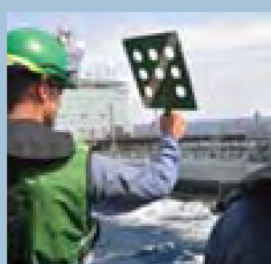
Public Sector Pension Investment Board

INVESTISSEMENTS PSP INVESTMENTS

Annual Report 2009

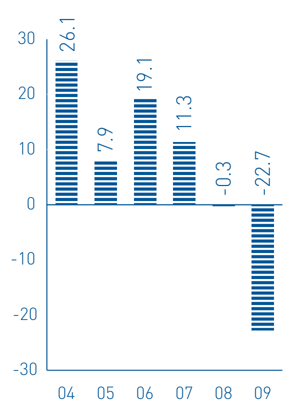


Corporate Profile — Who We Are and What We Do

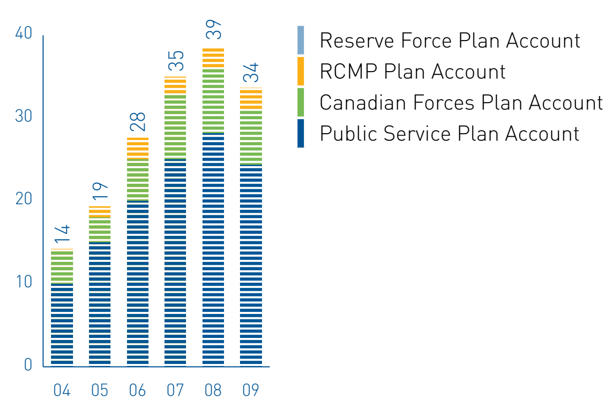
The Public Sector Pension Investment Board (PSP Investments) is a Crown corporation established to invest the proceeds of the net contributions received from the government since April 1, 2000 for the pension plans of the Public Service, the Canadian Forces and the Royal Canadian Mounted Police, and since March 1, 2007, for the Reserve Force Pension Plan. PSP Investments operates at arm's length from the federal government. Its statutory objectives are to manage the funds entrusted to it in the best interests of the contributors and beneficiaries of the plans and to maximize investment returns without undue risk of loss.

Financial Highlights

ANNUAL PERFORMANCE
As at March 31 (percent)



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



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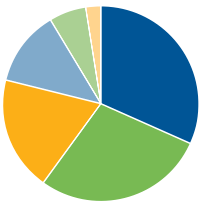
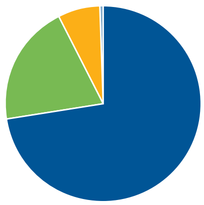
Highlights Fiscal Year 2009

- Consolidated net assets were $33.8 billion compared to $38.9 billion at the end of fiscal year 2008.
- Total portfolio return was negative 22.7% compared to Policy Benchmark of negative 17.6%.
- In fiscal year 2009, all Private Market asset classes (Real Estate, Private Equity, Infrastructure) exceeded public market equity returns and outperformed their respective benchmarks over a five-year period, or since their inception.
- Major direct investments continue to improve business fundamentals thereby increasing long-term value.
- A majority of Public Equity portfolios outperformed their benchmarks.
- All fixed income and real return bond portfolios recorded positive returns.
- Successful restructuring of third-party asset-backed commercial paper in Canada.
- Mr. Daniel Garant was hired to the senior position of First Vice President, Public Market Investments.
- Mr. John Valentini was promoted to the newly created senior position of Executive Vice President, Chief Operating Officer and Chief Financial Officer.



ASSET MIX
As at March 31, 2009 (percent)

Developed World Equity	31.9
Real-Return Assets	28.1
Nominal Fixed Income	19.0
Private Equity	12.4
Emerging Markets Equity	6.3
Small Cap Developed World Equity	2.3
	100.0



NET ASSETS PER PENSION PLAN
As at March 31, 2009 ($ millions)

Public Service	24,496	72.5%
Canadian Forces	6,750	20.0%
RCMP	2,416	7.2%
Reserve Force	115	0.3%
Net Assets	33,777	100.0%

Corporate Objectives Fiscal Year 2009

ENTERPRISE RISK MANAGEMENT

Continue to build on the Enterprise Risk Management (ERM) initiative begun in fiscal year 2008 by performing strategic risk reviews, monitoring and reporting on selected risks as well as promoting a risk awareness culture through education and training.

STATUS: COMPLETED AND ONGOING

Key accomplishments include:

- Strategic investment-related processes were identified, prioritized and reviewed and appropriate recommendations to mitigate risk were issued.
- A business continuity project with a full-scale continuity exercise was completed.
- A Corporate Information Security Policy based on best practice standards was developed.
- An ERM monitoring system was developed to capture and summarize key risks in order to improve the effectiveness of the Board of Directors' oversight capability.
- A new leadership talent training program was implemented and a new recruiting approach was adopted to ensure retention and attraction of qualified employees.

PUBLIC MARKETS

Build on new leadership in the Public Market Investments Group and set a course for increased internal management of assets in areas where PSP Investments demonstrates a competitive advantage to do so and can attract the necessary talent.

STATUS: COMPLETED

Key accomplishments include:

- Mr. Daniel Garant joined PSP Investments in September 2008 to lead the Public Market Group.
- A business plan for Public Markets, which includes the development of new internal management activities, was presented to the Board of Directors in February 2009.

Key Corporate Objectives Fiscal Year 2010

2010

REFINE POLICY PORTFOLIO ALIGNMENT

Define a policy portfolio, within an asset-liability framework, taking into account the liabilities of the plans and optimizing the Policy Portfolio Structure. Develop internal asset-liability capabilities and model.

2009

POLICY PORTFOLIO GOVERNANCE

Increase resources dedicated to monitoring the performance of Policy Portfolio changes and advise the Board of Directors on future improvements. Recommend changes to the asset allocation based on the economic and geopolitical outlook. Place increased emphasis on the Plans' liabilities.

STATUS: COMPLETED AND ONGOING

Key accomplishments include:

- Three new members joined the Asset Allocation Strategies and Research (AAS&R) Group. This group now acts as the Secretariat of the Policy Portfolio and incorporates the Economics, Asset-Liability Management and Research and Monitoring functions.
- PSP Investments developed its capabilities in Asset-Liability Modeling (ALM) and worked in close collaboration with the Office of the Chief Actuary of Canada to gather the required liability input. The new ALM framework was used by the AAS&R Group to analyze the existing Policy Portfolio.
- The development of an enhanced monitoring system for PSP Investments' Policy Portfolio was undertaken; this system will incorporate all the interconnectivity required to adjust to the future Enterprise Data Management environment.
- Quarterly "State of the World" updates are now being presented for discussion at the Management Investment Committee as well as at the Board of Directors level. The full integration of these perspectives will be part of our next review of the Policy Portfolio.

CONTINUE IMPLEMENTING ACTIVE INVESTMENT MANAGEMENT PHILOSOPHY

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

ENHANCE RISK MANAGEMENT

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

2010

PAUL CANTOR
Chair

Chair's Report

Well. That was quite a year. And at the time of writing this report, glimmers of light on the horizon were only slowly starting to emerge. PSP Investments' Board and Management had already fortified themselves last year with human resource changes, revised risk management practices and a cohesive approach to leadership. None of that protected us from the general market downturn, but it did mean that we were able to effectively manage our portfolios through the period. In particular, our continuing diversification reduced our dependence on publicly traded stocks and bonds into investments in real estate, private equity and infrastructure to help cushion the blows.

Our continuing diversification could not entirely shelter PSP Investments from the worst effects of the financial crisis. PSP Investments recorded a 22.7% loss during fiscal year 2009. We continue to believe that our portfolio represents solid long-term value and we expect our unrealized losses to recover when markets eventually return to health.

A critical question is how is PSP Investments positioned to respond to what happens next? For the next 21 years, PSP Investments' inflow of funds is expected to exceed our obligations to pensioners. Unlike many funds, we have no pressing short-term obligations to pensioners that will force us to sell assets today at distressed prices. In this highly fluid and uncertain market environment, it is extremely important to remain patient and grounded in our decision making if we are to take advantage of our substantial liquidity for the benefit of our stakeholders. To do so, it is critical that we move ahead on our goals and objectives.

It is remarkable that an organization can move ahead on goals and objectives while weathering a storm of this magnitude. Yet this was done in all parts of the organization. At the Board, we set ourselves goals which were directed to widening and deepening our ability to provide oversight of PSP Investments.

One initiative was to more closely link our investment strategies to the Plans' liabilities. The responsibilities of PSP Investments' Asset Allocation Strategies & Research Group were realigned to support the Board. In addition, the Group's work on key macroeconomic issues is being incorporated into portfolio allocation for Board approval.

A second initiative is risk definition and involves the modelling of projected cash flows related to both assets and liabilities. This has resulted in collaboration between us and our colleagues at Treasury Board Secretariat and in the Office of the Chief Actuary.

The third initiative is to design an enterprise-wide risk reporting framework at the Board level. Within that framework we are seeking to establish reporting at a level that we call "investment management literacy" that helps ensure that there is a clear understanding between management and the board of the opportunities and risks that are under discussion. We were somewhat surprised to find that this initiative is breaking new ground in the investment management community and that further work will be required next year to complete this project.

Beyond the specific objectives mentioned above, we know that building the cohesiveness of our team and our leadership is an important priority. One role of the Board of Directors is to set a tone at the top that ensures that PSP Investments has strong values and ethical standards. These standards should apply equally to how we operate internally and how we interact with our external stakeholders. They should guide our behaviour through even the most difficult periods.

Therefore, the Board welcomed the management initiative to develop Core Organizational Values on which all of us at PSP Investments can depend. The Values have been disseminated widely throughout the organization. They represent the bedrock on which we operate and they define our expectations of each other. It's also important for our people to know that the Board of Directors of PSP Investments is one hundred percent supportive of management's initiative. To that end, I have been writing a series of essays and speaking to the employees about the Values:

- ACT WITH **INTEGRITY**
- STRIVE FOR **TECHNICAL EXCELLENCE**
- ACT AS **ONE TEAM**
- **DELEGATE RESPONSIBILITY** AND **EMBRACE EMPOWERMENT**
- BE **RESULTS** ORIENTED

Executive Compensation

PSP Investments' Compensation Policy is designed to attract and retain talented employees, reward performance and reinforce our business strategies and priorities. As is the case throughout the investment industry, variable incentive compensation is the most important component of the total compensation offered to executives and portfolio managers.

Our variable incentive compensation programs are designed to reward total fund and asset class performance above a pre-established benchmark. They also reward individual performance against the achievement of objectives. Performance relative to markets is measured against investment performance in the current year and also against our prior four-year performance. Measuring against the four-year period serves to align the interests of our managers with the sustained investment objectives of PSP Investments. It also reduces the effect of extreme performance in any given year, either positive or negative, which aligns us more closely to our longer term perspective. PSP Investments introduced a new long-term incentive plan based on forward-looking four-year investment performance in fiscal year 2009.

As a result of 2009's underperformance, there were no short-term or long-term bonuses paid or allocated to any employees in respect of 2009 for total fund performance. The Board has decided to pay the short-term bonus based on the achievement of individual objectives. Consequently, short-term bonuses earned in 2009 by the highest compensated officers of PSP Investments are 39% lower than in the previous year. The 2009 underperformance will also adversely affect variable compensation until 2012 as performance incentives are based on a four-year period.

In addition, given the current financial and economic context, the Board and Management agreed that officers and senior managers receive no salary increase for fiscal 2010. The Board has also decided that its 2010 compensation will not be increased.

The deferred incentive payments in 2009 reflect the strong fund performance achieved over the four-year period from 2004 until 2007. Under the deferred incentive plan, payment of bonuses earned through 2007 was deferred for two years as a retention mechanism.

Acknowledgments

On behalf of the Board, and on behalf of our stakeholders, I want to thank our President and Chief Executive Officer Gordon J. Fyfe and all of the people at PSP Investments for their dedication and hard work during such a difficult time. They were called on to make an extraordinary effort and they rose to the occasion to do so.

Paul Cantor
Chair

PSP INVESTMENTS CORE VALUES

- **ACT WITH INTEGRITY:**
  By this we mean, first, conducting ourselves in a manner which is always legal, ethical and moral. But in addition, we mean keeping our promises to each other and to those we deal with.
- **STRIVE FOR TECHNICAL EXCELLENCE:**
  This means engaging in lifelong learning, paying attention to detail, and being the best in the world at what each of us does.
- **ACT AS ONE TEAM:**
  When we act as one team, we recognize that each of us brings some special expertise to PSP Investments and that none of us have the capacity to do everything. By working together, we can achieve more as a group than we could do as a collection of individuals.
- **DELEGATE RESPONSIBILITY AND EMBRACE EMPOWERMENT:**
  We want a decision to be made by the person who knows the most about the matter. If we make decisions at the wrong level, the person making the decision can't make the best decision, and the person who should have made the decision isn't accountable for it.
- **BE RESULTS ORIENTED:**
  The primary responsibility of PSP Investments is to support the fulfillment of the pension promise. It therefore follows that one of our Core Organizational Principles should be to achieve that objective. But we do not get there by a fixation on the bottom line. Instead, we get there by adherence to our Core Organization Principles, which, if we live by them, will lead inevitably to desirable long-term bottom line results.

GORDON J. FYFE
President and Chief Executive Officer

President's Report

We experienced exceptionally difficult financial and economic times in Canada and around the world over the last year. PSP Investments, like most institutional fund managers, recorded negative investment returns during the last fiscal year due to the worst deterioration of financial markets since the Great Depression. Our return for fiscal year 2009 was negative 22.7% largely as a result of the sharp decline in public equity markets during the latter half of the fiscal year.

After three years of first quartile performance amongst large Canadian Pension Plans [1], our performance is lagging that of our peers in fiscal year 2009. Our four-year average, on the other hand, remains at the median when compared to our peers.

State of the Markets

During the twelve-month period ended March 31, 2009, major stock markets including the S&P/TSX Equity, the S&P 500 and the EAFE recorded losses of between negative 32.4% and negative 38.1% in local currency. In the first three months of calendar year 2009, public equity markets hit their lowest level of the fiscal year. In March 2009, US stock markets were at 1997 levels, erasing 12 years of returns, while the TSX was trading at 2002 levels. In addition during our most recent fiscal year, the Canadian dollar reached a four-year low against the US dollar.

[1] RBC Dexia – Canadian Pension Plans over $1 billion.

Just two years ago, financial markets were awash with liquidity. Banks, hedge funds and other financial institutions were active lenders and were prepared to commit large amounts of capital to finance all types of businesses. As a result of the current financial crisis, credit and liquidity have disappeared and so have buyers. There are few transactions in real estate and private assets and they generally involve sellers in financial distress.

Our Performance

Like other institutional funds, PSP Investments has diversified its investment portfolio to reduce overall long-term risk. In addition to diversifying our public equity portfolios on a geographical basis, we have also diversified into other asset classes, including fixed income, private equity, infrastructure investments and real estate.

Despite the diversification of our risk into these very different asset classes, we still experienced a 22.7% decline in our overall investment portfolio. During the second half of fiscal year 2009, the panic in financial markets resulted in the decline in value of all asset classes except for government bonds.

PSP Investments hedges a portion of its total foreign currency exposure. The impact of the hedging policy on our 2009 results was negative 2.6%, as the Canadian dollar experienced a significant 22.6% drop against the US dollar.

Our Policy Portfolio's benchmark had a return of negative 17.6%, primarily as result of the sharp decline in global public equity markets. While we are disappointed with our relative performance, our underperformance is mainly attributable to additional write-downs on our asset-backed commercial paper and collateralized debt obligations investments which impacted our total return by negative 3.0%. Our Real Estate portfolio, with an annual return of negative 16.8% also underperformed its benchmark of positive 6.6%, impacting our relative return by negative 2.4%. Over a five-year period, our Real Estate portfolio has recorded an annualized return of 9.3%, outperforming its benchmark by 2.2%.

For the majority of our Public Equity portfolios, our portfolio managers were successful in limiting losses. While our returns were negative, our Canadian Equity, EAFE Large Cap Equity and Emerging Markets Equity all outperformed their respective benchmarks.

Our overall return was also positively impacted by the positive returns of our fixed income and real return bond portfolios: World Government Bonds 19.4%, World Inflation-Linked Bonds 5.9%, Canadian Fixed Income 4.7%, and Cash & Cash Equivalents portfolios 2.8%.

Private Market investments had a positive impact on overall results as they outperformed public equities. For instance, our Infrastructure portfolio, the result of our diversification strategy which began in 2004, recorded a positive return of 6.0% outperforming its benchmark of 5.8% for a three-year return (since inception) of 5.5%, 2.2% above its benchmark. Private Equity returned negative 32.3% below its benchmark of negative 31.6% for the year, but is outperforming its benchmark by 0.6% since inception.

Our Private Market investments suffered from fair-value or mark-to-market adjustments which require us to value our assets as if they were for sale as of March 31, 2009. We continue to hold effectively all of the investments for which we have recorded unrealized losses and remain confident in the quality of our assets. In a period when there are few buyers and weak sellers as well as limited transactions, we have to value our private market assets as if they had to be sold during the crisis and in a market with very few comparables. As long-term investors with no pressure to sell our investments in the short term, we measure the progress of our investments by improvements in the fundamentals such as cash flows and earnings. Our principal private market assets are continuing to perform well and according to plan.

Revera Inc. (Revera), Canada's largest provider of accommodation and care for seniors and our largest Private Market investment, was able to pay down debt and increase earnings before interest, taxes, depreciation and amortization (EBITDA) during this very difficult economic period. Despite those improvements, mark-to-market accounting rules required PSP Investments to write down the value of Revera. Since PSP Investments purchased Revera in 2006, the return on the investment remains positive and exceeds the Real Estate benchmark.

Furthermore, the fair value of Telesat Canada, a satellite operator and our second largest Private Market investment, has remained unchanged from last year, despite a significant increase in EBITDA and an increase in EBITDA margin during the last year.

In Real Estate, approximately 56% of our holdings are in residential rental properties, which have not been as affected by the downturn as have shopping centres and office towers, sectors where we have limited exposure. In doing so, we have limited our downside during the current recession.

Our Progress

Despite the financial crisis and its impact on PSP Investments' returns, fiscal year 2009 was marked by substantial progress in a number of critical areas.

An important achievement which provides us with a substantial competitive advantage is the upholding of PSP Investments' AAA credit rating during these difficult times. PSP Investments' AAA credit rating was reaffirmed by two credit rating agencies in late fall 2008. Throughout fiscal year 2009, our management team identified and implemented a variety of improvements and initiated process reviews in operations management, risk management and human resources. We continue to look for ways to improve in these and other key areas of our overall operations. In particular, we continue to enhance our risk management policies and practices.

A key appointment in the past twelve months was that of Daniel Garant as First Vice President, Public Market Investments. Mr. Garant brings exceptional experience in public markets to PSP Investments. We welcome him to our team and we look forward to his contribution to our efforts.

Credit Crisis

A critical development during fiscal year 2009 was the successful restructuring of the non-bank asset-backed commercial paper market. After many months of negotiations and hard work, the Pan-Canadian Investors Committee for Third-Party Asset-Backed Commercial Paper was able to successfully restructure the financial instruments in question. As at our fiscal year-end 2009, although losses have been recorded in the financial statements in accordance with accounting rules, there are no actual credit losses realized in this portfolio.

