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

On behalf of the Board of Directors:

Cheryl Barker
Interim 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

($ thousands)	**2014**	2013
INVESTMENT INCOME (NOTE 6)	**$ 64,798**	$ 38,506
OPERATING EXPENSES (NOTE 7)	**$ 1,142**	$ 1,029
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ 63,656**	$ 37,477

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

Statement of Changes in Net Assets

For the years ended March 31

($ thousands)	**2014**	2013
NET ASSETS, BEGINNING OF YEAR	**$401,750**	$364,273
Fund transfers (Note 5)	**–**	–
Net income from operations and comprehensive income	**63,656**	37,477
Increase in net assets for the year	**63,656**	37,477
NET ASSETS, END OF YEAR	**$465,406**	$401,750

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

Notes to the Financial Statements

For the year ended March 31, 2014

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 pursuant to the *Superannuation Act*s (defined below), for 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 Act*s"), and certain regulations under the CFSA (the "CFSA Regulations"). The pension plans established under the *Superannuation Act*s consist of the Public Service pension plan, the Canadian Forces pension plan, and the Royal Canadian Mounted Police pension plan, and the pension plan established under the CFSA Regulations is the Reserve Force pension plan (the "Plan"). The Plan and the other pension plans are herein referred to collectively as the "Plans".

The fund for which amounts are currently transferred to PSP Investments by the Government of Canada (the "Fund") relates to pension obligations under the Plan for service on or after March 1, 2007 ("Post-2007 Service"). The account managed by PSP Investments for the Fund is herein referred to as the "Plan Account". PSP Investments maintains records of the net contributions for the Fund, as well as the allocation of its investments and the results of its operations for the Fund in the Plan Account.

PSP Investments is responsible for managing amounts that are transferred to it for the Fund in the best interests of the beneficiaries and contributors under the CFSA Regulations. 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 Plan and the Plan's ability to meet its financial obligations.

Pursuant to the CFSA and the CFSA Regulations, the Government of Canada, which administers the Plan and the Fund, may at any time call upon the net assets of PSP Investments allocated to the Fund's Plan Account for amounts required for the purpose of paying benefits under the Plan in respect of Post-2007 Service or for the purpose of reducing any non-permitted surplus in the Fund.

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 for the Fund in respect of Post-2007 Service. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities under the Plan. 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, including those that meet the definition of a subsidiary and those over which PSP Investments exercises significant influence, 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 at the date upon which PSP Investments becomes a party to the associated contractual provisions, and are carried at fair value. Purchases and sales are recorded as of the trade date. Fair value is 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 year-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.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

Valuation techniques are generally applied to investments in real estate, private equity, infrastructure and renewable resources, over-the-counter (OTC) derivatives and certain fixed income securities. 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 the investments are described in Notes 3 (A) and 3 (B).

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 directly attributable to the external management of assets on behalf of PSP Investments. Management fees incurred for investments in private markets and certain private debt portfolios are paid by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment. Management fees are also incurred for certain public markets and alternative investments and 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 classified as dividend income. Private markets distributions from pooled funds, limited partnerships or from direct investments and co-investments are recognized as interest income, dividend income or realized gains (losses) as appropriate. Co-investments are investments in private entities where the investment is made in conjunction with an external manager with whom PSP Investments already has committed and delegated funds. Dividend expense related to securities sold short and securities lending income (net of fees on securities borrowed) are classified as other (net).

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

Amounts received for 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 paragraphs 149(1)*(d)* and 149(1)*(d.2)* of the *Income Tax Act* (Canada), respectively.

USE OF ESTIMATES

In preparing these financial statements, management makes certain estimates and assumptions which can affect the reported values of assets and liabilities. This is principally reflected in the valuation of private markets investments, valuation of certain fixed income securities, related income and expenses as well as note disclosures. Although estimates and assumptions reflect management's best judgment, actual results may differ from these estimates.

2 FUTURE CHANGES IN ACCOUNTING POLICIES

In 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 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, 2014.

In October 2012, the International Accounting Standards Board (IASB) issued "Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)". Such amendments require qualifying investment entities to measure particular subsidiaries at fair value through profit or loss instead of consolidating them. The amendments are effective for annual periods beginning on or after January 1, 2014.

In December 2012, the AcSB approved the incorporation of the above amendments to IFRS into Part I of the *CPA Canada Handbook – Accounting* released by the Chartered Professional Accountants of Canada (CPA Canada). The AcSB also confirmed the previously announced IFRS adoption date for Canadian investment companies applying AcG-18.