We have learned from this experience and consequently have taken certain measures, namely, new leadership in our Public Market Group as well as improvements in our investment risk management practices.

Putting our Liquidity to Work

The global credit crisis dried up liquidity and the business models that rely excessively on borrowed capital, such as hedge funds and other financial institutions, has changed dramatically. Buying power has shifted to institutions that enjoy significant long-term capital and liquidity such as PSP Investments.

PSP Investments is now pursuing investment opportunities arising from the current market disruption. Our 2004 diversification strategy was implemented precisely because PSP Investments has the ability to buy and hold illiquid assets for the long term even during periods of extreme stress as we just experienced.

Each year, we expect a steady cash inflow of new funds totalling approximately $4 billion, and net contributions are projected to remain positive until the year 2030. We are under no pressure to sell or otherwise realize on our investments in the short term or indeed at any time before we are ready to sell of our own accord.

We see opportunities in these markets and have added to our portfolio as opportunities for good assets at attractive prices have become available.

As a result, we have developed a Public Markets business plan that will facilitate our ability to recognize and invest in significant opportunities in public markets around the world. We have also recently completed PSP Investments' three-year strategic plan which is aimed at increasing internal and direct investments programs. Investment performance of our direct investments where we have a greater influence on long-term value creation has been very good, and we intend to continue to capitalize on this strategy.

Final Thoughts

Fiscal year 2009 was a very difficult year, requiring absolute commitment and dedication from a large number of people at, or associated with, PSP Investments.

I would like to thank each member of the Board of Directors, and in particular Paul Cantor, our Chair, for their incredible availability and support, specifically throughout October and November 2008 when the financial crisis was unfolding.

I would like to also congratulate John Valentini on his well-deserved promotion to Executive Vice President, Chief Operating Officer and Chief Financial Officer during the year. Finally, I would like to thank all of our employees for their commitment and dedication during fiscal year 2009. It took both team and individual effort to get through this very difficult year.

Sincerely,

Gordon J. Fyfe

Gordon J. Fyfe
President and Chief Executive Officer

Management's Discussion of Fund Performance and Results

Economic Overview and Background

Fiscal year 2009 was one of unprecedented economic and financial turmoil. What started as a crisis in the US housing market has led to the near-collapse of the global banking system, the deepest global recession of the post-war period and the worst equity bear market since the 1930s. While the U.S. remains at the epicenter of the storm, no region of the world has been spared. The industrialized economies are contracting sharply, and emerging markets—which some had seen as relatively immune from the crisis—have been severely shaken as well. Global trade is rapidly shrinking and commodity prices have collapsed. Meanwhile, the world's central banks have slashed their policy rates close to zero and non-conventional monetary policy tools such as direct purchases of securities are either being contemplated or implemented. Governments around the world are injecting huge sums into their economies to support growth. Yet, the headwinds facing the global economy remain immense: the banking system is in shambles, credit conditions remain tight and wealth destruction has been massive.

MAJOR ECONOMIES

The pace at which economic and market conditions have deteriorated over the past fiscal year is nothing short of stunning. While the credit crisis that unfolded between July and September 2007 did have a significant negative impact on the major economies, and especially the U.S., a recession of this severity still appeared to be a risk—albeit a significant one—rather than a reality. That all changed in the late summer and early autumn months of 2008. As the crisis intensified, the financial sector found itself with several institutions on the verge of collapse and government bailouts multiplied. However, the spark that truly ignited the powder keg was the bankruptcy of Lehman Brothers in September 2008. Until then, the failure of a major institution was only a possibility. At that point, it became a reality. Credit markets completely froze up and inter-bank lending ground to a halt. Liquidity evaporated, forcing the world's central banks to massively inject funds into short-term credit markets to ensure their viability. Credit spreads soared to all-time highs. Stock markets crashed across the globe, and both the extent and the speed of decline were devastating, the worst since the Great Depression. Measures of market volatility exploded to all-time peaks. As for government bond yields and money market rates, they plunged as investors fled for safety, and three-month US Treasury Bills yields even briefly traded in negative territory. In sum, there was nowhere to hide—with the exception of government bonds, all asset classes posted steep losses.

The intensification of the credit crunch had a devastating impact on the real economy. US consumers and businesses retrenched sharply and employment plunged. The malaise rapidly spread around the globe. The economies of the U.K., the Euro zone and Japan contracted significantly, and emerging markets either went into recession or slowed dramatically. Even the high-flying Chinese economy ground to a halt.

In response, the US Federal Reserve flooded the markets with liquidity. It doubled the size of its balance sheet via numerous facilities designed to spur credit creation and slashed its policy rate to near-zero. Other central banks continued to cut rates as well. Although the aggressive measures that were put into place helped thaw credit markets, these have not returned to normal. Expectations are mounting that further unconventional measures will be required to break the log-jam.

Canada

Although Canada's domestic economic fundamentals had been solid and its banking system relatively healthy, the Canadian economy could not resist the downward tow from its sinking US counterpart. Canada's economy fell into recession in the final quarter of calendar 2008, posting a 3.7% annualized decline, and recorded an even larger 5.4% drop in the opening quarter of 2009. Although the recession is largely the result of Canada's heavy export exposure to the U.S.—with manufacturing hit particularly hard—and tumbling commodity prices, domestic spending also shrank as consumer and business confidence faltered.

The plunge in global commodity prices also took a huge toll on the Canadian dollar, which was trading at parity with its US counterpart as recently as July 2008.

United States

The US economy went from bad to worse over the course of fiscal year 2009, with the economy falling into a deep and prolonged recession. While the downturn officially started in December 2007, it was relatively mild until the closing months of 2008 when economic conditions deteriorated dramatically. Real Gross Domestic Product (GDP) contracted at a 6.3% annualized pace in the final quarter of the calendar year—its worst drop since 1982—and recorded a similar 6.1% decline in the opening quarter of 2009. Consumer spending and business investment contracted sharply and exports faltered as a result of slumping world demand. Almost 5.2 million jobs were lost since the beginning of the downturn, and approximately two-thirds of those in the five months to March 2009 alone. The unemployment rate jumped to 8.5%, its highest since the early 1980s. As for the housing market, it continued to slide, with new home sales running at their lowest levels on record, house prices tumbling and foreclosures mounting.

Europe

The European economy was also hit hard by the crisis. The U.K., in particular, is in the throes of a severe recession and of a housing market meltdown. After performing relatively well for most of 2008, the Euro zone economies contracted sharply in the final quarter of the year and the opening quarter of 2009. Real GDP plunged at an annualized pace of 6.4% and 9.6% respectively as tight credit conditions, faltering confidence and shrinking export demand took their toll. Like other central banks, the European Central Bank continued to cut rates, and expectations are that it will continue to do so in 2009.

Japan

The Japanese economy has been heavily battered by the global credit crisis and is going through its most severe recession of the post-war period. GDP started contracting in the second quarter of 2008 and in the fourth quarter, it fell at a catastrophic annual pace of 14.4%. It continued to plunge in the first quarter of 2009 with a 15.2% decline. Exports collapsed, falling by more than 60% in the year to February 2009. As for industrial production, it tumbled by more than 20% in 2008. With the economy in such dire straits, deflation has returned as a serious concern.

Emerging Markets

Emerging markets have not been spared the pain of the global recession. In Asia, in particular, several economies—Singapore, Korea and Taiwan are but three examples—recorded catastrophic declines in output as the year drew to a close, in part due to collapsing exports. Even China, which had been posting double-digit growth rates, saw its year-over-year growth rate slow to 6.8% in the final quarter of 2008, suggesting that the economy essentially stalled as the year drew to a close. The People's Bank of China has been easing its monetary policy and the Chinese government is currently implementing an important stimulus plan in response to the slowdown.

FINANCIAL MARKETS

Global stock markets went through their worst performance of the post-war period as the declines recorded in fiscal year 2008 intensified over the course of the past year. After losing 37.4% in fiscal year 2009 in local currency terms, the MSCI (Morgan Stanley Capital International) World Index ended the fiscal year 48% below the peak reached in mid-October 2007. No major indices have been spared. The S&P 500 posted a 38.1% loss in fiscal year 2009, bringing the total loss from its peak to the end of the fiscal year to 47.2% as it recorded its worst performance since the Great Depression. European and Japanese markets were similarly battered. Finally, many emerging markets recorded even sharper declines before recovering some lost ground later in the year.

Canadian Equities

Canadian equities started the year by meaningfully outperforming their US counterparts, largely on the back of rising commodity prices. However, once fears of global recession sent commodity prices tumbling, they rapidly reversed course, catching up to US equities. Overall, the S&P TSX returned negative 32.4%, not far from the performance of US stocks. Energy and materials, two broad commodity-based sectors, were the more seriously affected. Financials also underperformed the broad index. In contrast, defensive sectors such as consumer staples fared better.

US Equities

In fiscal year 2009, US equities marked the most pronounced downturn since the 1929-1933 depression with the S&P 500 posting a negative return of 38.1%. All sectors were impacted, with financials being hit particularly hard. Indeed, the S&P 500 Financials index lost 63% during the year, a 75.1% fall from its peak in January 2007. Given the sharp depreciation of the Canadian dollar over the course of the year, the negative performance was not as severe in Canadian dollar terms, with the S&P 500 posting a negative return of 24.1%.

Emerging Market Equities

Most emerging markets recorded performances during the year that were similar, and in some cases worse, than those of the developed economy markets. After gaining ground in the early part of the year, the MSCI Emerging Market Index, expressed in local currency, plunged by more than 55% between May and October 2008. Although it regained some ground afterwards, it ended the fiscal year with a negative return of 36.7%. The BRIC (Brazil, Russia, India and China) performed somewhat worse with a loss of 41.9%, largely as a result of Russia's dramatic slide which at one point left its markets almost 75% of their peak. The best performing region was Latin America; the MSCI Emerging Market Latin America Index was off 32.5% in local currency terms and by the end of the fiscal year, was up some 33.8% since hitting bottom in October 2008.

Bonds

Fiscal year 2009 was a good year for government bonds as all the ingredients were in place to push yields sharply lower. The US Federal Reserve cut its Fed Funds Rate to virtually zero, and the world's major central banks followed in its footsteps. The collapse in equity markets fuelled a mass exodus towards safe assets—to the point where three-month T-Bill yields were momentarily in negative territory. Commodity prices tumbled, the global economy sank and fears of deflation started to spread. While they rose as high as 4.2% in May 2008, 10-year US Treasury yields fell to a mere 2.1% in October 2008. Bonds in Canada, U.K. and the European market rallied dramatically as these economies soured and their central banks aggressively cut rates. Fiscal year 2009 was also a dismal one for corporate bonds; yield spreads surged to record highs—more than 600 bps for Moody's BAA spreads and 275 bps for AA spreads.

Real Estate

Housing markets throughout most of the U.S. remained weak during fiscal year 2009. Even resilient markets, such as New York, began to deteriorate in the last two quarters of the year. As US home sales continued to plummet, prices plunged, and delinquencies surged. The MSCI REIT Index, which had already dropped substantially in fiscal year 2008, declined by more than 60%. The commercial real estate market also weakened significantly. As a result, Commercial Mortgage-Backed Securities (CMBS) spreads widened dramatically. Outside of the U.S., the picture was very similar. While certain markets or countries fared better than others, none were unaffected by the economic and financial crisis.

In Canada, which has one of the most stable banking systems in the world, real estate markets only began to soften in the last quarter of the year. Job losses in both the manufacturing and professional service sectors have resulted in reduced demand for commercial and industrial space, while demand for multi-family properties actually increased due to rising unemployment and mortgage financing restrictions.

Commodities

Fiscal year 2009 was disastrous for commodity markets. After peaking at the tail end of the commodity boom during the summer, prices collapsed. Crude oil went from as high as $145 per barrel in July 2008 to a low of less than $32 per barrel in December 2008. From base metals to agricultural commodities, most other commodity markets also posted stunningly sharp declines. Notably, the Commodity Research Bureau (CRB) Index is down almost 60% from its July peak. Gold represents the only real exception to the general trend; its safe-haven status momentarily propelled gold futures above $1,000 per ounce.

Investments Objectives, Investment Policy and the Policy Portfolio

INVESTMENT OBJECTIVES

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

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

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

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

INVESTMENT POLICY

In fiscal year 2009, PSP Investments developed its asset-liability modeling capabilities by building an internal function and teaming up with an external consultant. This development reflects PSP Investments' desire to improve the overall alignment of interests between all stakeholders. Discussions with TBS regarding the management of pension financing risks also contributed to a better understanding of related issues.

Fiscal year 2009 was also characterized by a building up of PSP Investments' capacity to integrate information into an enhanced Policy Portfolio monitoring dashboard. The integration of economic and geopolitical scenarios in the investment process is also being improved.

POLICY PORTFOLIO

The severe market movements underpinned by the possibility of a worldwide recession that marked fiscal year 2009 put stress on the narrow ranges allowed for the long-term target weights of certain asset classes within the Policy Portfolio. In response to this extraordinary situation, PSP Investments' Board of Directors approved temporary amendments to the Policy Portfolio on October 24, 2008. These amendments were meant to allow greater flexibility in managing the storm by increasing the allowed ranges.

Effective March 31, 2009, permanent changes to the Policy Portfolio were approved by the Board of Directors. These changes resulted in the regrouping of all equities into a broad asset class named "World Equity", while the other two broad asset classes: "Nominal Fixed Income" and "Real Return Assets" remained unchanged. New ranges for the asset class "World Equity" were also introduced.

At the end of fiscal year 2009, all asset classes were within the ranges prescribed in the Statement of Investment Policies, Standards and Procedures (SIP&P).

Change in Net Assets and Fund Performance

CHANGE IN NET ASSETS

The net assets for PSP Investments decreased by $5.1 billion, going from $38.9 billion at the end of fiscal year 2008 to $33.8 billion at the end of fiscal year 2009. The investment loss for PSP Investments is $9.5 billion, offset by contributions of $4.4 billion. The investment loss reflects a consolidated rate of return of negative 22.7% in fiscal year 2009, compared to a return of negative 0.3% in fiscal year 2008.

PERFORMANCE MEASUREMENT AND EVALUATION

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

BENCHMARKS

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

RATES OF RETURN

In fiscal 2009, PSP Investments' rate of return is negative 22.7% as compared to the Policy Benchmark rate of return of negative 17.6%. Over the last five fiscal years, PSP Investments has posted a positive rate of return of 2.0% as compared to the Policy Benchmark positive rate of return of 3.0% over that same period.

The overall performance was adversely influenced by the financial performance of the world's major stock markets. As outlined in the economic overview beginning on page 11, global stock markets recorded their worst declines of the post-war period. For the fiscal year ended March 31, 2009, declines in global markets ranged from negative 32.4% to negative 38.1% (Canadian, US and EAFE) in local currency. Some of the most important declines occured in the first three months of calendar year 2009, the last quarter of the fiscal year. Stock markets in the U.S. were at 1997 levels while the TSX was trading at 2002 levels. In the fourth quarter alone, the S&P 500 and EAFE declined by more than 10% in local currency. The fund's overall return was generally higher than the returns posted by the major global stock markets due to the portfolio being well diversified.

As a result of a well-diversified portfolio, PSP Investments' exposure to World Government Bonds, Infrastructure, World Inflation-Linked Bonds, Canadian Fixed Income, Cash & Cash Equivalents, Real Estate and Private Equity generally outperformed the world's major stock markets and helped cushion the effect of negative performance of public stock markets.

The overall rate of return was also affected by PSP Investments' foreign Currency Hedging Policy which is intended to hedge some of its foreign currency exposure in developed markets. Due to the weakening Canadian dollar in fiscal year 2009 against the US dollar, the overall rate of return was negatively impacted by 2.6%.

The following outlines the performance highlights by major asset class.

Public Markets

Public Markets is composed of Developed World Equity, Small Cap Developed World Equity, Emerging Markets Equity, Nominal Fixed Income and World Inflation-Linked bonds.

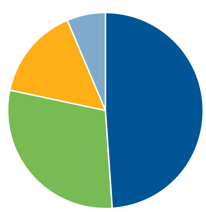
The majority of public equities portfolios recorded negative returns but were a source of value added in fiscal year 2009. Canadian Equity, EAFE Large Cap Equity and Emerging Markets Equity recorded negative returns but all outperformed their respective benchmark returns. In addition, all Nominal Fixed Income and World Inflation-Linked bond portfolios had positive returns for the fiscal year.

External equity and fixed income managers accounted for most of the underperformance. A major factor contributing to the decrease in fair value was related to the effect of increased credit spreads on the externally managed debt portfolios. On the other hand, internal active management added $62M of value, mostly coming from positions in merger arbitrage and fixed income strategies.

Private Equity

Private Equity's return of negative 32.3% for fiscal year 2009, underperformed its benchmark return of negative 31.6% by 0.7%. Since inception (the asset class has only existed for 4.75 years), Private Equity's return of negative 17.9% outperformed its benchmark return of negative 18.5% by 0.6%.

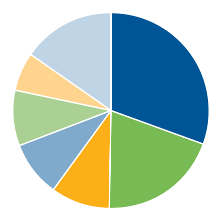
Major directly held investments are performing according to plan. However, the significant market disruption and mark-to-market accounting rules have nevertheless resulted in fair value write-downs. Also, in accordance with PSP Investments' Currency Hedging Policy, all foreign currency investments are hedged. The significant drop in the Canadian dollar has thereby impacted returns. Private Equity's return on an unhedged basis was negative 19.8% in fiscal 2009.



PRIVATE EQUITY –
DIVERSIFICATION BY GEOGRAPHY

United States	46.6%
Europe	27.5%
Canada	14.3%
Asia	11.6%

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



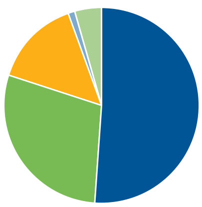
PRIVATE EQUITY –
DIVERSIFICATION BY SECTOR

Consumer Discretionary	30.6%
Telecom	19.8%
Information Technology	9.7%
Health Care	9.2%
Materials and Industrial	9.1%
Financial	6.4%
Other	15.2%

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

Real Estate

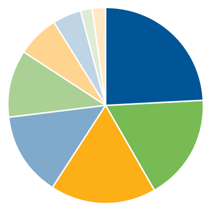
Real Estate's return of negative 16.8% for fiscal year 2009 underperformed the benchmark return of positive 6.6%. Over a five-year period, Real Estate's annualized return of positive 9.3% outperformed the benchmark return of positive 7.1% by 2.2%. Market disruption over the last year has driven capitalization rates higher when compared to prior years. The depressed global markets and the deleveraging process in the industry have negatively impacted capitalization rates resulting in a decline in fair values. However, most investment properties are performing to expectations and are maintaining or increasing net operating income. A defensive real estate strategy was maintained, with new investments focused primarily in multi-residential projects. Commercial real estate in general was avoided limiting the downside exposure related to this sector. Most foreign currency investments are hedged. Real Estate's return on an unhedged basis was negative 8.3% in fiscal year 2009.