The first annual consolidated financial statements of PSP Investments in accordance with IFRS will be for the fiscal year ending March 31, 2015. Consequently, PSP Investments' transition date is April 1, 2013 – the first day of the earliest comparative period required to be presented under IFRS.

Management is at an advanced stage in its analysis of the impact of adopting IFRS on PSP Investments' consolidated financial statements. To date, the impact on PSP Investments' opening consolidated statement of financial position as at April 1, 2013 is not expected to be significant. Other anticipated impacts include presenting a statement of cash flows as well as additional note disclosures.

3 INVESTMENTS

(A) INVESTMENT PORTFOLIO

The investment portfolio is organized according to the nature and common characteristics associated with the investments held. The following table presents the investment portfolio as at March 31:

	2014		2013	
($ thousands)	**Fair Value**	**Cost**	Fair Value	Cost
INVESTMENTS				
Public markets				
Canadian equity	**$ 45,323**	**$ 40,484**	$ 48,701	$ 49,225
Foreign equity	**137,835**	**100,775**	110,611	95,161
Private markets				
Real estate	**63,514**	**55,220**	57,532	52,807
Private equity	**40,149**	**23,959**	37,065	26,950
Infrastructure	**32,480**	**30,807**	23,538	24,626
Renewable resources	**5,890**	**5,149**	2,218	1,984
Fixed income				
Cash and money market securities	**19,219**	**19,219**	19,031	19,031
Government and corporate bonds	**84,904**	**81,854**	59,191	57,501
Inflation-linked bonds	**24,809**	**20,226**	23,108	19,718
Other fixed income securities	**35,801**	**30,834**	41,483	37,129
Alternative investments	**14,973**	**7,562**	9,462	3,123
	$504,897	**$416,089**	$431,940	$387,255
INVESTMENT-RELATED ASSETS				
Amounts receivable from pending trades	**$ 3,648**	**$ 3,648**	$ 5,921	$ 5,921
Interest receivable	**1,085**	**1,085**	805	805
Dividends receivable	**410**	**410**	352	352
Derivative-related receivables	**4,473**	**3,414**	4,601	1,501
	$ 9,616	**$ 8,557**	$ 11,679	$ 8,579
INVESTMENT-RELATED LIABILITIES				
Amounts payable from pending trades	**$ (4,710)**	**$ (4,710)**	$ (5,831)	$ (5,831)
Interest payable	**(133)**	**(133)**	(126)	(126)
Securities sold short	**(3,557)**	**(3,415)**	(2,475)	(2,454)
Securities sold under repurchase agreements	**(3,140)**	**(3,155)**	(3,215)	(3,217)
Derivative-related payables	**(6,019)**	**(2,855)**	(3,878)	(1,303)
Capital market debt financing (Note 8)	**(31,030)**	**(30,626)**	(25,845)	(25,532)
	$ (48,589)	**$ (44,894)**	$ (41,370)	$ (38,463)
NET INVESTMENTS	**$465,924**	**$379,752**	$402,249	$357,371

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Public Markets

Public markets consist of Canadian and foreign investments in the following securities: common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds units, pooled funds units, 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 using unit values obtained from each of the funds' administrators, which are derived from the fair value of the underlying investments in each pooled fund. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

(ii) Private Markets

Private markets consist of investments in real estate, private equity, infrastructure and renewable resources.

Real estate investments are comprised of direct equity positions in various private entities, fund investments, as well as properties in the real estate sector. Real estate investments focus on partnerships, companies and properties operating mainly in the retirement and residential, office, retail and industrial sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of real estate contracted by direct investments controlled by PSP Investments for the Plan Account was $20,133 thousand (2013 – $19,000 thousand).

Private equity investments are comprised of fund investments with similar objectives, co-investments in private entities as well as direct equity positions.

Infrastructure investments are comprised of direct equity positions, fund investments and co-investments in various private entities. Infrastructure investments focus on entities engaged in the management, ownership or operation of assets in energy, transportation and other regulated businesses. Infrastructure investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSP Investments for the Plan Account was $8,175 thousand (2013 – $1,461 thousand).

Renewable resources investments are comprised of direct investments in properties involved in the production and harvesting of timber and farmland.

Valuation Techniques

The fair value of private markets 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 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 discount rates, capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

For direct investments in private equity, direct investments and co-investments in infrastructure and in renewable resources, 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.

In the case of private equity, real estate and 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.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Fixed Income

Fixed income consists of cash and money market securities, government and corporate bonds, inflation-linked bonds and other fixed income securities.

Cash and money market securities include instruments having a maximum term to maturity of one year, such as treasury bills, certificates of deposit and bankers' acceptances.