REAL ESTATE –
DIVERSIFICATION BY GEOGRAPHY

Canada	51.2%
United States	28.8%
Europe	14.6%
Asia	1.2%
Other	4.2%

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



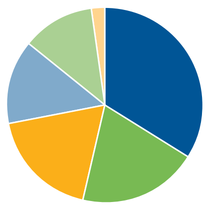
REAL ESTATE –
DIVERSIFICATION BY SECTOR

Senior Housing	24.4%
Residential	17.5%
Office	17.3%
Long-Term Care	14.1%
High-Yield Debt	11.1%
Retail	6.9%
Hotel	4.6%
Industrial	1.9%
Other	2.2%

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

Infrastructure

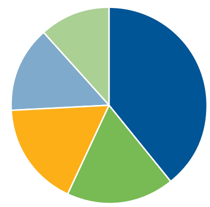
Infrastructure's return of positive 6.0% for fiscal year 2009 outperformed the benchmark return of positive 5.8% by 0.2%. Annualized return for three years (the asset class has only existed for three years) of positive 5.5% outperformed its benchmark return of positive 3.3% by 2.2%. The major contributors to the fiscal year 2009 performance were direct investments. Generally, the infrastructure portfolio benefited from its large exposure to the energy infrastructure and utilities sectors, which fared well because of their relatively stable cash flows and regulated environments. Infrastructure had limited exposure to the transportation sector, which proved opportunistic given the decline this year in traffic and volumes experienced in the toll roads, ports and airport industries. All foreign currency investments are hedged. Infrastructure's return on an unhedged basis was positive 18.7% in fiscal year 2009.



INFRASTRUCTURE – DIVERSIFICATION BY GEOGRAPHY

United States	33.9%
Europe	19.9%
United Kingdom	18.2%
South America	14.0%
Canada	12.0%
Australia	2.0%

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



INFRASTRUCTURE – DIVERSIFICATION BY SECTOR

Oil & Gas Storage and Transport	39.4%
Oil & Gas Exploration and Production	17.8%
Transportation	17.0%
Electric Transmission	14.2%
Water Utilities	11.6%

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

Other

From a value added perspective, our holdings in asset-backed commercial paper and collateralized debt obligations were significant contributors to underperformance in fiscal year 2009 versus the Policy Portfolio's benchmark return. For the year ended March 31, 2009, investments in asset-backed commercial paper decreased overall returns by 1.0%, which was due to a write-down of $483 million during the fiscal year. Our investment in collateralized debt obligations reflects a write-down of $725 million during the fiscal year, decreasing the overall rate of return by 2.0%. The investment losses related to asset-backed commercial paper and collateralized debt obligations generally reflects the ongoing credit crisis which first unfolded between July and September 2007 and further intensified this year, leading to the freeze of credit markets. As a result, credit spreads increased significantly, reaching all-time highs. The increased credit spreads are the primary cause of the write-downs incurred in both of these investments. As at March 31, 2009, although losses have been recorded in the financial statements in accordance with accounting rules, there are no actual credit losses realized in asset-backed commercial paper and few actual credit losses in the collateralized debt obligations.

Portfolio and Benchmark Returns

Asset Class	Fiscal Year 2009		5-year	
	Portfolio Returns %	Benchmark Returns %	Portfolio Returns %	Benchmark Returns %
Developed World Equity				
➤ Canadian Equity	-32.3	-32.4	3.4	3.2
➤ US Large Cap Equity	-27.7	-24.1	-7.6	-5.6
➤ EAFE Large Cap Equity	-33.6	-34.4	-3.2	-3.0
Small Cap Developed World Equity (4 years)	-30.0	-26.7	-9.4[1]	-7.3[1]
Emerging Markets Equity (4 years)	-34.0	-35.1	3.5[1]	3.8[1]
Private Equity (4.75 years)	-32.3	-31.6	-17.9[1]	-18.5[1]
Nominal Fixed Income				
➤ Cash & Cash Equivalents	2.8	2.4	3.3	3.2
➤ World Government Bonds (2 years)	19.4	19.4	11.8[1]	11.8[1]
➤ Canadian Fixed Income	4.7	4.9	5.2	5.2
Real Return Assets				
➤ World Inflation-Linked Bonds (4.9 years)	5.9	6.0	6.1[1]	6.4[1]
➤ Real Estate	-16.8	6.6	9.3	7.1
➤ Infrastructure (3 years)	6.0	5.8	5.5[1]	3.3[1]
Total Return	-22.7	-17.6	2.0	3.0

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

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

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

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

The total portfolio return includes the performance impact of absolute return strategies. Hedging investment returns are either netted against the return of the respective hedged assets, as is the case with Private Asset classes, or included in total return, as in the case of Public Markets.

Operating Expenses

Operating Expenses

PSP Investments' operating expenses during fiscal year 2009 totaled $86 million, compared to $77 million in fiscal year 2008. These costs amounted to 0.23% of average net assets compared with 0.21% in fiscal year 2008. The increase in operating costs in fiscal year 2009 can be attributed to a continuing shift to actively managed assets, which generally entail higher costs than passive mandates, as well as increased headcount due to the diversification of our investment strategy in the private equity, real estate and infrastructure asset classes. Operating expenses exclude external investment management fees and transactional costs which are applied against investment income.

PSP Investments goes through an annual budgeting process, which helps ensure operating costs remain reasonable and under control. During the year, actual results are monitored to the budgeted amounts that were set out at the beginning of the year. For fiscal year 2009 and as a result of the market crisis, which led to significantly declining assets under management, PSP Investments embarked on a cost control initiative for the year which resulted in reductions in total operating expenses. This initiative permitted PSP Investments to finish the year with operating expenses $9.9 million below budget.

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

International Financial Reporting Standards (IFRS)

In February 2008, the Accounting Standards Board (AcSB) confirmed that Canadian generally accepted accounting principles for publicly accountable enterprises will converge with IFRS effective January 1, 2011. The conversion to IFRS will be required, for PSP Investments, for interim and annual financial statements beginning on April 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences on recognition, measurement and disclosure.

PSP Investments is currently evaluating the impact of the adoption of IFRS on its Consolidated Financial Statements.

Risk Management

Risk Management Governance

Effective governance is essential in order to safeguard the capital entrusted to PSP Investments and to ensure that appropriate objectives are pursued and achieved in line with the fulfillment of its legislated mandate.

PSP Investments promotes a risk-aware culture involving all employees. The Board of Directors, senior management and employees are not only active participants in risk identification, but also in risk evaluation, risk monitoring and risk mitigation.

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

In fiscal year 2009, PSP Investments put in place solid foundations to support a comprehensive Enterprise Risk Management program. Amongst the significant achievements are:

- The development of an Enterprise Risk Management Policy which outlines the guiding principles for strategic risk reviews, annual risk assessments for all business units, risk monitoring and reporting processes for the Board of Directors, as well as the development of enterprise risk awareness by all employees;
- The addition of experienced professionals dedicated to risk management; and
- The identification of the major risks PSP Investments is facing and for which action plans have been developed.

Furthermore, PSP Investments implemented proactive and concrete methods of risk identification, monitoring, reporting and mitigation of all risks inherent in PSP Investments' activities including, but not limited to, investment risk and operational risk.

Investment Risk Management

PSP Investments defines investment risk as all risks inherent to the investment process, including financial risks, model risk and valuation risk. Financial risks include market risk, credit risk and liquidity risk:

- Market risk is the risk of loss due to changes in the level, volatility and correlation of equity prices, the term structure of interest rates, as well as currency and commodity spot and forward prices.
- Credit risk is the risk of loss resulting from the failure of a borrower or counterparty to honour its financial or contractual obligations.
- Liquidity risk is the risk of financial loss as a result of an institution's inability to meet day-to-day financial obligations as they come due, or the liquidation of an asset in adverse market conditions. The main sources of liquidity risk are treasury movements, renewal of corporate borrowings and contingency collateral calls.

INVESTMENT RISK CONTROLS

In fiscal year 2008, PSP Investments developed the Investment Risk Handbook ("the Handbook"). This Handbook contains an Investment Risk Policy, approved by the Board of Directors in fiscal year 2009, as well as Investment Risk Guidelines and Procedures, approved by senior management.

The Handbook establishes a framework, including a risk budget, to ensure that investment activities respect the Board of Directors' risk tolerance. In addition, the Handbook provides supplementary investment risk controls, including concentration limits by issuers, geographical regions, industries and financial products.

IMPACT OF RECENT MARKET EVENTS

In fiscal year 2009, unprecedented market events put unusual pressure on most of PSP Investments' investment risk measures. In this context, the Risk Management Group was called upon to contribute to the investment process by identifying the sources of risk and by presenting mitigation solutions. For instance, active risk measurement and credit risk monitoring were conducted in response to high volatility and increased default probabilities in the markets.

Operational Risk Management

The Operational Risk Management Policy currently in place within PSP Investments was approved by the Board of Directors in fiscal year 2009. This policy provides clear direction in terms of the definition of operational risk, the methodology used to assess operational risk, the roles and responsibilities of all stakeholders, new product approval and business continuity requirements.

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

- Human Resources Management
- Process Management
- System Management
- Theft and Fraud (External and Internal)
- Ethical, Fiduciary and Legal
- Disaster Risk
- Compliance

In fiscal year 2009, operational risk management activities were forward-looking with risk assessments and recommendations aimed at reducing or controlling operational risks. Furthermore, a business continuity exercise at the remote contingency site was successfully completed.

Internal Audit and Compliance

Internal Audit

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

Internal Controls

The internal control environment is derived from the Committee of Sponsoring Organizations (COSO) model. Assisted by internal auditors, PSP Investments reviews annually its control environment, general controls and key controls in all departments. The control functions are carried out at various levels: investment and operations' managers, risk management, compliance, internal and external audit. Each control is designed to ensure that PSP Investments' policies and procedures are respected and applied consistently. Internal policies and procedures provide a framework for the implementation of the main corporate controls. Corporate policies are approved by the Board of Directors and include, among other things, authority delegation, contract signatures, risk management and human resources. Corporate procedures present precise and specific guidelines for the adequate execution of internal processes.

Compliance

PSP Investments must act with integrity and maintain high ethical standards at all times. The objective of the Compliance Department is to ensure that PSP Investments complies with internal policies and procedures. This is mainly achieved through daily monitoring of transactions and processes ensuring compliance with the Code of Conduct for Officers and Employees (the "Code of Conduct"), policies and procedures, and industry regulations. In addition, PSP Investments requires employees to read and acknowledge compliance to the Code of Conduct on an annual basis. This document establishes rules of conduct, including maintaining the confidentiality of information, and governs the personal trading and investment activities of employees. Management reports quarterly on compliance matters to the Audit and Conflicts Committee of the Board of Directors.

Governance

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

Legislated Mandate

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

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

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

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

Roles and Responsibilities of the Board of Directors and Board Committees

BOARD OF DIRECTORS

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

- Appointment and termination of the President and CEO.
- Annual review and approval of proposed amendments to the written Statement of Investment Policies, Standards and Procedures (SIP&P).
- Approval of strategies and benchmarks for achieving investment performance objectives.
- Adoption of appropriate policies for the proper conduct and management of PSP Investments, including a Code of Conduct for Officers and Employees and Conflict of Interest Procedures for Directors.
- Ensuring that an effective operational and risk management system is in place, including appropriate risk management policies.
- 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 quarterly and annual financial statements for each underlying Pension Plan Account and for PSP Investments as a whole.

The Terms of Reference describing the roles and responsibilities of the Board Chair and the Board of Directors and its committees may be viewed in their entirety on PSP Investments' website **www.investpsp.ca** under "Governance – Duties & Responsibilities". Every three years, a governance review is conducted to assess the extent to which PSP Investments' Terms of Reference are being implemented and based on the examination, a governance report is submitted to the Governance Committee. The purpose of this report is to assist the Board of Directors in ensuring that each of the key fiduciaries has carried out its duties and responsibilities as set out in its Terms of Reference. The next governance review will take place at the end of fiscal year 2010. The Board of Directors also periodically reviews all policies and applicable procedures of PSP Investments.

BOARD COMMITTEES

The Board of Directors has established four standing committees and one special committee to assist in the fulfillment of its obligations. An Investment Sub-Committee existed prior to November 2008 but has since been abolished:

- Investment Committee
- Audit and Conflicts Committee
- Human Resources and Compensation Committee
- Governance Committee
- Special Committee
- Investment Sub-Committee (abolished on November 14, 2008)

Investment Committee

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

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

Audit and Conflicts Committee

The Audit and Conflicts Committee's role is generally to review the adequacy and effectiveness of PSP Investments' system of internal controls. This includes internal controls over the accounting and financial reporting systems within PSP Investments, as well as internal information system controls and security. The Audit and Conflicts Committee is also in charge of monitoring the application of the Code of Conduct for Officers and Employees.

Many of the duties of the Audit and Conflicts Committee are laid out in the Act. In addition to those mentioned above, these duties include:

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

On March 31, 2009, the Audit and Conflicts Committee was comprised of the following Directors:

- Keith G. Martell, Chair
- Cheryl Barker
- Jamie Baillie
- Anthony R. Gage
- Anil K. Rastogi
- William J. Saunderson

Human Resources and Compensation Committee

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

- Making recommendations to the Board of Directors regarding PSP Investments' human resources, training policy and compensation policies and periodically reviewing such policies and recommending changes as necessary;
- Making recommendations to the Board of Director on the remuneration of the officers of PSP Investments;
- Reviewing annually, on an aggregate basis, the total compensation of all employees of PSP Investments;
- Ensuring the compliance of PSP Investments' human resources policies and practices with applicable legislation; and
- Reviewing PSP Investments' succession planning and reporting to the Board of Directors on such planning.

On March 31, 2009, the Human Resources and Compensation Committee was comprised of the following Directors:

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

Governance Committee

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

- Monitoring and assessing the relationship between the Board of Directors and Management, defining the limits to Management's responsibilities and ensuring that the Board of Directors is able to function independently of Management;
- Reviewing on a biannual basis with the assistance and input of the Chief Executive Officer and the Chair of PSP Investments, the Terms of Reference for the Board of Directors and the committees of the Board of Directors, and recommending to the Board such amendments as may be necessary or advisable;
- Developing and recommending to the Board of Directors for its approval, the by-laws and governance-related policies;
- Overseeing the implementation of procedures for assessing the effectiveness of the Board of Directors as a whole and for conducting a peer review.

On March 31, 2009, the Governance Committee was comprised of the following Directors:

- Bob Baldwin, Chair
- Cheryl Barker
- Léon Courville
- Anil K. Rastogi
- William J. Saunderson

Special Committee

The Board of Directors established a Special Committee effective June 27, 2008 to assist in improving the linkage of the Plans' liabilities to PSP Investments' strategy.

On March 31, 2009, the Special Committee was comprised of the following Directors:

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

Investment Sub-Committee

The Investment Sub-Committee was abolished on November 14, 2008. Its main role was to review individual private or structured investments in securities not publicly traded, and to make recommendations to the Investment Committee regarding such investments. Since the abolishment of the Investment Sub-Committee, the duties previously performed by the Investment Sub-Committee are performed by the Investment Committee.

Accountability and Reporting to Government

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

The President of the Treasury Board is also required to table PSP Investments' annual report in Parliament. PSP Investments is required to provide its annual report as well as quarterly financial statements to the President of the Treasury Board, the Minister of National Defence and the Minister of Public Safety. During the last fiscal year, PSP Investments conducted a thorough review of its annual report disclosure with a view of complying with best corporate governance and disclosure practices.

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

Pursuant to the *Financial Administration Act* (FAA), the Auditor General of Canada serves as the joint auditor of PSP Investments and is responsible, amongst other duties, for conducting a special examination. Until recently, PSP Investments was subject to a Special Examination held once every five years, as provided for in the FAA. The *2009 Budget Implementation Act* amended the FAA. Pursuant to the new FAA provisions, a Special Examination in respect of PSP Investments and its subsidiaries must be carried out at least once every ten years. The most recent Special Examination in respect of PSP Investments was conducted in fiscal year 2006. The results, which were presented in a Special Examination Report dated November 15, 2005, indicated that there were no significant deficiencies in PSP Investments' systems and practices.

In collaboration with the Auditor General of Canada, the Board of Directors recommended to conduct the next Special Examination of PSP Investments in a year from now.

Directors' Selection

PSP Investments' Board of Directors is comprised of twelve members including the Chair, all of whom are considered "independent" for the purposes of Canadian securities legislation.

As at March 31, 2009, eleven board positions were occupied and the vacant position was in the process of being filled. On April 3, 2009, following the resignation of a Director, the number of vacant positions was increased to two.

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

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

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. A short biography for each of the Directors as of March 31, 2009 can be found at pages 46-48.

Assessment of Board Performance

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

To facilitate the assessment process, guidelines for evaluating the performance of the Chair of the Board, the individual performance of all Board members, of the chairs of the Board committees and of the Board as a whole are distributed once a year to every Director as well as to the President and CEO. The guidelines take the form of a questionnaire. Directors submit their completed questionnaires to the Chair of the Governance Committee, who summarizes the information and presents it to the Board of Directors. The Board discussion focuses on concerns and opportunities for improvement, what is working properly and what has improved since previous assessments.

Conflict of Interest Procedures for Directors

The Conflict of Interest Procedures for Directors are intended to provide a workable process for identifying, minimizing and resolving potential conflicts of interest. Derived from the Act and the *Conflict of Interest Act*, they set out in detail Directors' statutory and fiduciary duties relating to conflicts of interest and help ensure that Directors have a full understanding and appreciation of PSP Investments' principles and values. Ultimately, these procedures aim to assist Directors in determining appropriate business practices and behaviour.

The Conflict of Interest Procedures for Directors, among other things:

- Require Directors to give written notice to the Board of Directors of the nature and extent of their interest in a transaction or proposed transaction;
- Prohibit Directors from voting on a resolution or participating in a discussion in any circumstances if they have a conflict of interest;
- Require the disclosure of any other business activity in which they participate which directly or indirectly affects PSP Investments' activities or is in competition with PSP Investments's activities.

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

Director Education Program

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

To improve Directors' financial knowledge and skills, PSP Investments created a Director Education Program which provides financial and staff resources to Directors. In fiscal year 2009, each Director was allocated an individual budget equal to 15% of the retainer meeting fees he or she earned in fiscal year 2008 to be used mainly to strengthen their understanding of investment management. In addition to offering individual courses, conferences and reading material, the Director Education Program also includes group training sessions organized the day before each regular Board of Directors' meeting. During these sessions, distinguished speakers are invited to make presentations on various subjects to enhance the Board's expertise.

Code of Conduct

In accordance with the Act, PSP Investments has a Code of Conduct for Officers and Employees (the "Code of Conduct"). In addition to ensuring stringent compliance with the relevant statutory requirements, the Code of Conduct serves as a framework that provides officers and employees with a full understanding of the organization's corporate principles and values with the objective to assist them in determining appropriate business practices and behaviour.

The Code of Conduct includes a whistleblowing provision designed to encourage officers and employees to step forward and report any financial fraud or other fraudulent and inappropriate activities. Among other things, the Code of Conduct deals with overall honesty and integrity; compliance with the Code of Conduct and the law; conflict of interest procedures for officers and employees; the integrity of accounting records and financial information; the handling and use of confidential information; prohibitions on insider trading; the reporting of personal investment transactions; receiving entertainment or gifts; external appointments or employment within any organisation or association; political activities; and dealings with public officials.

The Audit and Conflicts Committee is responsible for monitoring the application of the Code of Conduct. The Code of Conduct may be viewed on PSP Investments' website **www.investpsp.ca** under "Governance – Code of Conduct for Officers and Employees".

Directors' Compensation

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

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

The following remuneration for Directors was approved by the Board of Directors in fiscal year 2009 and the Board has agreed that there will be no increase of these amounts for fiscal year 2010:

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

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

The Board of Directors met 13 times during fiscal year 2009 and its committees held 34 meetings. This amounted to a total remuneration for Directors of $825,409. The tables on the following two pages illustrate and breakdown the above mentioned results.

[1] For a meeting of less than one hour: $500. Only a single fee is paid when Board of Directors and Investment Committee meetings are held concurrently.

Attendance of Directors
Board and Committees – Fiscal Year 2009

	Board of Directors/ Investment Committee		Audit and Conflicts Committee		Governance Committee		Human Resources and Compensation Committee		Investment Sub-Committee [4]	Special Committee
	Regular	Special	Regular	Special	Regular	Special	Regular	Special		
Number of meetings Fiscal Year 2009	8	5	5	3	4	-	5	3	5	9
Jamie Baillie	6/8	4/5	5/5	3/3					5/5	
Bob Baldwin	8/8	4/5			4/4		5/5	3/3		9/9
Cheryl Barker	8/8	4/5	5/5	3/3	4/4					
Paul Cantor [1]	8/8	5/5								
Léon Courville	8/8	5/5			4/4				5/5	
Anthony R. Gage [2]	8/8	3/5	5/5	3/3			5/5	3/3	5/5	8/9
Jean Lefebvre	8/8	4/5					5/5	3/3	5/5	8/9
Keith G. Martell [3]	8/8	5/5	4/5	3/3			1/1		4/5	
Michael P. Mueller	8/8	5/5					5/5	3/3	5/5	8/8
Anil K. Rastogi	8/8	5/5	5/5	3/3	4/4					
William J. Saunderson	7/8	2/5	4/5	1/3	4/4					

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

[2] Mr. Gage was appointed Chair of the Investment Committee on November 14, 2008.

[3] Mr. Martell's mandate as a member of the Human Resources and Compensation Committee terminated on April 3, 2008.

[4] The Investment Sub-Committee was abolished on November 14, 2008.

Remuneration of Directors Fiscal Year 2009

	Remuneration [1]				
Name	Annual Retainer	Chair of a Committee/ Retainer	Boards/ Committees Meeting Fees	Travel Fees	Total
Jamie Baillie	$27,500	–	$28,000	$9,000	$64,500
Bob Baldwin	$27,500	$8,750	$41,250	–	$77,500
Cheryl Barker	$27,500	–	$30,000	$12,000	$69,500
Paul Cantor	$125,000 (Chairperson)	–	–	–	$125,000
Léon Courville	$27,500	–	$28,500	–	$56,000
Anthony R. Gage	$27,500	$8,750	$48,000	$9,000	$93,250
Jean Lefebvre	$27,500	$6,659	$40,750	–	$74,909
Keith G. Martell	$27,500	$8,750	$31,000	$9,000	$76,250
Michael P. Mueller	$27,500	$8,750	$42,250	–	$78,500
Anil K. Rastogi	$27,500	–	$31,500	–	$59,000
William J. Saunderson	$27,500	–	$23,500	–	$51,000

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

Investment Governance Oversight

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

SOCIAL AND ENVIRONMENTAL RESPONSIBILITY

The primary responsibility of PSP Investments is to support the fulfillment of the pension promise. PSP Investments adopted a Policy on Social and Environmental Responsibility in 2005 which embodies PSP Investments' belief, that the adoption of socially responsible policies and practices in the corporations and entities in which it invests will enhance long-term shareholder value. The Policy on Social and Environmental Responsibility may be viewed on PSP Investments' website **www.investpsp.ca** under "Investments – Investment Policies – Policy on Social & Environmental Responsibility".

PROXY VOTING GUIDELINES

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

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

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

In fiscal year 2009, PSP Investments reviewed and amended the Guidelines to take into consideration the principal trends noted in the last proxy season.

To ensure a more active management of its proxy voting, PSP Investments is assisted by two service providers in voting the equities held in accounts managed internally as well as in segregated accounts managed by external managers. With the assistance of a service provider and through collaborative initiatives with other like-minded institutional investors, PSP Investments is also actively engaging issuers to improve their corporate governance practices.

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

COLLABORATIVE INITIATIVES

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

In 2006, PSP Investments became a signatory of the Carbon Disclosure Project and is now part of a group of 475 institutional investors representing $55 trillion in assets under management who are encouraging public companies to disclose how they are managing climate change risks and opportunities that may be affecting their business.

Compensation

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

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

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

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

In order to ensure that we offer competitive compensation to our employees, managers and officers, we benchmark our compensation packages with those of peers. Our reference market is a representative sample of organizations in the pension fund and investment management industry, the financial services industry and other selected samples, if appropriate, for the positions being benchmarked. Organizations comprising our core comparator group include the following large Canadian public pension plans: Alberta Investment Management Corporation, British Columbia Investment Management Corporation, *Caisse de dépôt et placement du Québec*, Canada Pension Plan Investment Board, Hospitals of Ontario Pension Plan, Ontario Municipal Employees Retirement System and Ontario Teachers Pension Plan. Our selection is based on the following three main criteria, being the size of the pension plans, their business sector and their talent pool. Data from these external reference markets is gathered periodically and on ad-hoc basis using compensation surveys generated by well-established specialized compensation consulting firms.

To remain competitive, PSP Investments aims at the following:

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

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

To ensure the alignment of officers' compensation with the organization's Compensation Policy, the Board of Directors retained the services of independent compensation consulting firms to recommend the appropriate annual base salary adjustments for fiscal year 2009 and the appropriate compensation levels, especially with respect to incentive compensation.

BASE SALARY

In fiscal year 2009, base salaries were increased in accordance with our Compensation Policy, but officers' and senior managers' base salaries were not increased for fiscal year 2010.

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

INCENTIVE PLAN

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

As a result of the review, the Board of Directors approved:

- a Short-Term Incentive Plan (STIP), which replaced the Annual Incentive Plans (AIP) as of April 1, 2008 and better recognizes the current year performance results;
- a Long-Term Incentive Plan (LTIP), which replaced the Deferred Incentive Plan (DIP) as of April 1, 2008 and is based on four-year forward-looking cycles with possible payouts after the fourth year; and
- a new Restricted Fund Unit Plan (RFU), effective on April 1, 2009, and which introduces performance and retention awards for key participants.

Short-Term Incentive Plan

DESCRIPTION OF THE PLAN

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

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

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

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

The Human Resources and Compensation Committee reviews the annual incentive compensation payment process and is satisfied that the 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 2009 PERFORMANCE

In fiscal year 2009, the total fund investment performance of PSP Investments ended below the incentive threshold and, therefore, no payouts were earned for that component of the short-term incentive plan. The four-year total fund performance ended below threshold and generated no incentive payment for eligible participants.

The one-year investment performance of asset classes ended either below or slightly above incentive thresholds and, therefore, incentive payouts were earned for eligible participants in asset classes that exceeded incentive thresholds. The four-year asset class performance ended above threshold for Real Estate, Private Equity and Infrastructure (three years since inception) and generated incentive payments for eligible participants.

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

The total incentive amount earned under the STIP was $5.2 million in fiscal year 2009, $6.1 million in fiscal year 2008 and $7.9 million in fiscal year 2007.

Long-Term Incentive Plan

DESCRIPTION OF THE PLAN

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

The LTIP is a cash-based plan that pays a percentage of base salary to participants based on the achievement of investment performance on the assets managed by PSP Investments. It is provided to PSP Investments' permanent employees in managerial positions as well as to any other employees who are recommended by the CEO and approved by the Human Resource and Compensation Committee of the Board of Directors.

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

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

In order to transition from the Deferred Incentive Plan using a three-year payout cycle to the LTIP using a four-year payout cycle and to compensate for the gap in the incentive opportunity between the payout cycles of the two plans, a shadow Deferred Incentive Plan has been maintained in fiscal year 2009. Earned Deferred Incentive Plan awards in fiscal year 2009 will be calculated at the end of fiscal year 2011 for payout early fiscal year 2012.

The Human Resources and Compensation Committee reviewed the long-term incentive compensation grant process and is satisfied that the grants were calculated in accordance with the terms of the LTIP.

In addition, the Board of Directors approved the Deferred Incentive Plan compensation payable and long-term incentive compensation granted to officers of PSP Investments.

DEFERRED INCENTIVE PAYMENTS

The Deferred Incentive Plan amounts paid in fiscal year 2009 were amounts earned in fiscal year 2007 with a two-year deferral period. The Human Resources and Compensation Committee is satisfied that the payouts were calculated in accordance with the terms of the Deferred Incentive Plan.

The total incentive amount paid under the Deferred Incentive Plan was $3.0 million in fiscal year 2009, $2.6 million in fiscal year 2008 and $2.5 million in fiscal year 2007.

Restricted Fund Unit

PSP Investments' Restricted Fund Unit (the "RFU") was established in February 2009 with effect as of April 1, 2009. Under the RFU, annual grants of restricted fund units can be made to the CEO and to employees who report directly to this position upon the recommendation of the CEO and with the approval of the Human Resources and Compensation Committee of the Board of Directors. Upon the recommendation of the CEO and with the approval of the Human Resources and Compensation Committee, annual discretionary grants may also be made to other participants based on performance-related considerations.

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

Group Insurance Benefits

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

Other Remuneration

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

Retirement Plans

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

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

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

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

Retirement Benefits

Name	Number of Years of Credited Service [1]	Annual Benefit		Accrued Obligation at Start of Year (Proposed Regulations) [2, 4]	Accrued Obligation at Start of Year (Final Regulations) [4, 5]	Compensatory Increase [6]	Non-Compensatory Increase [7]	Accrued Obligation at Year End [2, 8]
		At Year End [2]	At Age 65 [2, 3]					
Gordon J. Fyfe	5.50	$51,600	$183,600	$365,200	$493,200	$98,500	$(90,300)	$501,400
Bruno Guilmette	3.42	$16,100	$119,300	–	$112,100	$40,000	$(30,500)	$121,600
Neil Cunningham	1.42	$ 6,400	$ 73,200	$ 14,200	$ 23,700	$49,200	$ (6,400)	$ 66,500
Derek Murphy	5.08	$29,800	$107,500	$204,300	$294,800	$66,200	$(49,800)	$311,200
John Valentini	4.00	$23,800	$132,900	$118,800	$183,300	$85,900	$(41,900)	$227,300

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

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

3 For the purpose of calculating the annual benefits payable at age 65, the final average earnings are calculated as at March 31, 2009.

4 Accrued obligation using a discount rate of 5.3%. The obligations are calculated as at March 31, 2008 using the assumptions and methods that were used for the accounting disclosures as at December 31, 2007 with the exception that there were no salary projections. These obligations were calculated based on our interpretation at that time of the proposed Canadian Securities Administrators (CSA) requirements.

5 Accrued obligation using a discount rate of 5.3%. The obligations are calculated as at March 31, 2008 using the assumptions and methods that were used for the accounting disclosures as at December 31, 2007. These obligations are in line with the final CSA requirements.

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

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

8 Accrued obligation using a discount rate of 6.6%. The obligations are calculated as at March 31, 2009 using the assumptions and methods that were used for the accounting disclosures as at December 31, 2008. These obligations are in line with the final CSA requirements.

Summary Compensation Table

Payments under the Annual Incentive Plan for 2009 are 39% lower than in the previous year reflecting the total fund performance for 2009. Total compensation earned in fiscal year 2009 by PSP Investments' most highly compensated officers is 8% lower than in the previous year and excludes payments under the Deferred Incentive Plan.

Compensation paid during the fiscal year 2009 to the most highly compensated officers of PSP Investments includes the payment of amounts earned over the four-year period ended March 31, 2007 under the Deferred Incentive Plan and deferred for two years as a retention mechanism.

Name	Fiscal Year	Base Salary	Annual Incentive Plan	Deferred Incentive Plan [3]	Benefits and Other Compensation	Pension and SERP Plans	Total Compensation
Gordon J. Fyfe [1]	2009	$485,000	$189,122	$611,100	$35,876	$98,500	$1,419,598
President and Chief Executive Officer	2008	$466,000	$153,780	$546,163	$32,062	$83,100	$1,281,105
	2007	$450,000	$660,800	$504,400	$35,000	$72,500	$1,722,700
Bruno Guilmette [2]	2009	$263,000	$310,941	$423,542	$24,748	$40,000	$1,062,231
First Vice President, Infrastructure investments	2008	$250,000	$240,000	–	$24,516		$514,516
	2007	$200,000	$339,301	–			$539,301
Neil Cunningham	2009	$260,000	$180,760	$364,673	$25,660	$49,200	$880,293
First Vice President, Real Estate Investments	2008	$240,365	$531,026	$314,612	$19,562	$11,200	$1,116,765
	2007	$195,000	$364,700	$338,500	$15,000		$913,200
Derek Murphy	2009	$314,000	$117,762	$336,105	$25,668	$66,200	$859,735
First Vice President, Private Equity	2008	$300,000	$389,773 [4]	$257,093	$22,062	$58,100	$1,027,028
	2007	$275,000	$332,900	$322,200	$25,000	$43,800	$998,900
John Valentini [5]	2009	$342,250	$170,890	$207,653	$29,235	$85,900	$835,928
Executive Vice President, Chief Operating Officer and Chief Financial Officer	2008	$290,000	$174,400	$83,383	$22,062	$34,000	$603,845
	2007	$275,000	$204,782	–	$22,000	$32,200	$533,982
Derek Watchorn [6]	2009	$569,250	$390,648	$538,000	$25,295	$10,000	$1,533,193
President and Chief Executive Officer of Revera Inc.	2008	$568,880	$426,938	$199,552	$34,261	$9,500	$1,239,131
	2007	$550,000	$134,100	–	$33,225	$9,000	$726,325

Notes

1 If Mr. Fyfe's employment is terminated for any reason other than for good and sufficient cause, he is entitled to a payment equal to two times his 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. Mr. Fyfe is subject to post employment non-solicitation of employees and confidentiality obligations.

2 If Mr. Guilmette's employment is terminated for any reason other than for good and sufficient cause, he is entitled to a payment equal to one time his base salary, plus one year of annual incentive equivalent to the greater of either the previous year's annual incentive payment or the annual target incentive at the time of departure. Mr. Guilmette is subject to post employment non-solicitation of employees and confidentiality obligations.

3 Amounts paid in fiscal year 2009 were earned in fiscal year 2007.

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

5 Mr. Valentini's role was expanded and he was promoted to the position of Executive Vice President, Chief Operating Officer and Chief Financial Officer on July 1, 2008. If Mr. Valentini's employment is terminated for any reason other than for good and sufficient cause, he is entitled to a payment equal to one time his base salary, plus one year of annual incentive equivalent to the greater of either the previous year's annual incentive payment or the annual target incentive at the time of departure. Mr. Valentini is subject to post employment non-solicitation of employees and confidentiality obligations.

6 Mr. Watchorn is not an employee of PSP Investments, but is employed by Revera Inc., a wholly-owned subsidiary of PSP Investments. His compensation is based on a contract with Revera Inc. Revera Inc.'s financial year ends on December 31.

Glossary

A

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

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

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

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

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

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

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

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

B

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

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

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

C

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

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

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

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

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

Glossary

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

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

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

D

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

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

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

E

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

F

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

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

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

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

G

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

I

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

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

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

INFRASTRUCTURE

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

INTEREST RATE RISK

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

INTERNAL RATE OF RETURN (IRR)

The discount rate at which the net present value of an investment equals zero.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

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

INVESTMENT MANAGEMENT FEE

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

L

LIMITED PARTNER

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

LIMITED PARTNERSHIP

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

LIQUIDITY RISK

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

M

MARKET RISK

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

MEZZANINE DEBT FINANCING

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

MSCI EAFE INDEX

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

N

NET PRESENT VALUE (NPV)

The present value of an investment's future net cash flows less the initial investment.

O

OPTION

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

Glossary

P

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

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

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

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

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

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

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

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

R

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

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

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

S

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

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

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

STATEMENT OF INVESTMENT POLICIES, STANDARDS AND PROCEDURES (SIP&P)

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

STRUCTURED INVESTMENT VEHICLE

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

SUBPRIME MORTGAGE

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

SWAPS

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

T

TIME-WEIGHTED RATE OF RETURN

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

V

VALUE-AT-RISK (VaR)

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

VOLATILITY

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

Directors' Biographies

PAUL CANTOR *Chair, PSP Investments* *Senior Advisor, Bennett Jones LLP* Member: Investment Committee Board member since March 28, 2000	Mr. Cantor is Senior Advisor at Bennett Jones LLP where he advises on business and governance related issues. Previously, he was Chair & CEO of National Trust Company; President & CEO of Confederation Life; and President, Investment Bank, Canadian Imperial Bank of Commerce (CIBC). Mr. Cantor was Managing Partner and then Chair of Russell Reynolds Associates Canada. He was the founding Executive Director of the World Bank-Canada government sponsored Leadership Centre for Financial Sector Supervision at York University. He began his career at the Government of Canada's Department of Finance and its crown corporation, Polysar Limited. Mr. Cantor has held Board appointments at CIBC, National Trust, Torstar, E-L Financial, Hees International Bancorp, ING Direct and Intact Financial Corporation. He is Chair of the Board of Governors of York University. He also served on the Federal Reserve Bank of New York's International Capital Markets Committee; on Revenue Canada Taxation's Advisory Committee; and on the Ontario Premier's Council on Economic Renewal. More recently, Mr. Cantor acted as Chair of the ICD Commission on the Governance of Executive Compensation. Mr. Cantor holds a B.A. from the University of Alberta, an LL.B. from the University of Toronto and is a Fellow of the Institute of Canadian Bankers (Ryerson University).

JAMIE BAILLIE *President and Chief Executive Officer* *Credit Union Atlantic* Member: Audit and Conflict Committee / Investment Committee Board member since March 5, 2007	Mr. Baillie was appointed President & CEO of Credit Union Atlantic in 2005. Prior to joining the credit union, he held various leadership roles in Nova Scotia business and government, including three years as Chief of Staff, Office of the Premier. Previously, Mr. Baillie was a Partner with Robertson Surrette, a prominent executive search firm. Mr. Baillie is also a member of the Equifax Canada, Inc. Advisory Board. For the past three years, Mr. Baillie has been named one of Atlantic Canada's Top 50 CEOs by Atlantic Business Magazine. As an active community volunteer, he is past-chair of the Board of Neptune Theatre, and is an active member of the Boards of Dalhousie University and the Halifax International Airport Authority. Mr. Baillie holds a B.Comm. degree from Dalhousie University, a Chartered Accountant (CA) designation, and is a graduate of the Canadian Securities Institute.

BOB BALDWIN *Consultant* Member: Governance Committee – Chair / Human Resources and Compensation Committee / Special Committee / Investment Committee Board member since March 28, 2000	Mr. Baldwin is an Ottawa-based consultant who specializes in pensions, ageing society and labour market issues. Previously, Mr. Baldwin was Director of Social and Economic Policy at the Canadian Labour Congress (CLC) and was the CLC's pension specialist from 1977 to 2005. Mr. Baldwin is a member of the Committee on Professional Conduct of the Canadian Institute of Actuaries; he chairs the Board of Trustees of the Canada Wide Industrial Pension Plan and advises the Trade Union Advisory Committee to the OECD on pension issues. Mr. Baldwin is a Senior Associate with Informetrica Limited, Adjunct Research Professor at Carleton University and a Policy Associate of the Caledon Institute of Social Policy. He holds a Masters Degree in Political Science from the University of Western Ontario.