Government and corporate bonds include Canadian and foreign, federal, provincial, territorial and municipal bonds. Inflation-linked bonds are fixed income securities that earn inflation adjusted returns.

Other fixed income securities consist of asset-backed securities, floating rate notes as well as private debt portfolios.

Asset-backed securities consist mainly of asset-backed term notes (ABTNs) and mortgage-backed securities. 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. Potential margin calls on the ABTNs are supported by funding facilities, as described in Note 10.

Private debt portfolios consist mainly of investments in the real estate sector in the form of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, as well as other structured finance products. They also include real estate debt funds where significant portions of the value are attributed to the underlying real estate assets.

Private debt portfolios also include debt securities of private companies or other entities such as venture capital organizations, held mainly through private funds. Such debt securities take the form of senior debt, mezzanine and distressed debt.

Valuation Techniques

Cash and money market securities include short-term instruments that are recorded at cost plus accrued interest, which approximates fair value.

Fair values of government and corporate bonds, inflation-linked bonds, floating rate notes and mortgage-backed securities are based on prices obtained from third-party pricing sources. Such prices 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 whereby management relies on the valuation work performed by a recognized third-party expert. Management ensures that the valuation conducted by such expert uses acceptable industry methods. Financial information used in the valuation of ABTNs includes interest rates, credit spreads and the underlying investments' terms to maturity. In addition to the values determined by the expert, management integrated certain assumptions in the fair value of ABTNs that are not fully supported by market observable data, such as liquidity estimates and the impact of the funding facilities described in Note 10.

The fair value of private debt portfolios in the real estate sector is obtained from third-party appraisers and 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.

The fair value of fund investments included as part of private debt portfolios is determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

(iv) Alternative Investments

Alternative investments consist mainly of units of funds that hold a mix of equity, fixed income and derivative instruments as well as hedge funds.

Valuation Techniques

The fair value of these investments is obtained from each of the funds' administrators and reflects the fair value of the underlying equity, fixed income or derivative instruments, as applicable. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(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 and Dividends Receivable

Interest and dividends are recorded at the amounts expected to be received as at the reporting date, which approximates fair value.

(vii) Interest Payable

Interest is accrued at the amount expected to be paid as at the reporting date, which approximates fair value.

(viii) Securities Sold Short

Securities sold short reflect PSP Investments' obligation to purchase securities pursuant to short selling transactions. In such transactions, PSP Investments sells securities it does not own with an obligation to purchase 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 within public markets and fixed income.

(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 at a 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 approximates fair value.

(x) Derivative-Related Receivables and Payables

The description and valuation of derivative-related receivables and payables are described in Note 3 (B).

(xi) Capital Market Debt Financing

PSP Investments' capital market debt program is described in Note 8. Short-term promissory notes are recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' medium-term notes is based on prices that are obtained from third-party pricing sources. Such prices are determined using an interest rate curve with a spread consistent with PSP Investments' credit quality.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date. The value of such instruments is derived from changes in the value of the 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. Derivative financial instruments can be listed or traded OTC. OTC instruments consist of those that are bilaterally negotiated and settled, and those that are cleared (OTC-cleared) by a central clearing party (CCP).

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.

(ii) Futures

Futures are standardized contracts to take or make delivery of an asset (buy or sell) at a predefined price and predefined future date. 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 at a predefined date in the future. Forwards are used to adjust exposures to specified assets without directly purchasing or selling the underlying assets.

(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

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-cleared derivatives are recorded at fair value using prices obtained from the CCP. 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 collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behavior of the default correlation. Such assumptions are not observable in the market.

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, 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:

	2014				2013			
		Fair Value				Fair Value		
($ thousands)	**Notional Value**	**Assets**	**Liabilities**	**Net**	Notional Value	Assets	Liabilities	Net
Equity and commodity derivatives								
Futures	**$ 6,964**	**$ –**	**$ –**	**$ –**	$ 4,468	$ –	$ –	$ –
Total return swaps	**67,383**	**1,056**	**(109)**	**947**	52,455	878	(261)	617
Warrants and rights	**27**	**30**	**–**	**30**	11	1	–	1
Options:								
Listed-purchased	**3,423**	**97**	**–**	**97**	13,570	146	–	146
Listed-written	**2,057**	**–**	**(85)**	**(85)**	5,293	–	(81)	(81)
OTC-purchased	**27,271**	**1,529**	**–**	**1,529**	6,638	867	–	867
OTC-written	**30,279**	**–**	**(1,751)**	**(1,751)**	6,532	–	(768)	(768)
Currency derivatives								
Forwards	**154,121**	**759**	**(2,245)**	**(1,486)**	181,054	1,807	(1,761)	46
Futures	**345**	**–**	**–**	**–**	222	–	–	–
Swaps	**17,668**	**45**	**(622)**	**(577)**	5,612	125	(151)	(26)
Options:								
OTC-purchased	**19,987**	**163**	**–**	**163**	27,452	410	–	410
OTC-written	**17,423**	**–**	**(79)**	**(79)**	25,605	–	(354)	(354)
Interest rate derivatives								
Bond forwards	**3,483**	**1**	**(3)**	**(2)**	4,468	30	(34)	(4)
Futures	**12,089**	**–**	**–**	**–**	7,021	–	–	–
Interest rate swaps:								
OTC	**58,920**	**196**	**(427)**	**(231)**	61,049	119	(209)	(90)
OTC-cleared	**41,604**	**–**	**–**	**–**	–	–	–	–
Total return swaps	**–**	**–**	**–**	**–**	13	–	–	–
Swaptions	**156,807**	**405**	**(346)**	**59**	14,840	40	(29)	11
Options:								
Listed-purchased	**131,612**	**88**	**–**	**88**	26,688	20	–	20
Listed-written	**138,021**	**–**	**(44)**	**(44)**	26,226	–	(18)	(18)
OTC-purchased	**50,506**	**76**	**–**	**76**	9,299	50	–	50
OTC-written	**74,753**	**–**	**(73)**	**(73)**	14,697	–	(52)	(52)
Credit derivatives [1]								
OTC-purchased	**10,608**	**5**	**(228)**	**(223)**	10,107	89	(91)	(2)
OTC-sold	**2,723**	**23**	**(7)**	**16**	4,931	19	(69)	(50)
OTC-cleared-purchased	**4,232**	**–**	**–**	**–**	–	–	–	–
OTC-cleared-sold	**6,384**	**–**	**–**	**–**	–	–	–	–
Total	**$ 1,038,690**	**$ 4,473**	**$ (6,019)**	**$ (1,546)**	$ 508,251	$ 4,601	$ (3,878)	$ 723

[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.

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, 2014:

($ thousands)

Less than 3 months	$ 461,742
3 to 12 months	385,201
Over 1 year	191,747
Total	**$ 1,038,690**

(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 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.

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, 2014:

($ thousands)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 42,049	$ 3,274	$ –	$ –	$ 45,323
Foreign equity	116,624	21,211	–	–	137,835
Private markets					
Real estate	–	–	63,514	–	63,514
Private equity	–	–	40,149	–	40,149
Infrastructure	–	–	32,480	–	32,480
Renewable resources	–	–	5,890	–	5,890
Fixed income					
Cash and money market securities	4,033	15,186	–	–	19,219
Government and corporate bonds	–	84,904	–	–	84,904
Inflation-linked bonds	–	24,809	–	–	24,809
Other fixed income securities	–	15,226	20,575	–	35,801
Alternative investments	–	5,591	9,382	–	14,973
	$162,706	$170,201	$171,990	$ –	$504,897
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 3,648	$ 3,648
Interest receivable	–	–	–	1,085	1,085
Dividends receivable	–	–	–	410	410
Derivative-related receivables	214	4,257	2	–	4,473
	$ 214	$ 4,257	$ 2	$ 5,143	$ 9,616
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (4,710)	$ (4,710)
Interest payable	–	–	–	(133)	(133)
Securities sold short	(3,557)	–	–	–	(3,557)
Securities sold under repurchase agreements	–	(3,140)	–	–	(3,140)
Derivative-related payables	(130)	(5,889)	–	–	(6,019)
Capital market debt financing	–	(31,030)	–	–	(31,030)
	$ (3,687)	$ (40,059)	$ –	$ (4,843)	$ (48,589)
NET INVESTMENTS	$159,233	$134,399	$171,992	$ 300	$465,924

[1] With respect to the amounts reflected in this column, cost approximates fair value. Consequently, no fair value hierarchy classification is required for such amounts.

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, 2013:

($ thousands)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 48,701	$ –	$ –	$ –	$ 48,701
Foreign equity	90,907	19,704	–	–	110,611
Private markets					
Real estate	–	–	57,532	–	57,532
Private equity	–	–	37,065	–	37,065
Infrastructure	–	–	23,538	–	23,538
Renewable resources	–	–	2,218	–	2,218
Fixed income					
Cash and money market securities	3,321	15,710	–	–	19,031
Government and corporate bonds	–	59,191	–	–	59,191
Inflation-linked bonds	–	23,108	–	–	23,108
Other fixed income securities	–	17,943	23,540	–	41,483
Alternative investments	–	4,672	4,790	–	9,462
	$142,929	$140,328	$148,683	$ –	$431,940
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 5,921	$ 5,921
Interest receivable	–	–	–	805	805
Dividends receivable	–	–	–	352	352
Derivative-related receivables	166	4,432	3	–	4,601
	$ 166	$ 4,432	$ 3	$ 7,078	$ 11,679
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (5,831)	$ (5,831)
Interest payable	–	–	–	(126)	(126)
Securities sold short	(2,475)	–	–	–	(2,475)
Securities sold under repurchase agreements	–	(3,215)	–	–	(3,215)
Derivative-related payables	(99)	(3,758)	(21)	–	(3,878)
Capital market debt financing	–	(25,845)	–	–	(25,845)
	$ (2,574)	$ (32,818)	$ (21)	$ (5,957)	$ (41,370)
NET INVESTMENTS	$140,521	$111,942	$148,665	$ 1,121	$402,249

[1] With respect to the amounts reflected in this column, cost approximates fair value. Consequently, no fair value hierarchy classification is required for such amounts.

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 year-end.

During the year ended March 31, 2014, listed Canadian equity securities with a fair value of $3,158 thousand classified as Level 1 were transferred to a non-listed fund held by PSP Investments. Consequently, the securities were classified as Level 2 as at March 31, 2014 (no significant transfers during the year ended March 31, 2013).

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

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, 2014:

($ thousands)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Private markets	**$ 120,353**	**$ 35,044**	**$ (21,736)**	**$ –**	**$ 3,787**	**$ 5,980**	**$ (1,395)**	**$ 142,033**
Fixed income	**23,540**	**3,685**	**(6,184)**	**(1,439)**	**1,591**	**(618)**	**–**	**20,575**
Alternative investments	**4,790**	**4,450**	**(134)**	**–**	**9**	**267**	**–**	**9,382**
Derivative-related receivables/payables (net)	**(18)**	**42**	**(49)**	**–**	**7**	**20**	**–**	**2**
Total	**$ 148,665**	**$ 43,221**	**$ (28,103)**	**$ (1,439)**	**$ 5,394**	**$ 5,649**	**$ (1,395)**	**$ 171,992**

As at March 31, 2013, two private markets investments were classified under Level 3 as their fair values were determined based on significant unobservable inputs. During the year ended March 31, 2014, such investments were transferred to Level 2 as the underlying investees indirectly held by PSP Investments became publicly traded. In the case of one of the two private markets investments, the instruments held by PSP Investments are subject to restrictions as at March 31, 2014 and may only be resold upon registration.

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, 2013:

($ thousands)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Public markets	$ 949	$ 6	$ (31)	$ –	$ 5	$ (115)	$ (814)	$ –
Private markets	103,242	26,478	(10,043)	–	1,146	(470)	–	120,353
Fixed income	22,517	7,420	(6,397)	(352)	1,079	(727)	–	23,540
Alternative investments	1,714	3,155	–	–	–	(79)	–	4,790
Derivative-related receivables/payables (net)	(60)	46	(54)	–	10	40	–	(18)
Total	$ 128,362	$ 37,105	$ (16,525)	$ (352)	$ 2,240	$ (1,351)	$ (814)	$ 148,665

[1] Includes Plan Account allocation adjustments.

As at March 31, 2012, an investment in a non-listed fund that held listed securities was classified under Level 3 due to the nature of the contractual restrictions on the redemption of the fund units. During the year ended March 31, 2013, the listed securities held by the fund were transferred to PSP Investments and were classified as Level 1 as at March 31, 2013.

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 7% increase and 5% decrease (2013 – 4% increase and 4% decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios and fund investments of $65,217 thousand allocated to the Plan Account (2013 – $53,738 thousand), where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of 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 private debt portfolios, the fair value is obtained from third-party appraisers as described in Note 3 (A).

(D) SECURITIES LENDING AND 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, 2014, PSP Investments, on behalf of the Plan Account, has re-invested $11,990 thousand of collateral held (2013 – $11,701 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)	**2014**	2013
Securities lending		
Securities lent	**$ 47,829**	$ 39,048
Collateral held[1]	**50,914**	41,126
Securities borrowing		
Securities borrowed	**3,557**	2,475
Collateral pledged[2]	**3,728**	2,485

[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.

(E) SECURITIES SOLD AND 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 relevant 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 relevant 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 $3,137 thousand as at March 31, 2014 (2013 – $3,215 thousand).

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 reporting 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 Statement of Investment Policies, Standards and Procedures (SIP&P). The objective of this policy is to provide a framework to manage the investment risks that PSP Investments is exposed to, namely market, credit and liquidity risks.