CHERYL BARKER *Corporate Director* Member: Audit and Conflicts Committee / Governance Committee / Investment Committee Board member since December 18, 2006	Ms. Barker is a member of the Board of Directors and Chair of the Finance/Audit Committee of Canadian Television Fund as well as a trustee of Lanesborough REIT and Chair of its Audit Committee. Ms. Barker was President of Manitoba Telecom Services Inc. (MTS) from 2004 until her retirement from MTS in February 2006. Ms. Barker's career in the telecommunications industry and business community as a whole is extensive. She spent the last 19 years with MTS, serving in a variety of key positions, including President and Chief Operating Officer of MTS Communications Inc., Chair, President and Chief Executive Officer of Bell Intrigna Inc., Executive Vice-President Finance, Chief Financial Officer and Treasurer of MTS. Ms. Barker is a Chartered Accountant, and holds a Bachelor of Science and a Certificate of Education from the University of Manitoba.

LÉON COURVILLE *Corporate Director* Member: Governance Committee / Investment Committee Board member since March 5, 2007	Mr. Léon Courville dedicated his entire career to the sciences of management and of finance, first by working at universities in Canada and the United States as a professor and a researcher, and, subsequently, by serving as President of the National Bank of Canada. Mr. Courville is presently enjoying an active retirement as a corporate director and as vineyard owner, Domaine Les Brome which he started in 1999. The works of Mr. Courville have garnered awards and bursaries in Canada and abroad, including the Coopers & Lybrand Award for a business publication for his work entitled The Storm-Navigating the New Economy. Mr. Courville holds a Ph.D in Economics from Carnegie-Mellon University. He is currently a member of the Board of Directors of Nav Canada and the Institut du Tourisme et de l'Hôtellerie du Québec.

ANTHONY R. GAGE *Corporate Director* Member: Investment Committee – Chair / Audit and Conflicts Committee / Human Resources and Compensation Committee / Special Committee Board member since June 27, 2006	Mr. Gage is currently on the Board of Governors of the University of Victoria, a director of Sky Investment Counsel and Head of the Management Committee of JEA Pension System Solutions. He is a former Chair of the Board of Phillips, Hager & North Investment Management. His career at Phillips, Hager & North spanned over 20 years including being President and Chief Executive Officer from 1994-1999. Prior to Phillips, Hager & North, 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 and Masters in Business Administration (Finance) from the University of British Columbia. He is a Chartered Financial Analyst (CFA) and an accredited Chartered Director (McMaster University).

JEAN LEFEBVRE *Corporate Director* Member: Special Committee – Chair / Human Resources and Compensation Committee / Investment Committee Board member since August 25, 2003	Mr. Jean Lefebvre is currently an independent asset management consultant. Previously, he was the former Senior Vice-President at TAL Global Asset Management from 1998 to 2001. In addition, Mr. Lefebvre worked in the consulting business as pension and asset management consultant with William M. Mercer. From 1976 to 1980, he worked with Tomenson-Alexander under the same capacity. Mr. Lefebvre's career began at the Dominion Life Insurance Company as actuarial assistant. He later held the position of Chief Actuary at AEterna Life and at Westmount Life where he was also Chief Administrative Officer and member of the Board of Directors. Throughout the first 16 years of his early career, Mr. Lefebvre was lecturer in actuarial science at the University of Montréal. Mr. Lefebvre has a B.A. and a B.Sc. from the University of Montréal and is a Fellow of the Society of Actuaries and a Fellow of the Canadian Institute of Actuaries.

Directors' Biographies

KEITH G. MARTELL *Executive Chair of the Board* *First Nations Bank of Canada* Member Audit and Conflicts Committee – Chair / Investment Committee Board member since January 23, 2001	Mr. Martell has been Chair of the Board of First Nations Bank of Canada since it was founded in 1996. He is also a member of the Boards of Directors of the North West Company Inc., Potash Corporation of Saskatchewan Inc., and Saskatoon Friendship Inn, and is a Trustee on the Primrose Lake Settlement Trust. Mr. Martell received a Bachelor of Commerce degree from the University of Saskatchewan in 1985 and is a Chartered Accountant. His experience includes audit and consulting with KPMG and positions as the Executive Director of Finance and Senior Official for Fiscal Relations with the Federation of Saskatchewan Indian Nations.

MICHAEL P. MUELLER *Corporate Director* Member Human Resources and Compensation Committee – Chair / Investment Committee / Special Committee Board member since December 18, 2006	Mr. Mueller is Chairman of the Board of The Scarborough Hospital, and a board member of AIM Therapeutics, Budco, The Katimavik Foundation and The Scarborough Hospital Foundation. He also serves as a strategic advisor to a number of Canadian, US and European companies. From 2003 until 2005 he was President and CEO of MDS Capital Corporation. Prior to that, Mr. Mueller held a series of senior executive positions at TD Bank, including Vice Chairman and Global Head of Investment and Corporate Banking. Mr. Mueller is a former board director of TM BioScience, MDS Capital and Canadian Medical Discoveries Fund I and II. Mr. Mueller holds a Bachelor of Science Degree from the University of Western Ontario, and a Master of Business Administration from York University.

ANIL K. RASTOGI* *Corporate Director* Member: Audit and Conflicts Committee / Governance Committee / Investment Committee Board member since October 12, 2004	Mr. Rastogi was Vice President and Chief Information Officer of McCain Foods Limited ("McCain") from 1995 until his retirement from McCain in November 2007. Prior to joining McCain in 1995, Mr. Rastogi held various senior positions mainly in the technology sector, at VIA Rail Canada Inc., Morgan Financial Corporation, Wellington Insurance Company, William M. Mercer Limited, AT&T Capital Canada and Simpson Limited. Mr. Rastogi had begun his career with IBM in Norway in 1968, where he held positions of increasing responsibility. In addition to his MBA from the Ivey Business School, UWO, he has a Diploma in International Management and is a CGA. He completed the Directors Education Program with the Institute of Corporate Directors Corporate Governance College, in October 2006, and holds the institute-certified designation of ICD.D.

WILLIAM J. SAUNDERSON *Corporate Director* Member: Audit and Conflicts Committee / Governance Committee / Investment Committee Board member since December 18, 2006	Mr. Saunderson is a Fellow of the Ontario Institute of Chartered Accountants and a recipient of its Award of Outstanding Merit. He obtained a Bachelor of Arts degree from the University of Toronto (Trinity College) and received an Honourary Doctorate degree from the University of Ottawa. Currently, he is Chairman of ROI Fund and Vice Chairman of the University of Ottawa Pension Investment Committee. He co-founded Sceptre Investment Counsel and then became a Member of the Legislative Assembly of Ontario, serving as Minister of Economic Development, Trade and Tourism and Chairman of Ontario Exports. He is actively involved with the Toronto Symphony Orchestra, Shaw Festival, Anglican Diocese of Toronto, Trinity College and University of Toronto Schools.

* Mr. Rastogi resigned from the Board of Directors on April 3, 2009.

Management Team

GUY ARCHAMBAULT	*First Vice President, Human Resources*
NEIL CUNNINGHAM	*First Vice President, Real Estate Investments*
GORDON J. FYFE	*President and Chief Executive Officer*
DANIEL GARANT	*First Vice President, Public Market Investments*
BRUNO GUILMETTE	*First Vice President, Infrastructure Investments*
PIERRE MALO	*First Vice President, Asset Allocation Strategies and Research*
DEREK MURPHY	*First Vice President, Private Equity*
JOHN VALENTINI	*Executive Vice President, Chief Operating Officer and Chief Financial Officer*

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, 2009 were in accordance with the Act and the SIP&P.

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

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

Gordon J. Fyfe
President and
Chief Executive Officer
May 11, 2009

John Valentini
Executive Vice President,
Chief Operating Officer and Chief Financial Officer
May 11, 2009

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, 2009 were in accordance with the Act and PSP Investments' Statement of Investment Policies, Standards and Procedures".

Paul Cantor
Chair of the Board
May 11, 2009

AUDITORS' REPORT

To the President of the Treasury Board

We have audited the Consolidated Balance Sheet of the Public Sector Pension Investment Board (PSP Investments) as at March 31, 2009, and the Consolidated Statements of Net Loss from Operations and Comprehensive Income and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of PSP Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of PSP Investments as at March 31, 2009, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

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

Deloitte & Touche LLP[1]

[1] Chartered accountant auditor permit No. 18527

Montreal, Canada
May 11, 2009

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 11, 2009

CONSOLIDATED BALANCE SHEET

As at March 31

($ millions)	2009	2008
ASSETS		
Investments (Note 3 (a))	**$ 38,431**	$ 42,176
Investment-related assets (Note 3 (a))	**741**	2,333
Cash	**1**	4
Other assets	**40**	23
TOTAL ASSETS	**$ 39,213**	$ 44,536
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 5,375**	$ 5,536
Accounts payable and accrued liabilities	**61**	75
TOTAL LIABILITIES	**$ 5,436**	$ 5,611
NET ASSETS	**$ 33,777**	$ 38,925
Share capital (Note 5)	**$ –**	$ –
Public Service Pension Plan Account	**24,496**	28,264
Canadian Forces Pension Plan Account	**6,750**	7,819
Royal Canadian Mounted Police Pension Plan Account	**2,416**	2,787
Reserve Force Pension Plan Account	**115**	55
NET ASSETS	**$ 33,777**	$ 38,925

Commitments (Note 13)

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

On behalf of the Board of Directors:

Paul Cantor
Chair of the Board

Keith Martell
Chair of the Audit and Conflicts Committee

CONSOLIDATED STATEMENT OF NET LOSS FROM OPERATIONS AND COMPREHENSIVE INCOME

For the year ended March 31

($ millions)	2009	2008
INVESTMENT LOSS (Note 7)	**$ (9,493)**	$ (197)
OPERATING EXPENSES (Note 8)	**$ 86**	$ 77
NET LOSS FROM OPERATIONS AND COMPREHENSIVE INCOME (Note 9)	**$ (9,579)**	$ (274)

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

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2009	2008
NET ASSETS, BEGINNING OF YEAR (as previously reported)	**$ 38,925**	$ 34,968
Change in accounting policy – financial instruments	**–**	(6)
NET ASSETS, BEGINNING OF YEAR (as restated)	**$ 38,925**	$ 34,962
Fund transfers (Note 6)	**4,431**	4,237
Net loss from operations and comprehensive income	**(9,579)**	(274)
(Decrease) increase in net assets for the year	**(5,148)**	3,963
NET ASSETS, END OF YEAR	**$ 33,777**	$ 38,925

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

ORGANIZATION

The Public Sector Pension Investment Board ("PSP Investments") was formed pursuant to the *Public Sector Pension Investment Board Act* ("the Act") with a mandate to invest the net contributions of the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans in financial markets. At the end of March 2007, PSP Investments' mandate was expanded to include the investment of the net contributions of the Reserve Force pension plan. The first net contributions were received from the Reserve Force pension plan in April 2007.

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These consolidated financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it from the Public Service, Canadian Forces, Royal Canadian Mounted Police and Reserve Force Pension Funds ("the Pension Funds"). Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of all the Pension Funds. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and the requirements of the Act. PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value were included in investment income as net unrealized gains or losses in the year the change occurred (Note 7 (a)).

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

PLAN ACCOUNTS

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS

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

Market prices or rates are used to determine fair value where an active market exists (such as a recognized stock exchange), as it is the best evidence of the fair value of an investment. If quoted market prices or rates are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the balance sheet dates. If available, market observable inputs are applied to valuation models.

Valuation techniques are generally applied to private equity, infrastructure and real estate investments as well as over-the-counter (OTC) derivatives. 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.

Fair values of investments are determined as follows:

(a) Cash & Cash equivalent investments are recorded at cost plus accrued interest, which approximate fair value, and are mostly comprised of cash, floating rate notes, term deposits and government short-term securities.

(b) Quoted market prices for public equities, using the bid price for long positions and the ask price for short positions, are used to present the fair value of these investments.

Unit values obtained from each of the funds' administrators, reflecting the market prices of the underlying securities, are used to present the fair value of pooled funds.

(c) Private equity and infrastructure investments are fair-valued at least annually.

The fair value for investments held directly by PSP Investments is determined using acceptable industry valuation methods such as earnings multiples, discounted cash flows analysis, price of recent investments and publicly traded comparables. Valuation techniques involve assumptions including discount rates and the projected length of cash flows. The valuation methodologies have been developed based on the *International Private Equity and Venture Capital Valuation Guidelines*.

In the case of investments in fund portfolios, fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

For each investment the relevant methodology is applied consistently over time.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

(d) The fair value of investments in real estate held directly by PSP Investments is determined at least annually, using acceptable industry valuation methods, such as discounted cash flows and comparable transactions. Valuation techniques involve various assumptions including capitalization rate and the projected cash flows and/or net operating income. The assumptions are supported by observable market data. Management uses the services of a third-party appraiser to determine the fair value of real estate investments. These valuations are prepared using professional appraisal standards, such as the Canadian Uniform Standards of Professional Appraisal Practice and the Uniform Standards of Professional Appraisal Practice in the United States of America.

In the case of investments in fund portfolios, fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

The fair value of real estate loans is estimated by discounting expected future cash flows using interest rates offered for similar loans to borrowers with similar credit ratings. Management may use the services of a third-party appraiser to determine the fair value of real estate loans.

For each investment the relevant methodology is applied consistently over time.

(e) Fixed income securities are valued at quoted market prices using the bid price for long positions and the ask price for short positions, where available. Where quoted market prices are not available, estimated values are calculated using either an appropriate interest rate curve with a spread associated with the credit quality of the issuer or other generally accepted pricing methodologies.

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

The fair value of credit derivatives, including credit default swaps and synthetic collateralized debt obligations, are also determined based on valuation techniques. Certain assumptions are made with respect to the probability of the event of default of the underlying securities, of its recovery rate and its corresponding impact on cash distributions. The instrument is then valued by discounting the expected cash flows by an appropriate discount factor.

VALUATION OF CAPITAL DEBT FINANCING

The fair value of PSP Investments' short-term capital debt financing includes the cost amount and accrued interest, which approximates fair value. The fair value of PSP Investments' long-term capital debt financing is determined based on quoted market prices.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

Investment management fees are costs directly attributable to the external management of funds on behalf of PSP Investments. Investment management fees incurred for the Private Equity, Real Estate and Infrastructure asset classes are paid, as determined by the fund manager, either by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment (Note 3 (a) (ii)). These amounts are recorded against investment income. Investment management fees are also incurred for certain public equity investments and these amounts are paid directly by PSP Investments and recorded against investment income (Note 7).

INCOME RECOGNITION

Investment income is made up of dividends, accrued interest income, realized gains and losses on the disposal of investments and unrealized gains and losses which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Dividend income is recognized on the ex-dividend date. Investment income from private market investments also includes the related distributions from pooled funds, limited partnerships as well as from direct and co-investments.

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

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

INCOME TAXES

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

USE OF ESTIMATES

In preparing these consolidated financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of private equity, infrastructure and real estate investments, related income and expenses and note disclosures. Actual results may differ from estimates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

2. CHANGES IN ACCOUNTING POLICIES

NEW ACCOUNTING STANDARDS

On April 1, 2008, PSP Investments adopted the *Canadian Institute of Chartered Accountants (CICA) Handbook* Section 1535, "Capital Disclosures", as well as Section 3862, "Financial Instruments – Disclosures" and Section 3863, "Financial Instruments – Presentation".

Section 1535, "Capital Disclosures" specifies the disclosure of (i) an entity's objectives, policies, and processes for managing capital, (ii) quantitative data about what the entity regards as capital, (iii) whether the entity has complied with any capital requirements, and (iv) if it has not complied, the consequences of such non-compliance. The adoption of this standard has no significant impact on PSP Investments' consolidated financial statements other than additional note disclosure in Note 11.

Section 3862, "Financial Instruments – Disclosures" and Section 3863, "Financial Instruments – Presentation" replace Section 3861, "Financial Instruments – Disclosure and Presentation". The new standards revise and enhance disclosures about the significance of financial instruments to the entity's financial position and performance, the nature and extent of the risks arising from financial instruments and how the entity manages those risks. The adoption of this standard is disclosed in Note 4.

Additionally, in January 2009, the Emerging Issues Committee (EIC) of the CICA issued EIC-173 "Credit risk and the fair value of financial assets and financial liabilities" which requires that the fair value of financial instruments (including derivative financial instruments) take into account the counterparties' credit risk for assets and PSP Investments' credit risk for liabilities. The adoption of EIC-173 did not have a significant impact on PSP Investments' consolidated financial statements.

FUTURE ACCOUNTING CHANGES

In February 2008, the Accounting Standards Board (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises will be converged with International Financial Reporting Standards (IFRS) effective January 1, 2011. PSP Investments will be required to report under IFRS for interim and annual consolidated financial statements effective April 1, 2011 with IFRS comparatives.

PSP Investments is currently evaluating the impact of the adoption of IFRS on its consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

($ millions)	2009		2008	
	Fair Value	**Cost**	Fair Value	Cost
Developed World Equity				
Canadian Equity	**$ 6,356**	**$ 7,700**	$ 7,614	$ 7,083
US Large Cap Equity	**716**	**985**	1,847	2,086
EAFE Large Cap Equity	**1,161**	**1,847**	1,989	2,117
Small Cap Developed World Equity	**740**	**994**	1,375	1,624
Emerging Markets Equity	**1,461**	**1,838**	1,836	1,615
Private Equity	**4,247**	**4,982**	4,040	3,901
Nominal Fixed Income				
Cash & Cash Equivalents	**3,075**	**3,325**	3,670	3,669
World Government Bonds	**759**	**675**	1,790	1,799
Canadian Fixed Income	**7,282**	**7,319**	8,712	9,152
Real Return Assets				
World Inflation-Linked Bonds	**196**	**198**	207	195
Real Estate	**7,105**	**6,425**	5,737	4,648
Infrastructure	**2,711**	**2,335**	1,376	1,347
Absolute Return	**2,622**	**2,731**	1,983	2,017
INVESTMENTS	**$ 38,431**	**$ 41,354**	$ 42,176	$ 41,253
Investment-Related Assets				
Amounts receivable from pending trades	**$ 256**	**$ 264**	$ 1,781	$ 1,777
Derivative-related receivables	**485**	**65**	552	85
Total Investment-Related Assets	**$ 741**	**$ 329**	$ 2,333	$ 1,862
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (505)**	**$ (506)**	$ (1,981)	$ (1,983)
Securities sold short	**(527)**	**(612)**	(727)	(746)
Derivative-related payables	**(1,710)**	**(98)**	(1,277)	(52)
Capital debt financing (Note 10)				
Short-term	**(1,579)**	**(1,579)**	(1,551)	(1,551)
Long-term	**(1,054)**	**(1,024)**	–	–
Total Investment-Related Liabilities	**$ (5,375)**	**$ (3,819)**	$ (5,536)	$ (4,332)
NET INVESTMENTS	**$ 33,797**	**$ 37,864**	$ 38,973	$ 38,783

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Developed World Equity, Small Cap Developed World Equity and Emerging Markets Equity

Developed World Equity, Small Cap Developed World Equity and Emerging Markets Equity (referred to as "Public Market Equities") include common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds, and securities convertible into common shares of publicly listed issuers.