(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 funding risk. Funding risk is the risk that the assets under management will be insufficient to meet the relevant pension liabilities of the Plans, which may require the contributions to the Funds of the Plans to be increased. 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. For investments that are not actively traded, the calculation of VaR uses securities with similar risk attributes as a proxy.

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.

	2014	2013
Policy Portfolio VaR	**20.3 %**	20.2 %
Active VaR	**2.8**	2.6
Total VaR (undiversified)	**23.1**	22.8
Diversification effect	**(0.1)**	(1.3)
Total VaR	**23.0 %**	21.5 %

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 terms to maturity of the investments with the most significant exposure to interest rate risk were as follows as at March 31, 2014:

($ thousands)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Other	Total
Government bonds	$ 8,851	$ 26,556	$ 9,014	$ 13,236	$ –	$ 57,657
Corporate bonds	3,324	15,072	6,983	1,868	–	27,247
Inflation-linked bonds	15	6,062	6,951	11,781	–	24,809
Asset-backed securities	55	8,015	123	–	–	8,193
Private debt portfolios:						
Directly held	868	2,409	–	–	–	3,277
Held through funds [1]	–	–	–	–	9,770	9,770
Total investments with significant exposure to interest rate risk	**$ 13,113**	**$ 58,114**	**$ 23,071**	**$ 26,885**	**$ 9,770**	**$130,953**
Other investments [2]	**$ –**	**$ –**	**$ –**	**$ –**	**$ 33,780**	**$ 33,780**
Total fixed income	**$ 13,113**	**$ 58,114**	**$ 23,071**	**$ 26,885**	**$ 43,550**	**$164,733**

[1] Due to their nature, information in connection with the terms to maturity of fund investments included in the private debt portfolios is not available.

[2] Consists of $19,219 thousand in cash and money market securities and $14,561 thousand in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

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

Alternative investments as well as derivative contracts described in Notes 3(A) (iv) and 3 (B), respectively, are also subject to interest rate risk exposures. These exposures are reflected in the VaR calculation described in Note 4 (A).

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. In October 2013, PSP Investments amended its policy to fully hedge foreign currency investments in government and corporate bonds, inflation-linked bonds, certain other fixed income securities, as well as investments in real estate, infrastructure and renewable resources. PSP Investments' previous policy was to hedge a target of 50% of its foreign currency investments in non-emerging countries. 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:

(in thousands of Canadian $)	**2014**		2013	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$122,224**	**61.0 %**	$ 80,727	53.3 %
Euro	**17,225**	**8.6**	13,584	9.0
British Pound	**9,229**	**4.6**	11,233	7.4
Japanese Yen	**7,812**	**3.9**	6,036	4.0
Hong Kong Dollar	**6,512**	**3.3**	5,461	3.6
Korean Won	**6,508**	**3.2**	4,093	2.7
Brazilian Real	**6,276**	**3.1**	6,363	4.2
Swiss Franc	**3,959**	**2.0**	2,016	1.3
Taiwanese New Dollar	**3,043**	**1.5**	2,469	1.6
Australian Dollar	**2,520**	**1.3**	4,982	3.3
Indian Rupee	**2,335**	**1.2**	1,863	1.2
South African Rand	**1,948**	**1.0**	1,604	1.1
Swedish Krona	**1,314**	**0.6**	382	0.3
Colombian Peso	**1,217**	**0.6**	919	0.6
Mexican Peso	**1,049**	**0.5**	1,280	0.9
Others	**7,162**	**3.6**	8,330	5.5
Total	**$200,333**	**100.0 %**	$151,342	100.0 %

As at March 31, 2014, PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $59,673 thousand (US$50,023 thousand, €1,289 thousand, £142 thousand, R110 thousand South African Rands, R$1,405 thousand Brazilian Reals, $305,832 thousand Colombian pesos and ₹74,057 thousand Indian Rupees) for the Plan Account which were not included in the foreign currency exposure table.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

PSP Investments is exposed to credit risk, that is, the risk that the issuer of a debt security or 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 relevant 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.

As at March 31, 2014, the Plan Account's maximum exposure to credit risk amounted to approximately $149 million (2013 – approximately $137 million). This amount excludes investments in distressed debt in the amount of approximately $7.8 million as at March 31, 2014 (2013 – approximately $7.2 million). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 3 (D), 3 (E) and 4 (B) and the impact of guarantees and indemnities disclosed in Note 10.

As at March 31, 2014, the Plan Account had a net notional exposure of $274 thousand (2013 – $633 thousand) to various tranches of collateralized debt obligations, of which approximately 53% (2013 – approximately 67%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 10, to support potential margin calls on the ABTNs.

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 markets investments.

PSP Investments' concentration of credit risk by credit rating, excluding the items described above and any other credit enhancement, for the Plan Account was as follows as at March 31:

	2014	2013
Investment grade (AAA to BBB–)	**97.4 %**	97.9 %
Below investment grade (BB+ and below)	**1.0**	1.0
Not rated:		
Rated by a single credit rating agency	**0.5**	0.1
Not rated by credit rating agencies	**1.1**	1.0
Total	**100.0 %**	100.0 %

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 requires that counterparties provide adequate collateral and meet its credit rating requirements. PSP Investments frequently monitors the credit rating of its counterparties as determined by recognized credit rating agencies. With respect to derivative contracts, PSP Investments has the ability to terminate all trades with most counterparties whose credit rating is downgraded below its requirements.

For OTC derivatives, 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. In the case of OTC-cleared derivatives, the CCP regulates trading activities between parties under terms that are customary to such transactions.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master Agreement contractually binds counterparties to close-out netting provisions in the case of default by one of the counterparties. 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 under the CSA 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. Similarly, in the case of OTC-cleared derivatives, the CCP requires collateral in cash, high quality debt instruments or securities and is authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments pledged securities with a fair value of $2,880 thousand as collateral with respect to derivative contracts at March 31, 2014 (2013 – $379 thousand), $133 thousand of which are with respect to OTC-cleared derivatives (2013 – nil). Securities with a fair value of $174 thousand were received from counterparties as collateral at March 31, 2014 (2013 – $764 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 (D) and 3 (E) 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.

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, 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, bonds and public equities are expected to be highly liquid as they will be invested in securities that are actively traded. Management utilizes appropriate measures and controls to monitor liquidity risk in order to ensure that there is sufficient liquidity to meet financial obligations as they come due. A liquidity report taking into consideration future forecasted cash flows is prepared and presented to senior management on a weekly basis. This ensures that sufficient cash reserves are available to meet forecasted cash outflows. Additionally, sufficient sources of liquidity are maintained for deployment in case of market disruption.

PSP Investments has the ability to raise additional capital through the use of its capital market 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 market debt program.

The terms to maturity of the notional amount of derivatives are disclosed in Note 3 (B).

4 INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial instruments, aggregated according to their maturities as at March 31, 2014:

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities [1]				
Amounts payable from pending trades	$ (4,710)	$ –	$ –	$ (4,710)
Interest payable	(121)	(12)	–	(133)
Securities sold short	(3,557)	–	–	(3,557)
Securities sold under repurchase agreements	(3,140)	–	–	(3,140)
Capital market debt financing	(16,397)	(3,937)	(10,696)	(31,030)
Accounts payable and other liabilities	(415)	–	(230)	(645)
Total	$ (28,340)	$ (3,949)	$ (10,926)	$ (43,215)

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial instruments				
Derivative-related receivables	$ 2,058	$ 1,569	$ 846	$ 4,473
Derivative-related payables [1]	(2,312)	(2,172)	(1,535)	(6,019)
Total	$ (254)	$ (603)	$ (689)	$ (1,546)

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

5 FUND TRANSFERS

PSP Investments did not receive any fund transfers from the Government of Canada for the year ended March 31, 2014 (2013 – no transfers) for the Fund, recorded in the Plan Account.

6 INVESTMENT INCOME

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

($ thousands)	2014	2013
Interest income	$ 5,500	$ 4,366
Dividend income	7,002	6,412
Interest expense (Note 8)	(504)	(549)
Transaction costs	(490)	(271)
External investment management fees [1]	(161)	(201)
Other (net)	(164)	(96)
	11,183	9,661
Net realized gains [2]	12,321	12,071
Net unrealized gains [3]	41,294	16,774
Investment income	$ 64,798	$ 38,506

[1] Consists of amounts incurred for investments in public markets that are paid directly by PSP Investments. This excludes fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of $276 thousand for the year ended March 31, 2014 (2013 – $113 thousand).

This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSP Investments. Such fees, which generally vary between 0.1% and 2.0 % of the total invested and/or committed amount, totalled $765 thousand for the year ended March 31, 2014 (2013 – $669 thousand).

[2] Includes realized foreign currency losses of $7,628 thousand for the year ended March 31, 2014 (2013 – realized foreign currency losses of $1,088 thousand).

[3] Includes unrealized foreign currency gains of $21,105 thousand for the year ended March 31, 2014 (2013 – unrealized foreign currency gains of $1,074 thousand).