(ii) Private Equity, Real Estate and Infrastructure

The private equity asset class is comprised of direct investments and fund portfolios in equity ownerships or investments with the risk and return characteristics of equity. They include investments in private companies, mezzanine debt and distressed debt. As at March 31, 2009, the total amount of financing included in the private equity portfolio for direct investments controlled by PSP Investments is nil (2008 – nil).

The real estate asset class is comprised of direct ownerships in properties, third-party debts and fund investments in the real estate sector. The real estate investments are classified into two portfolios (an equity portfolio and a debt portfolio). The equity portfolio is comprised of direct ownerships in income-producing properties in office, retail, industrial, hospitality and residential sectors, as well as private funds and publicly traded securities invested in real estate assets. The debt portfolio is comprised of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, mezzanine loans and other structured investments where significant portions of the value are attributed to the underlying real estate assets. Real estate investments are made in accordance with the approved policies for leverage specifically applicable for this asset class. The real estate asset class is accounted for in the investment portfolio net of all third-party financings. As at March 31, 2009, the total amount of financing included in the real estate portfolio for direct investments controlled by PSP Investments is approximately $3,750 million (2008 – $2,900 million).

Infrastructure investments are comprised of direct investments and fund portfolios in equity and debt instruments in public and private companies primarily engaged in the management, ownership or operation of assets in power, regulated businesses, transportation, telecom or social infrastructure. Infrastructure investments are made in accordance with the approved policies for leverage specifically applicable for this asset class. As at March 31, 2009, the total amount of financing included in the infrastructure portfolio for direct investments controlled by PSP Investments is approximately $550 million (2008 – $350 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

The fair value of certain direct investments in Private Equity and Infrastructure are determined using valuation techniques whereby certain assumptions cannot be fully supported by prices from observable current market transactions. Varying certain key elements of the valuation technique will have an impact on the fair value of the investments as at March 31, 2009. For example, increasing the discount rate by 50 bps would result in a decrease to the fair value of these investments of $236 million; decreasing the discount rate by 50 bps would result in an increase to the fair value of these investments of $387 million.

The Private Equity, Real Estate and Infrastructure asset classes are referred to as “Private Market Investments”. The fair values of the majority of private market investments are reviewed at least annually, and any resulting adjustments are reflected as unrealized gains or losses in investment income. The fair value of private market investments that are invested in funds are determined based on the audited annual financial statements received from external investment managers.

Investment management fees, as disclosed in Note 1, are incurred for private market investments and generally vary between 0.2% and 5.5% of the total invested amount. Investment management fees of $193 million for the year ended March 31, 2009 (2008 – $123 million) were recorded against investment income.

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

Nominal Fixed Income includes Cash & Cash Equivalents and Bonds. Cash on hand and cash equivalents include the following instruments having a maximum term of one year or less: demand deposits, Treasury bills, short-term notes, bankers’ acceptances, term deposits and guaranteed investment certificates. Floating rate notes are considered cash and cash equivalents provided the coupons reset more than once per year. Bonds include Canadian government bonds, Canadian provincial and territorial bonds, Canadian municipal and corporate bonds, as well as international sovereign bonds.

PSP Investments held third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007.

Subsequent to the liquidity disruption event, PSP Investments participated in a restructuring process with other investors. On August 16, 2007, a standstill agreement was entered into by a number of significant investors and financial institutions that transacted with the non-bank sponsored conduits. The Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper (“the Investors’ Committee”) was subsequently formed, consisting of an important number of major ABCP investors, to oversee the restructuring process during this standstill period.

As part of the Investors’ Committee restructuring plan, the following asset categories were pooled together under three separate vehicles: (1) leveraged super senior (LSS) tranches of collateralized debt obligations and other assets (collectively referred to as “LSS/Hybrid Assets”); (2) Traditional Assets which include securitized assets (for example, credit card receivables and auto loans); and (3) Ineligible Assets which include assets with uncertain credit quality by reason of their exposure to US subprime mortgages or otherwise. Investors in ABCP received long-term floating rate notes (for each of the aforementioned investment vehicles) with maturities based upon the maturity of the underlying assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

Under the Investors' Committee restructuring plan, the LSS/Hybrid Assets were split into two separate and distinct master asset vehicles (MAV); the first, referred to as "MAV1", in which case investors elected to commit their pro rata share of a margin funding facility associated with their underlying assets; and the second, referred to as "MAV2", whereby investors are able to commit less than, or none of their pro rata share of a margin funding facility, in which case certain investors, foreign banks and Canadian banks will fund the remaining portion. PSP Investments participated in MAV1. Within the MAV1, the LSS/Hybrid assets were further restructured into different classes (Class A-1, Class A-2, Class B, Class C, Traditional Assets (TA) and Ineligible Assets (IA)) of floating rate notes in order to permit a credit rating to be obtained on two of these notes (Class A-1 and Class A-2). A third MAV, referred to as "MAV3", includes series secured solely by TA and IA notes. Additionally, the margin funding facilities in MAV1 and MAV2 are provided by third-party lenders, Canadian banks, asset providers, noteholders and the Federal and Provincial governments of Canada. These facilities are designed to reduce the risk that the newly formed vehicles will not be able to meet margin calls if future circumstances warrant them. The key parties to the restructuring have also agreed to enhance the transaction by including a moratorium which prevents collateral calls for a period of 18 months from the implementation and closing date of the restructuring.

As at January 21, 2009, the Investors' Committee implemented and closed the ABCP restructuring transaction. Pursuant to the terms of the restructuring, ABCP holders exchanged their investments for long-term floating rate notes. As at January 21, 2009, PSP Investments held ABCP with an overall face value of $1,962 million. PSP Investments has adopted a valuation technique to determine the fair value of the long-term floating rate notes that were received.

Under the terms of the restructuring plan, PSP Investments has received $878 million of MAV1 Class A-1 notes, $590 million of MAV1 Class A-2 notes, $101 million of MAV1 Class B notes, $48 million of MAV1 Class C notes, $28 million of MAV1 TA tracking notes, $89 million of MAV1 IA tracking notes, $114 million of MAV3 TA tracking notes and $114 million of MAV3 IA tracking notes. In addition, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has provided funding facilities of a maximum amount of $969 million to support potential margin calls on the long-term floating rate notes.

The MAV1 notes, excluding TA and IA notes, are expected to return approximately Banker's Acceptance (BA) plus 30 bps (before funding facility and administrative costs) and have an average maturity of eight years. The MAV1 and MAV3 TA tracking notes and the MAV1 and MAV3 IA tracking notes reflect the net return and maturity of the respective series' underlying assets (assumed to have a maturity of eight years). For the purpose of valuation, the restructured floating rate notes of MAV1, excluding TA and IA notes, were proxied to comparable eight-year floating rate notes as at January 21, 2009. The Class A-1 and Class A-2 notes are A-rated and the Class B and Class C notes are established at a credit rating of BB for valuation purposes, and accordingly, were proxied to floating rate notes with similar credit quality and terms. MAV1 and MAV3 TA tracking notes are assumed to be AAA-rated and to have a maturity of eight years and a return of BA + 40 bps. The TA tracking notes were proxied to comparable floating rate notes as at January 21, 2009. The MAV1 and MAV3 IA tracking notes contain principally assets that have exposure to US subprime loans and mortgages. A valuation of the IA tracking notes was performed based on the credit quality of the underlying assets. The implicit cost of the funding facilities, approximating 120 bps, reduces the expected yield of the long-term floating rate notes.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

Based on the above valuation methodology, management's best estimate of the fair value of PSP Investments' ABCP, prior to the exchange into long-term floating rate notes at January 21, 2009, is equal to approximately $971 million (March 31, 2008 – $1,522 million).

On March 31, 2009, PSP Investments measured the fair value of its new long-term floating rate notes. During this valuation, PSP Investments reviewed the assumptions made in its valuation technique, taking into consideration new information available as well as changes in the credit market environment. As at March 31, 2009, the fair value of the new long-term floating rate notes amounted to $1,039 million and the cumulative write-down on both the ABCP and new long-term floating rate notes amounted to $923 million, representing 47% of the original face value. The fair value calculation includes a negative amount of $94 million in respect of the funding facilities as at March 31, 2009.

The long-term floating rate notes are reported as Canadian fixed income under the investment portfolio (Note 3 (a)). The write-down on the ABCP is included as part of the absolute return on investment income in Note 7 (b).

The fair value of the long-term floating rate notes was established as a function of the information available as at March 31, 2009, which includes certain assumptions used in the valuation model such as interest rate spreads, assumed credit rating of restructured notes, expected returns of the restructured notes, as well as the maturity and liquidity of the restructured notes. Varying certain key elements of the valuation technique will have an impact on the fair value of the long-term floating rate notes as at March 31, 2009. For example, increasing interest rate spreads by 50 bps would result in a decrease to the fair value of the long-term floating rate notes by $60 million. The fair value of the long-term floating rate notes may change in future periods as a result of fluctuations in the major elements of the valuation methodology.

(iv) Absolute Return

In addition to the different asset classes outlined in the asset mix policy, PSP Investments employs a number of absolute return strategies, consisting of derivative financial products such as those described in Note 3 (b), whose objective is to generate positive returns regardless of market conditions.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

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

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

(i) Swaps

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

($ millions)	2009		2008	
INVESTMENTS	**Notional Value**	**Fair Value**	Notional Value	Fair Value
Equity and Commodity Derivatives				
Futures	**$ 628**	**$ –**	$ 876	$ 8
Total Return Swaps	**2,909**	**106**	5,160	(41)
Variance Swaps	**107**	**6**	229	(3)
Warrants	**1**	**1**	38	10
Options: Listed-purchased	**–**	**–**	188	6
Listed-written	**–**	**–**	197	(6)
Currency Derivatives				
Forwards	**20,620**	**(171)**	14,356	(183)
Swaps	**–**	**–**	833	(71)
Options: OTC-purchased	**619**	**7**	1,730	32
OTC-written	**156**	**(2)**	917	(27)
Interest Rate Derivatives				
Bond forwards	**349**	**–**	2,766	2
Futures	**–**	**–**	1,426	–
Interest Rate Swaps	**3,933**	**(4)**	5,492	16
Total Return Swaps	**3,525**	**55**	3,367	15
Swaptions	**2,506**	**–**	7,219	–
Options: Listed-purchased	**–**	**–**	868	1
Listed-written	**2,494**	**–**	1,229	(3)
OTC-written	**1,500**	**–**	–	–
Credit Derivatives: [1]				
Purchased	**64**	**52**	62	29
Sold	**1,632**	**(1,275)**	1,351	(510)
Total	**$ 41,043**	**$ (1,225)**	$ 48,304	$ (725)

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The fair value of derivative contracts, as at March 31, is represented by:

($ millions)	2009	2008
Derivative-related receivables	$ 485	$ 552
Derivative-related payables	(1,710)	(1,277)
Total	**$ (1,225)**	$ (725)

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

($ millions)	2009	2008
Under 1 year	$ 36,265	$ 34,589
1 to 5 years	4,170	11,741
Over 5 years	608	1,974
Total	**$ 41,043**	$ 48,304

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(C) INVESTMENT ASSET MIX

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

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

($ millions)	2009			2008		
Asset Class	Fair Value		Policy Portfolio Long-Term Target	Fair Value		Policy Portfolio Long-Term Target
Developed World Equity						
Canadian Equity	$ 8,815	26.1%	30.0%	$ 11,538	29.6%	30.0%
US Large Cap Equity	926	2.7	5.0	1,763	4.5	5.0
EAFE Large Cap Equity	1,043	3.1	5.0	1,831	4.7	5.0
Small Cap Developed World Equity	781	2.3	5.0	1,930	5.0	5.0
Emerging Markets Equity	2,122	6.3	7.0	2,726	7.0	7.0
Private Equity	4,191	12.4	10.0	3,972	10.2	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	73	0.2	2.0	533	1.4	2.0
World Government Bonds	2,105	6.2	5.0	2,248	5.8	5.0
Canadian Fixed Income	4,253	12.6	8.0	4,849	12.4	8.0
Real Return Assets						
World Inflation-Linked Bonds	2,389	7.1	5.0	2,211	5.7	5.0
Real Estate	4,653	13.8	10.0	4,029	10.3	10.0
Infrastructure	2,446	7.2	8.0	1,343	3.4	8.0
NET INVESTMENTS	$ 33,797	100.0%	100.0%	$ 38,973	100.0%	100.0%

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(D) SECURITIES LENDING

PSP Investments participates in securities lending programs whereby it lends securities in order to enhance portfolio returns. Any such securities lending requires collateral in cash, high-quality debt instruments or shares securities with a fair value equal to no less than 102% of the value of the securities lent. As at March 31, 2009, securities with an estimated fair value of $2,701 million (2008 – $5,097 million) were loaned out, while securities contractually receivable as collateral had an estimated fair value of $2,827 million (2008 – $5,292 million).

(E) SECURITIES COLLATERAL

PSP Investments deposited or pledged securities with a fair value of $1,042 million as collateral with various financial institutions as at March 31, 2009 (2008 – $411 million). Securities with a fair value of $106 million (2008 – $31 million) have been received from other counterparties as collateral. PSP Investments does not repledge any collateral held. All collateral deposited, pledged and received were held with counterparties who had a minimum credit rating of “A–” as at March 31, 2009. The terms and conditions are outlined in Note 4 (b) (i).

4. INVESTMENT RISK MANAGEMENT

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

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

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

Risk Management is responsible for overseeing the various risk management functions including, but not limited to, investment risk functions. Risk Management monitors these risks and reports to senior management on a continuous basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK

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

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

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

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

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

Active Risk Taken

(Relative VaR – $ millions)	**2009**	2008
Public Market Equities	**$ 788**	$ 414
Nominal Fixed Income	**–**	10
Real Return Assets	**1,065**	843
Absolute Return	**1,160**	204
Total Relative VaR (Undiversified)	**3,013**	1,471
Diversification Effect	**(1,660)**	(591)
Total Relative VaR	**$ 1,353**	$ 880

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

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

(i) Interest Rate Risk

Interest rate risk refers to the effect on the fair value of PSP Investments' net asset value due to fluctuations in interest rates. Changes in interest rates will directly affect the fair value of PSP Investments' assets. The most significant exposure to interest rate risk is the investment in bonds and real estate loans.

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

	Terms to Maturity					
($ millions)	Within 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	2009 Total	2008 Total
Government of Canada bonds	$ 1,278	$ 1,228	$ 238	$ 454	$ 3,198	$ 1,783
Provincial and Territorial bonds	302	412	269	495	1,478	1,295
Municipal bonds	12	22	50	4	88	119
Corporate bonds	125	593	408	1,392	2,518	5,515
Total Canadian Fixed Income	$ 1,717	$ 2,255	$ 965	$ 2,345	$ 7,282	$ 8,712
Total World Government Bonds	$ 9	$ 305	$ 246	$ 199	$ 759	$ 1,790
Total World Inflation-Linked Bonds	$ –	$ 18	$ 25	$ 153	$ 196	$ 207
Real Estate Loans [1]	$ 359	$ 364	$ –	$ 29	$ 752	$ 504
Grand Total	$ 2,085	$ 2,942	$ 1,236	$ 2,726	$ 8,989	$ 11,213

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(i) Interest Rate Risk (continued)

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

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

Additionally, accounts receivable from pending trades and Cash & Cash equivalents are considered short-term in nature, and, as a result, their exposure to interest rate risk would not be significant.

(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 exchange forward contracts, positions in foreign currencies. PSP Investments' policy is to hedge 50% of its foreign currency investments excluding emerging markets equity.

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

	2009		2008	
Currency (in Canadian $)	**Fair Value** **($ millions)**	**% of Total**	Fair Value ($ millions)	% of Total
US Dollar	**$ 4,624**	**52.9%**	$ 5,822	52.8%
Euro	**2,066**	**23.6**	2,294	20.8
British Pound	**519**	**5.9**	917	8.3
Yen	**389**	**4.5**	640	5.8
Hong Kong Dollar	**300**	**3.4**	246	2.2
New Taiwan Dollar	**174**	**2.0**	231	2.1
Korean Won	**166**	**1.9**	245	2.2
Australian Dollar	**165**	**1.9**	188	1.7
Brazilian Real	**65**	**0.7**	432	3.9
Others	**278**	**3.2**	21	0.2
Total	**$ 8,746**	**100.0%**	$ 11,036	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies of $7,108 million ($4,737 million US, €651 million, £2 million and 433 million South African Rands (ZAR)) which are not included in the foreign currency exposure table.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

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

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

To monitor the evolution of credit risk, PSP Investments periodically produces a concentration report by credit rating of all credit-sensitive financial securities with the exception of securities held in pooled funds or for private market investments. Concentration tables are also produced by issuer, geographic area and industry.

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

	2009	2008
Investment grade (AAA to BBB–)	**88.7%**	86.5%
Below investment grade (BB+ and below)	**–**	0.3
Not rated:		
Rated by a single credit rating agency [1]	**8.5**	0.4
Not rated by credit rating agencies [2]	**2.8**	12.8
Total	**100.0%**	100.0%

[1] As at March 31, 2009, includes Class A-1 and Class A-2 ABCP holdings that were restructured and converted to floating rate long-term notes on January 21, 2009. These notes are A-rated by Dominion Bond Rating Service (DBRS) (Note 3 (a) (iii)).

[2] Includes Class A-1 and Class A-2 ABCP holdings that were not rated by DBRS as at March 31, 2008.

The breakdown of credit concentration risk does not include investments in distressed debt included in pooled funds in the amount of approximately $2 billion as at March 31, 2009 (2008 – $507 million). Such investments are excluded as they typically include debt securities of issuers close to default, and the investment in such securities are quasi-equity in nature.

As at March 31, 2009, PSP Investments also has a net notional exposure of $1.4 billion to collateralized debt obligations, of which 71% of the dollar exposure is rated "Investment grade", as well as funding facilities of a maximum amount of $969 million to support potential margin calls on the long-term floating rate notes (Note 3 (a) (iii)).

As at March 31, 2009, PSP Investments' maximum exposure to credit risk, not taking into consideration the excluded elements described above, amounts to approximately $11.0 billion (2008 – $13.6 billion).

(i) Counterparty Risk

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(ii) Counterparty Risk (continued)

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

Additionally, the CSA to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the event of the failure of the counterparty and requires PSP Investments to contribute further collateral when requested. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. Note 3 (e) provides information on the collateral deposited and received.

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

(C) LIQUIDITY RISK

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

PSP Investments has the ability to raise additional capital through the use of its capital debt program. This program allows PSP Investments to issue short-term promissory notes and medium-term notes to a maximum amount of $3 billion and $1 billion, respectively. Note 10 provides additional information on the usage of the capital debt program.

The terms to maturity of the notional amount of derivatives, including related payable amounts, are disclosed in Note 3 (b). All other significant financial liabilities have a term to maturity of one year or less.