7 EXPENSES

(A) ALLOCATION OF EXPENSES

The Act requires that the costs of operation of PSP Investments be charged to the plan accounts ("Plan Accounts") for the Plans for which it provides investment services. Under section 4(3) of the Act, the President of the Treasury Board shall determine to which Plan Account these costs will be charged, in consultation with the Minister of National Defence and the Minister of Public Safety. An allocation policy 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:

	2014	2013
Public Service Pension Plan Account	72.9 %	73.0 %
Canadian Forces Pension Plan Account	19.5	19.3
Royal Canadian Mounted Police Pension Plan Account	7.1	7.1
Reserve Force Pension Plan Account	0.5	0.6
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)	2014	2013
Salaries and benefits	$ 728	$ 684
Professional and consulting fees	127	66
Office supplies and equipment	114	105
Other operating expenses	43	44
Depreciation of fixed assets	73	73
Occupancy costs	36	35
Custodial fees	15	16
Remuneration earned by Directors	4	4
Travel and related expenses for Directors	1	1
Communication expenses	1	1
Total	$ 1,142	$ 1,029

8 CAPITAL MARKET DEBT FINANCING

PSP Investments' capital market debt 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 private market investments. It is unconditionally and irrevocably guaranteed by PSP Investments in accordance with its corporate leverage policy.

The maximum amount authorized by the Board of Directors for the capital market debt program is 10% of the net investments plus all recourse debt outstanding of PSP Investments at the time of commitment to issuance. Under this limit, the short-term promissory note component cannot exceed $3 billion for issuances in Canada and US$3 billion for issuances in the United States.

PSP Investments' capital market debt financing was in compliance with the limits authorized by the Board of Directors during the year ended March 31, 2014.

The following outlines the terms as well as the fair value of the notes issued under the capital market debt program allocated to the Plan Account as at March 31:

	2014		2013	
($ thousands)	**Capital amounts payable at maturity**	**Fair Value**	Capital amounts payable at maturity	Fair Value
Short-term Canadian Dollar promissory notes, bearing interest between 0.99% and 1.19% and maturing within 7 and 364 days of issuance (March 31, 2013 – 31 and 191 days)	**$ 7,138**	**$ 7,128**	$ 4,555	$ 4,548
Short-term US Dollar promissory notes, bearing interest between 0.11% and 0.30% and maturing within 35 and 365 days of issuance (March 31, 2013 – 29 and 189 days)	**11,466**	**11,462**	5,364	5,362
Medium-term notes Series 1, bearing interest of 4.57% per annum and matured on December 9, 2013	**–**	**–**	5,280	5,402
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	**3,480**	**3,573**	3,696	3,834
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on February 16, 2015	**1,740**	**1,744**	1,848	1,856
Medium-term notes Series 4, bearing interest of 2.26% per annum and maturing on February 16, 2017	**4,474**	**4,566**	4,752	4,843
Medium-term notes Series 5, bearing interest of 3.03% per annum and maturing on October 22, 2020	**2,485**	**2,557**	–	–
Total	**$ 30,783**	**$ 31,030**	$ 25,495	$ 25,845

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)	**2014**	2013
Short-term promissory notes	**$ 72**	$ 57
Medium-term notes	**432**	492
Total	**$ 504**	$ 549

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 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 market debt financing and Note 4 (C) provides information on PSP Investments' liquidity.

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

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 indemnities.

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.

PSP Investments unconditionally and irrevocably guarantees all credit facilities, as well as short-term promissory notes and medium-term notes issued by PSP Capital Inc., as described in Note 8.

PSP Capital Inc. provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $4,840 thousand has been allocated to the Plan Account. As at March 31, 2014, the margin funding facilities have not been drawn upon since inception.

In certain investment transactions, PSP Investments provided guarantees, indemnifications or issued letters of credit to third parties, the most significant of which are as follows:

As at March 31, 2014, PSP Investments agreed to guarantee and, in some cases, provide indemnification for the performance of certain investees under contractual agreements. The majority of these agreements are borrowing arrangements. In the event a default occurs under such agreements, which is of limited recourse in certain cases, the Plan Account could assume obligations of up to $6,080 thousand (2013 – $5,275 thousand) plus applicable interest and other related costs. The arrangements mature between January 2014 and September 2028.

Additionally, PSP Investments and its subsidiaries issued letters of credit totalling $82 million as at March 31, 2014 (2013 – $41 million), of which $410 thousand has been allocated to the Plan Account (2013 – $218 thousand) in relation to investment transactions.

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, 2014:

($ thousands)

Real estate	$ 5,943
Private equity	20,243
Infrastructure	12,589
Renewable resources	3,978
Other fixed income securities	10,342
Alternative investments	9,073
Total	**$ 62,168**

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