5. SHARE CAPITAL

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

6. FUND TRANSFERS

PSP Investments received fund transfers of $4,431 million for the year ended March 31, 2009 (2008 – $4,237 million) from the Pension Funds. The transfers received are comprised of the net employer and employee contributions to their respective pension plans in respect of member service after April 1, 2000 for the Public Service, Canadian Forces and Royal Canadian Mounted Police Pension Funds. The transfers received from the Reserve Force Pension Fund are comprised of the net employer and employee contributions in respect of member service after March 1, 2007.

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

($ millions)	**2009**	2008
Public Service Pension Fund	**$ 3,179**	$ 3,057
Canadian Forces Pension Fund	**853**	842
Royal Canadian Mounted Police Pension Fund	**314**	282
Reserve Force Pension Fund	**85**	56
Total	**$ 4,431**	$ 4,237

7. INVESTMENT INCOME (LOSS)

(A) INVESTMENT INCOME (LOSS)

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

($ millions)	**2009**	2008
Interest income	**$ 468**	$ 725
Dividend income	**409**	371
Other income	**239**	109
Security lending income	**7**	9
Interest expense (Note 10)	**(67)**	(51)
Transaction costs	**(37)**	(23)
External investment management fees [1]	**(53)**	(61)
	966	1,079
Net realized (losses) gains [2]	**(6,202)**	1,563
Net unrealized losses [3]	**(4,257)**	(2,839)
Investment Income (Loss)	**$ (9,493)**	$ (197)

[1] These are amounts incurred for public market investments and paid directly by PSP Investments (Note 1). Amounts incurred for Private Market Investments are disclosed in Note 3 (a) (ii).

[2] Includes foreign currency losses of $606 million for the year ended March 31, 2009 (2008 – $585 million).

[3] Includes unrealized gains of $184 million for the year ended March 31, 2009 for certain direct investments in Private Equity and Infrastructure determined using valuation techniques for which certain assumptions cannot be fully supported by prices from observable current market transactions.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

7. INVESTMENT INCOME (LOSS) (continued)

(B) INVESTMENT INCOME (LOSS) BY ASSET MIX

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

($ millions)	2009	2008
Developed World Equity		
Canadian Equity	$ (3,598)	$ 236
US Large Cap Equity	(449)	(469)
EAFE Large Cap Equity	(593)	(239)
Small Cap Developed World Equity	(492)	(636)
Emerging Markets Equity	(985)	171
Private Equity	(1,591)	262
Nominal Fixed Income		
Cash & Cash Equivalents	35	56
World Government Bonds	478	167
Canadian Fixed Income	195	293
Real Return Assets		
World Inflation-Linked Bonds	164	79
Real Estate	(782)	753
Infrastructure	112	27
Absolute Return [1]	(1,987)	(897)
Investment Income (Loss)	$ (9,493)	$ (197)

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

8. OPERATING EXPENSES

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

($ thousands)	2009	2008
Salaries and benefits	$ 48,287	$ 34,584
Professional and consulting fees	9,993	20,509
Office supplies and equipment	8,780	6,882
Other operating expenses	7,986	6,265
Depreciation of fixed assets	4,657	3,189
Occupancy costs	3,614	2,523
Custodial fees	1,253	2,041
Remuneration earned by Directors	911	762
Travel and related expenses for Directors	383	162
Communication expenses	93	163
Total	$ 85,957	$ 77,080

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

8. OPERATING EXPENSES (continued)

Professional and consulting fees paid or accrued to the external auditors include audit fees of $526,000 (2008 – $352,000), audit-related fees of $156,000 (2008 – $140,000) and non-audit fees of $68,000 (2008 – nil). Audit fees of $571,000 (2008 – $418,500) and non-audit fees of $268,000 (2008 – $103,000) were paid and accrued to the externally contracted internal auditors of PSP Investments.

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

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

(A) INVESTMENT INCOME (LOSS)

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

(B) EXPENSES

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

All other operating expenses, excluding the direct cost of investment activities listed above, for the year ended March 31, have been allocated as follows:

	2009	2008
Public Service Pension Plan Account	**72.6%**	72.6%
Canadian Forces Pension Plan Account	**20.1**	20.1
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.1**	0.1
Total	**100.0%**	100.0%

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

10. CAPITAL DEBT FINANCING

As of March 31, 2009, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $1,579 million (2008 – $1,551 million) of short-term promissory notes outstanding with maturity dates between 28 and 364 days of issuance. These notes are included in Note 3 (a) as a short-term investment-related liability. As at March 31, 2009, PSP Capital Inc. has $1 billion (2008 – nil) of medium-term notes issued and outstanding. These medium-term notes bear interest of 4.57% per annum and have a maturity date of December 9, 2013; $600 million of these medium-term notes were issued on December 9, 2008 and $400 million were issued on February 24, 2009. These medium-term notes are included in Note 3 (a) as a long-term investment-related liability. As at March 31, 2009, the fair value, including accrued interest, of these medium-term notes is $1,054 million (2008 – nil). The maximum authorized by the Board of Directors for the short-term promissory notes and medium-term notes is $3 billion and $1 billion, respectively. The capital raised was used primarily to finance real estate and infrastructure investments and is unconditionally and irrevocably guaranteed by PSP Investments.

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

($ millions)	2009	2008
Short-term promissory notes	$ 57	$ 51
Medium-term notes	10	–
Total	**$ 67**	$ 51

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, with regards to the funding, policies and requirements of the pension plans established under the *Superannuation Acts*. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.
- To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc., and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 10 provides information on the capital debt financing and Note 4 (c) provides information on PSP Investments' liquidity. Additionally, as at March 31, 2009, PSP Investments has an operating line of credit of $10 million. As at March 31, 2009, no amounts have been withdrawn.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2009

12. GUARANTEES AND INDEMNITY

PSP Investments provides indemnification to its Directors, its Officers and to certain PSP Investments representatives who are asked to serve the boards or like bodies of entities in which PSP Investments has made a substantial investment. As a result, but subject to the Act, PSP Investments may be required to indemnify these parties for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

As part of investment transactions, PSP Investments and its subsidiaries guaranteed letter of credit facilities totaling $15 million as at March 31, 2009 (2008 – $12 million). The beneficiaries of these letter of credit facilities have the ability to draw against these facilities to the extent that the contractual obligations, as defined in the related agreements, are not met.

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

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

13. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, 2009, the outstanding commitments amounted to $7,578 million ($4,629 million for private equity investments, $1,795 million for real estate investments, $578 million for public market investments and $576 million for infrastructure investments).

AUDITORS' REPORT

To the President of the Treasury Board

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Public Service Pension Plan Account ("the Public Service Pension Plan Account") as at March 31, 2009, and the Statements of Net Loss from Operations and Comprehensive Income and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's (PSP Investments) management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Public Service Pension Plan Account as at March 31, 2009, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

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

Deloitte & Touche LLP[1]

[1] Chartered accountant auditor permit No. 18527

Montreal, Canada
May 11, 2009

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 11, 2009

BALANCE SHEET

As at March 31

($ millions)	2009	2008
ASSETS		
Investments (Note 3 (a))	**$ 27,865**	$ 30,620
Investment-related assets (Note 3 (a))	**537**	1,693
Other assets	**26**	13
Due from the Canadian Forces Pension Plan Account (Note 7)	**6**	12
Due from the Royal Canadian Mounted Police Pension Plan Account (Note 7)	**2**	4
TOTAL ASSETS	**$ 28,436**	$ 32,342
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 3,897**	$ 4,019
Accounts payable and accrued liabilities	**43**	59
TOTAL LIABILITIES	**$ 3,940**	$ 4,078
NET ASSETS	**$ 24,496**	$ 28,264
Accumulated net income from operations and comprehensive income	**$ 184**	$ 7,131
Accumulated fund transfers	**24,312**	21,133
NET ASSETS	**$ 24,496**	$ 28,264

Commitments (Note 11)

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

On behalf of the Board of Directors:

Paul Cantor
Chair of the Board

Keith Martell
Chair of the Audit and Conflicts Committee

STATEMENT OF NET LOSS FROM OPERATIONS AND COMPREHENSIVE INCOME

For the year ended March 31

($ millions)	2009	2008
INVESTMENT LOSS (Note 6)	**$ (6,884)**	$ (143)
OPERATING EXPENSES (Note 7)	**$ 63**	$ 56
NET LOSS FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ (6,947)**	$ (199)

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

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2009	2008
NET ASSETS, BEGINNING OF YEAR (as previously reported)	**$ 28,264**	$ 25,410
Change in accounting policy – financial instruments	**–**	(4)
NET ASSETS, BEGINNING OF YEAR (as restated)	**$ 28,264**	$ 25,406
Fund transfers (Note 5)	**3,179**	3,057
Net loss from operations and comprehensive income	**(6,947)**	(199)
(Decrease) increase in net assets for the year	**(3,768)**	2,858
NET ASSETS, END OF YEAR	**$ 24,496**	$ 28,264

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) was formed pursuant to the *Public Sector Pension Investment Board Act* ("the Act") with a mandate to invest the net contributions of the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans in financial markets. At the end of March 2007, PSP Investments' mandate was expanded to include the investment of the net contributions of the Reserve Force pension plan. The first net contributions were received from the Reserve Force pension plan in April 2007.

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it from the Public Service Pension Fund in respect of member service after April 1, 2000. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of the Public Service Pension Fund. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and the requirements of the Act. PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value were included in investment income as net unrealized gains or losses in the year the change occurred (Note 6 (a)).

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS

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

Market prices or rates are used to determine fair value where an active market exists (such as a recognized stock exchange), as it is the best evidence of the fair value of an investment. If quoted market prices or rates are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the balance sheet dates. If available, market observable inputs are applied to valuation models.

Valuation techniques are generally applied to private equity, infrastructure and real estate investments as well as over-the-counter (OTC) derivatives. 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.

Fair values of investments are determined as follows:

(a) Cash & Cash equivalent investments are recorded at cost plus accrued interest, which approximate fair value, and are mostly comprised of cash, floating rate notes, term deposits and government short-term securities.

(b) Quoted market prices for public equities, using the bid price for long positions and the ask price for short positions, are used to present the fair value of these investments.

Unit values obtained from each of the funds' administrators, reflecting the market prices of the underlying securities, are used to present the fair value of pooled funds.

(c) Private equity and infrastructure investments are fair-valued at least annually.

The fair value for investments held directly by PSP Investments is determined using acceptable industry valuation methods such as earnings multiples, discounted cash flows analysis, price of recent investments and publicly traded comparables. Valuation techniques involve assumptions including discount rates and the projected length of cash flows. The valuation methodologies have been developed based on the *International Private Equity and Venture Capital Valuation Guidelines*.

In the case of investments in fund portfolios, fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

For each investment the relevant methodology is applied consistently over time.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

(d) The fair value of investments in real estate held directly by PSP Investments is determined at least annually, using acceptable industry valuation methods, such as discounted cash flows and comparable transactions. Valuation techniques involve various assumptions including capitalization rate and the projected cash flows and/or net operating income. The assumptions are supported by observable market data. Management uses the services of a third-party appraiser to determine the fair value of real estate investments. These valuations are prepared using professional appraisal standards, such as the Canadian Uniform Standards of Professional Appraisal Practice and the Uniform Standards of Professional Appraisal Practice in the United States of America.

In the case of investments in fund portfolios, fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

The fair value of real estate loans is estimated by discounting expected future cash flows using interest rates offered for similar loans to borrowers with similar credit ratings. Management may use the services of a third-party appraiser to determine the fair value of real estate loans.

For each investment the relevant methodology is applied consistently over time.

(e) Fixed income securities are valued at quoted market prices using the bid price for long positions and the ask price for short positions, where available. Where quoted market prices are not available, estimated values are calculated using either an appropriate interest rate curve with a spread associated with the credit quality of the issuer or other generally accepted pricing methodologies.

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

The fair value of credit derivatives, including credit default swaps and synthetic collateralized debt obligations, are also determined based on valuation techniques. Certain assumptions are made with respect to the probability of the event of default of the underlying securities, of its recovery rate and its corresponding impact on cash distributions. The instrument is then valued by discounting the expected cash flows by an appropriate discount factor.

VALUATION OF CAPITAL DEBT FINANCING

The fair value of PSP Investments' short-term capital debt financing includes the cost amount and accrued interest, which approximates fair value. The fair value of PSP Investments' long-term capital debt financing is determined based on quoted market prices.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

Investment management fees are costs directly attributable to the external management of funds on behalf of PSP Investments. Investment management fees incurred for the Private Equity, Real Estate and Infrastructure asset classes are paid, as determined by the fund manager, either by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment (Note 3 (a) (ii)). These amounts are recorded against investment income. Investment management fees are also incurred for certain public equity investments and these amounts are paid directly by PSP Investments and recorded against investment income (Note 6).

INCOME RECOGNITION

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

Investment income is made up of dividends, accrued interest income, realized gains and losses on the disposal of investments and unrealized gains and losses which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Dividend income is recognized on the ex-dividend date. Investment income from private market investments also includes the related distributions from pooled funds, limited partnerships as well as from direct and co-investments.

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

Amounts received from the Public Service Pension Fund are recorded in its respective plan account.

INCOME TAXES

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

USE OF ESTIMATES

In preparing these financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of private equity, infrastructure and real estate investments, related income and expenses and note disclosures. Actual results may differ from estimates.

2. CHANGES IN ACCOUNTING POLICIES

NEW ACCOUNTING STANDARDS

On April 1, 2008, PSP Investments adopted the *Canadian Institute of Chartered Accountants (CICA) Handbook* Section 1535, "Capital Disclosures", as well as Section 3862, "Financial Instruments – Disclosures" and Section 3863, "Financial Instruments – Presentation".

Section 1535, "Capital Disclosures" specifies the disclosure of (i) an entity's objectives, policies, and processes for managing capital, (ii) quantitative data about what the entity regards as capital, (iii) whether the entity has complied with any capital requirements, and (iv) if it has not complied, the consequences of such non-compliance. The adoption of this standard has no significant impact on PSP Investments' financial statements other than additional note disclosure in Note 9.

Section 3862, "Financial Instruments – Disclosures" and Section 3863, "Financial Instruments – Presentation" replace Section 3861, "Financial Instruments – Disclosure and Presentation". The new standards revise and enhance disclosures about the significance of financial instruments to the entity's financial position and performance, the nature and extent of the risks arising from financial instruments and how the entity manages those risks. The adoption of this standard is disclosed in Note 4.

Additionally, in January 2009, the Emerging Issues Committee (EIC) of the CICA issued EIC-173 "Credit risk and the fair value of financial assets and financial liabilities" which requires that the fair value of financial instruments (including derivative financial instruments) take into account the counterparties' credit risk for assets and PSP Investments' credit risk for liabilities. The adoption of EIC-173 did not have a significant impact on PSP Investments' financial statements.

FUTURE ACCOUNTING CHANGES

In February 2008, the Accounting Standards Board (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises will be converged with International Financial Reporting Standards (IFRS) effective January 1, 2011. PSP Investments will be required to report under IFRS for interim and annual financial statements effective April 1, 2011 with IFRS comparatives.

PSP Investments is currently evaluating the impact of the adoption of IFRS on its financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

($ millions)	2009		2008	
	Fair Value	**Cost**	Fair Value	Cost
Developed World Equity				
Canadian Equity	**$ 4,608**	**$ 5,588**	$ 5,528	$ 5,146
US Large Cap Equity	**519**	**715**	1,341	1,516
EAFE Large Cap Equity	**842**	**1,340**	1,444	1,538
Small Cap Developed World Equity	**536**	**721**	998	1,180
Emerging Markets Equity	**1,059**	**1,333**	1,333	1,172
Private Equity	**3,080**	**3,611**	2,933	2,833
Nominal Fixed Income				
Cash & Cash Equivalents	**2,230**	**2,411**	2,665	2,664
World Government Bonds	**550**	**489**	1,300	1,306
Canadian Fixed Income	**5,280**	**5,307**	6,325	6,644
Real Return Assets				
World Inflation-Linked Bonds	**142**	**144**	150	142
Real Estate	**5,152**	**4,656**	4,165	3,374
Infrastructure	**1,966**	**1,693**	999	978
Absolute Return	**1,901**	**1,983**	1,439	1,464
INVESTMENTS	**$ 27,865**	**$ 29,991**	$ 30,620	$ 29,957
Investment-Related Assets				
Amounts receivable from pending trades	**$ 186**	**$ 191**	$ 1,293	$ 1,290
Derivative-related receivables	**351**	**47**	400	62
Total Investment-Related Assets	**$ 537**	**$ 238**	$ 1,693	$ 1,352
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (366)**	**$ (367)**	$ (1,438)	$ (1,440)
Securities sold short	**(382)**	**(444)**	(528)	(542)
Derivative-related payables	**(1,240)**	**(71)**	(926)	(38)
Capital debt financing (Note 8)				
Short-term	**(1,145)**	**(1,145)**	(1,127)	(1,127)
Long-term	**(764)**	**(742)**	–	–
Total Investment-Related Liabilities	**$ (3,897)**	**$ (2,769)**	$ (4,019)	$ (3,147)
NET INVESTMENTS	**$ 24,505**	**$ 27,460**	$ 28,294	$ 28,162

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Developed World Equity, Small Cap Developed World Equity and Emerging Markets Equity

Developed World Equity, Small Cap Developed World Equity and Emerging Markets Equity (referred to as "Public Market Equities") include common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds, and securities convertible into common shares of publicly listed issuers.

(ii) Private Equity, Real Estate and Infrastructure

The private equity asset class is comprised of direct investments and fund portfolios in equity ownerships or investments with the risk and return characteristics of equity. They include investments in private companies, mezzanine debt and distressed debt. As at March 31, 2009, the total amount of financing included in the private equity portfolio for direct investments controlled by PSP Investments for the Plan is nil (2008 – nil).

The real estate asset class is comprised of direct ownerships in properties, third-party debts and fund investments in the real estate sector. The real estate investments are classified into two portfolios (an equity portfolio and a debt portfolio). The equity portfolio is comprised of direct ownerships in income-producing properties in office, retail, industrial, hospitality and residential sectors, as well as private funds and publicly traded securities invested in real estate assets. The debt portfolio is comprised of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, mezzanine loans and other structured investments where significant portions of the value are attributed to the underlying real estate assets. Real estate investments are made in accordance with the approved policies for leverage specifically applicable for this asset class. The real estate asset class is accounted for in the investment portfolio net of all third-party financings. As at March 31, 2009, the total amount of financing included in the real estate portfolio for direct investments controlled by PSP Investments for the Plan is approximately $2,720 million (2008 – $2,100 million).

Infrastructure investments are comprised of direct investments and fund portfolios in equity and debt instruments in public and private companies primarily engaged in the management, ownership or operation of assets in power, regulated businesses, transportation, telecom or social infrastructure. Infrastructure investments are made in accordance with the approved policies for leverage specifically applicable for this asset class. As at March 31, 2009, the total amount of financing included in the infrastructure portfolio for direct investments controlled by PSP Investments for the Plan is approximately $400 million (2008 – $250 million).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

The fair value of certain direct investments in Private Equity and Infrastructure are determined using valuation techniques whereby certain assumptions cannot be fully supported by prices from observable current market transactions. Varying certain key elements of the valuation technique will have an impact on the fair value of the investments as at March 31, 2009. For example, increasing the discount rate by 50 bps would result in a decrease to the fair value of these investments of $171 million; decreasing the discount rate by 50 bps would result in an increase to the fair value of these investments of $281 million.

The Private Equity, Real Estate and Infrastructure asset classes are referred to as "Private Market Investments". The fair values of the majority of private market investments are reviewed at least annually, and any resulting adjustments are reflected as unrealized gains or losses in investment income. The fair value of private market investments that are invested in funds are determined based on the audited annual financial statements received from external investment managers.

Investment management fees, as disclosed in Note 1, are incurred for private market investments and generally vary between 0.2% and 5.5% of the total invested amount. Investment management fees of $140 million for the year ended March 31, 2009 (2008 – $91 million) were recorded against investment income.

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

Nominal Fixed Income includes Cash & Cash Equivalents and Bonds. Cash on hand and cash equivalents include the following instruments having a maximum term of one year or less: demand deposits, Treasury bills, short-term notes, bankers' acceptances, term deposits and guaranteed investment certificates. Floating rate notes are considered cash and cash equivalents provided the coupons reset more than once per year. Bonds include Canadian government bonds, Canadian provincial and territorial bonds, Canadian municipal and corporate bonds, as well as international sovereign bonds.

PSP Investments held third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007.

Subsequent to the liquidity disruption event, PSP Investments participated in a restructuring process with other investors. On August 16, 2007, a standstill agreement was entered into by a number of significant investors and financial institutions that transacted with the non-bank sponsored conduits. The Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper ("the Investors' Committee") was subsequently formed, consisting of an important number of major ABCP investors, to oversee the restructuring process during this standstill period.

As part of the Investors' Committee restructuring plan, the following asset categories were pooled together under three separate vehicles: (1) leveraged super senior (LSS) tranches of collateralized debt obligations and other assets (collectively referred to as "LSS/Hybrid Assets"); (2) Traditional Assets which include securitized assets (for example, credit card receivables and auto loans); and (3) Ineligible Assets which include assets with uncertain credit quality by reason of their exposure to US subprime mortgages or otherwise. Investors in ABCP received long-term floating rate notes (for each of the aforementioned investment vehicles) with maturities based upon the maturity of the underlying assets.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

Under the Investors' Committee restructuring plan, the LSS/Hybrid Assets were split into two separate and distinct master asset vehicles (MAV); the first, referred to as "MAV1", in which case investors elected to commit their pro rata share of a margin funding facility associated with their underlying assets; and the second, referred to as "MAV2", whereby investors are able to commit less than, or none of their pro rata share of a margin funding facility, in which case certain investors, foreign banks and Canadian banks will fund the remaining portion. PSP Investments participated in MAV1. Within the MAV1, the LSS/Hybrid assets were further restructured into different classes (Class A-1, Class A-2, Class B, Class C, Traditional Assets (TA) and Ineligible Assets (IA)) of floating rate notes in order to permit a credit rating to be obtained on two of these notes (Class A-1 and Class A-2). A third MAV, referred to as "MAV3", includes series secured solely by TA and IA notes. Additionally, the margin funding facilities in MAV1 and MAV2 are provided by third-party lenders, Canadian banks, asset providers, noteholders and the Federal and Provincial governments of Canada. These facilities are designed to reduce the risk that the newly formed vehicles will not be able to meet margin calls if future circumstances warrant them. The key parties to the restructuring have also agreed to enhance the transaction by including a moratorium which prevents collateral calls for a period of 18 months from the implementation and closing date of the restructuring.

As at January 21, 2009, the Investors' Committee implemented and closed the ABCP restructuring transaction. Pursuant to the terms of the restructuring, ABCP holders exchanged their investments for long-term floating rate notes. As at January 21, 2009, PSP Investments held ABCP with an overall face value of $1,962 million, of which $1,422 million has been allocated to the Plan. PSP Investments has adopted a valuation technique to determine the fair value of the long-term floating rate notes that were received.

Under the terms of the restructuring plan, PSP Investments has received $878 million of MAV1 Class A-1 notes, $590 million of MAV1 Class A-2 notes, $101 million of MAV1 Class B notes, $48 million of MAV1 Class C notes, $28 million of MAV1 TA tracking notes, $89 million of MAV1 IA tracking notes, $114 million of MAV3 TA tracking notes and $114 million of MAV3 IA tracking notes. The amounts that have been allocated to the Plan are as follows: $636 million of MAV1 Class A-1 notes, $428 million of MAV1 Class A-2 notes, $72 million of MAV1 Class B notes, $35 million of MAV1 Class C notes, $20 million of MAV1 TA tracking notes, $65 million of MAV1 IA tracking notes, $83 million of MAV3 TA tracking notes and $83 million of MAV3 IA tracking notes. In addition, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has provided funding facilities of a maximum amount of $969 million to support potential margin calls on the long-term floating rate notes.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

The MAV1 notes, excluding TA and IA notes, are expected to return approximately Banker's Acceptance (BA) plus 30 bps (before funding facility and administrative costs) and have an average maturity of eight years. The MAV1 and MAV3 TA tracking notes and the MAV1 and MAV3 IA tracking notes reflect the net return and maturity of the respective series' underlying assets (assumed to have a maturity of eight years). For the purpose of valuation, the restructured floating rate notes of MAV1, excluding TA and IA notes, were proxied to comparable eight-year floating rate notes as at January 21, 2009. The Class A-1 and Class A-2 notes are A-rated and the Class B and Class C notes are established at a credit rating of BB for valuation purposes, and accordingly, were proxied to floating rate notes with similar credit quality and terms. MAV1 and MAV3 TA tracking notes are assumed to be AAA-rated and to have a maturity of eight years and a return of BA + 40 bps. The TA tracking notes were proxied to comparable floating rate notes as at January 21, 2009. The MAV1 and MAV3 IA tracking notes contain principally assets that have exposure to US subprime loans and mortgages. A valuation of the IA tracking notes was performed based on the credit quality of the underlying assets. The implicit cost of the funding facilities, approximating 120 bps, reduces the expected yield of the long-term floating rate notes.

Based on the above valuation methodology, management's best estimate of the fair value of ABCP allocated to the Plan, prior to the exchange into long-term floating rate notes at January 21, 2009, is equal to approximately $704 million (March 31, 2008 – $1,105 million).

On March 31, 2009, PSP Investments measured the fair value of its new long-term floating rate notes. During this valuation, PSP Investments reviewed the assumptions made in its valuation technique, taking into consideration new information available as well as changes in the credit market environment. As at March 31, 2009, the fair value of the new long-term floating rate notes allocated to the Plan amounted to $755 million and the cumulative write-down on both the ABCP and new long-term floating rate notes allocated to the Plan amounted to $667 million, representing 47% of the original face value. The fair value calculation includes a negative amount of $68 million in respect of the funding facilities allocated to the Plan as at March 31, 2009.

The long-term floating rate notes allocated to the Plan are reported as Canadian fixed income under the investment portfolio (Note 3 (a)). The write-down on the ABCP is included as part of the absolute return on investment income in Note 6 (b).

The fair value of the long-term floating rate notes was established as a function of the information available as at March 31, 2009, which includes certain assumptions used in the valuation model such as interest rate spreads, assumed credit rating of restructured notes, expected returns of the restructured notes, as well as the maturity and liquidity of the restructured notes. Varying certain key elements of the valuation technique will have an impact on the fair value of the long-term floating rate notes allocated to the Plan as at March 31, 2009. For example, increasing interest rate spreads by 50 bps would result in a decrease to the fair value of the long-term floating rate notes allocated to the Plan by $44 million. The fair value of the long-term floating rate notes allocated to the Plan may change in future periods as a result of fluctuations in the major elements of the valuation methodology.

(iv) Absolute Return

In addition to the different asset classes outlined in the asset mix policy, PSP Investments employs a number of absolute return strategies, consisting of derivative financial products such as those described in Note 3 (b), whose objective is to generate positive returns regardless of market conditions.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

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

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

(i) Swaps

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

(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

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

($ millions)		2009		2008	
INVESTMENTS		**Notional Value**	**Fair Value**	Notional Value	Fair Value
Equity and Commodity Derivatives					
Futures		**$ 455**	**$ –**	$ 636	$ 6
Total Return Swaps		**2,109**	**77**	3,746	(30)
Variance Swaps		**78**	**5**	166	(2)
Warrants		**1**	**1**	27	7
Options:	Listed-purchased	**–**	**–**	137	4
	Listed-written	**–**	**–**	143	(5)
Currency Derivatives					
Forwards		**14,951**	**(126)**	10,422	(133)
Swaps		**–**	**–**	605	(52)
Options:	OTC-purchased	**449**	**5**	1,256	24
	OTC-written	**113**	**(1)**	666	(20)
Interest Rate Derivatives					
Bond forwards		**253**	**–**	2,008	2
Futures		**–**	**–**	1,035	–
Interest Rate Swaps		**2,852**	**(3)**	3,987	12
Total Return Swaps		**2,556**	**40**	2,444	11
Swaptions		**1,817**	**–**	5,241	–
Options:	Listed-purchased	**–**	**–**	631	1
	Listed-written	**1,807**	**–**	892	(2)
	OTC-written	**1,088**	**–**	–	–
Credit Derivatives: [1]					
	Purchased	**46**	**38**	46	21
	Sold	**1,183**	**(925)**	980	(370)
Total		**$ 29,758**	**$ (889)**	$ 35,068	$ (526)

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

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The fair value of derivative contracts, as at March 31, is represented by:

($ millions)	**2009**	2008
Derivative-related receivables	**$ 351**	$ 400
Derivative-related payables	**(1,240)**	(926)
Total	**$ (889)**	$ (526)

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

($ millions)	**2009**	2008
Under 1 year	**$ 26,294**	$ 25,111
1 to 5 years	**3,024**	8,523
Over 5 years	**440**	1,434
Total	**$ 29,758**	$ 35,068

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(C) INVESTMENT ASSET MIX

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

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

($ millions)	2009			2008		
Asset Class	Fair Value		Policy Portfolio Long-Term Target	Fair Value		Policy Portfolio Long-Term Target
Developed World Equity						
Canadian Equity	$ 6,391	26.1%	30.0%	$ 8,377	29.6%	30.0%
US Large Cap Equity	672	2.7	5.0	1,280	4.5	5.0
EAFE Large Cap Equity	756	3.1	5.0	1,329	4.7	5.0
Small Cap Developed World Equity	566	2.3	5.0	1,401	5.0	5.0
Emerging Markets Equity	1,539	6.3	7.0	1,979	7.0	7.0
Private Equity	3,039	12.4	10.0	2,884	10.2	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	53	0.2	2.0	386	1.4	2.0
World Government Bonds	1,526	6.2	5.0	1,632	5.8	5.0
Canadian Fixed Income	3,084	12.6	8.0	3,521	12.4	8.0
Real Return Assets						
World Inflation-Linked Bonds	1,732	7.1	5.0	1,605	5.7	5.0
Real Estate	3,374	13.8	10.0	2,925	10.3	10.0
Infrastructure	1,773	7.2	8.0	975	3.4	8.0
NET INVESTMENTS	$ 24,505	100.0 %	100.0%	$ 28,294	100.0%	100.0%

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(D) SECURITIES LENDING

The Plan participates in securities lending programs whereby it lends securities in order to enhance portfolio returns. Any such securities lending requires collateral in cash, high-quality debt instruments or shares securities with a fair value equal to no less than 102% of the value of the securities lent. As at March 31, 2009, securities with an estimated fair value of $1,958 million (2008 – $3,701 million) were loaned out, while securities contractually receivable as collateral had an estimated fair value of $2,050 million (2008 – $3,842 million).

(E) SECURITIES COLLATERAL

The Plan deposited or pledged securities with a fair value of $755 million as collateral with various financial institutions as at March 31, 2009 (2008 – $298 million). Securities with a fair value of $77 million (2008 – $23 million) have been received from other counterparties as collateral. PSP Investments does not repledge any collateral held. All collateral deposited, pledged and received were held with counterparties who had a minimum credit rating of "A–" as at March 31, 2009. The terms and conditions are outlined in Note 4 (b) (i).

4. INVESTMENT RISK MANAGEMENT

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

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

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

Risk Management is responsible for overseeing the various risk management functions including, but not limited to, investment risk functions. Risk Management monitors these risks and reports to senior management on a continuous basis.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK

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

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

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

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

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

Active Risk Taken

(Relative VaR – $ millions)	**2009**	2008
Public Market Equities	**$ 571**	$ 300
Nominal Fixed Income	**–**	7
Real Return Assets	**772**	613
Absolute Return	**841**	148
Total Relative VaR (Undiversified)	**2,184**	1,068
Diversification Effect	**(1,203)**	(429)
Total Relative VaR	**$ 981**	$ 639

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

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

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

(i) Interest Rate Risk

Interest rate risk refers to the effect on the fair value of PSP Investments' net asset value due to fluctuations in interest rates. Changes in interest rates will directly affect the fair value of PSP Investments' assets. The most significant exposure to interest rate risk is the investment in bonds and real estate loans.

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

	Terms to Maturity					
($ millions)	Within 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	2009 Total	2008 Total
Government of Canada bonds	$ 927	$ 890	$ 173	$ 328	$ 2,318	$ 1,295
Provincial and Territorial bonds	219	299	195	359	1,072	940
Municipal bonds	9	16	36	3	64	86
Corporate bonds	91	430	296	1,009	1,826	4,004
Total Canadian Fixed Income	$ 1,246	$ 1,635	$ 700	$ 1,699	$ 5,280	$ 6,325
Total World Government Bonds	$ 7	$ 221	$ 178	$ 144	$ 550	$ 1,300
Total World Inflation-Linked Bonds	$ –	$ 13	$ 18	$ 111	$ 142	$ 150
Real Estate Loans [1]	$ 260	$ 264	$ –	$ 21	$ 545	$ 366
Grand Total	$ 1,513	$ 2,133	$ 896	$ 1,975	$ 6,517	$ 8,141

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(i) Interest Rate Risk (continued)

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

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

Additionally, accounts receivable from pending trades and Cash & Cash equivalents are considered short-term in nature, and, as a result, their exposure to interest rate risk would not be significant.

(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 exchange forward contracts, positions in foreign currencies. PSP Investments' policy is to hedge 50% of its foreign currency investments excluding emerging markets equity.

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

	2009		2008	
Currency (in Canadian $)	**Fair Value** **($ millions)**	**% of Total**	Fair Value ($ millions)	% of Total
US Dollar	**$ 3,353**	**52.9%**	$ 4,227	52.8%
Euro	**1,498**	**23.6**	1,666	20.8
British Pound	**376**	**5.9**	666	8.3
Yen	**282**	**4.5**	464	5.8
Hong Kong Dollar	**217**	**3.4**	179	2.2
New Taiwan Dollar	**126**	**2.0**	167	2.1
Korean Won	**120**	**1.9**	178	2.2
Australian Dollar	**120**	**1.9**	136	1.7
Brazilian Real	**47**	**0.7**	313	3.9
Others	**202**	**3.2**	16	0.2
Total	**$ 6,341**	**100.0%**	$ 8,012	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies of $5,154 million ($3,435 million US, €472 million, £2 million and 314 million South African Rands (ZAR)) which are not included in the foreign currency exposure table.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

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

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

To monitor the evolution of credit risk, PSP Investments periodically produces a concentration report by credit rating of all credit-sensitive financial securities with the exception of securities held in pooled funds or for private market investments. Concentration tables are also produced by issuer, geographic area and industry.

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

	2009	2008
Investment grade (AAA to BBB–)	**88.7%**	86.5%
Below investment grade (BB+ and below)	**–**	0.3
Not rated:		
Rated by a single credit rating agency [1]	**8.5**	0.4
Not rated by credit rating agencies [2]	**2.8**	12.8
Total	**100.0%**	100.0%

[1] As at March 31, 2009, includes Class A-1 and Class A-2 ABCP holdings that were restructured and converted to floating rate long-term notes on January 21, 2009. These notes are A-rated by Dominion Bond Rating Service (DBRS) (Note 3 (a) (iii)).

[2] Includes Class A-1 and Class A-2 ABCP holdings that were not rated by DBRS as at March 31, 2008.

The breakdown of credit concentration risk does not include investments in distressed debt included in pooled funds in the amount of approximately $2 billion as at March 31, 2009 (2008 – $507 million). Such investments are excluded as they typically include debt securities of issuers close to default, and the investment in such securities are quasi-equity in nature.

As at March 31, 2009, PSP Investments also has a net notional exposure of $1.4 billion to collateralized debt obligations, of which 71% of the dollar exposure is rated "Investment grade", as well as funding facilities of a maximum amount of $969 million to support potential margin calls on the long-term floating rate notes (Note 3 (a) (iii)).

As at March 31, 2009, PSP Investments' maximum exposure to credit risk, not taking into consideration the excluded elements described above, amounts to approximately $11.0 billion (2008 – $13.6 billion).

(i) Counterparty Risk

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

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

Additionally, the CSA to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the event of the failure of the counterparty and requires PSP Investments to contribute further collateral when requested. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. Note 3 (e) provides information on the collateral deposited and received.

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

(C) LIQUIDITY RISK

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

PSP Investments has the ability to raise additional capital through the use of its capital debt program. This program allows PSP Investments to issue short-term promissory notes and medium-term notes to a maximum amount of $3 billion and $1 billion, respectively. Note 8 provides additional information on the usage of the capital debt program.

The terms to maturity of the notional amount of derivatives, including related payable amounts, are disclosed in Note 3 (b). All other significant financial liabilities have a term to maturity of one year or less.

5. FUND TRANSFERS

PSP Investments received fund transfers of $3,179 million for the year ended March 31, 2009 (2008 – $3,057 million) from the Public Service Pension Fund. The transfers received are comprised of the net employer and employee contributions to the Public Service pension plan in respect of member service after April 1, 2000.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

6. INVESTMENT INCOME (LOSS)

(A) INVESTMENT INCOME (LOSS)

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

($ millions)	2009	2008
Interest income	$ 339	$ 527
Dividend income	297	269
Other income	173	79
Security lending income	5	7
Interest expense (Note 8)	(48)	(37)
Transaction costs	(26)	(16)
External investment management fees [1]	(38)	(45)
	702	784
Net realized (losses) gains [2]	(4,499)	1,138
Net unrealized losses [3]	(3,087)	(2,065)
Investment Income (Loss)	**$ (6,884)**	$ (143)

[1] These are amounts incurred for public market investments and paid directly by PSP Investments (Note 1). Amounts incurred for Private Market Investments are disclosed in Note 3 (a) (ii).

[2] Includes foreign currency losses of $439 million for the year ended March 31, 2009 (2008 – $425 million).

[3] Includes unrealized gains of $133 million for the year ended March 31, 2009 for certain direct investments in Private Equity and Infrastructure determined using valuation techniques for which certain assumptions cannot be fully supported by prices from observable current market transactions.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

6. INVESTMENT INCOME (LOSS) (continued)

(B) INVESTMENT INCOME (LOSS) BY ASSET MIX

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

($ millions)	2009	2008
Developed World Equity		
Canadian Equity	$ (2,610)	$ 172
US Large Cap Equity	(326)	(341)
EAFE Large Cap Equity	(430)	(174)
Small Cap Developed World Equity	(357)	(461)
Emerging Markets Equity	(715)	124
Private Equity	(1,153)	190
Nominal Fixed Income		
Cash & Cash Equivalents	25	41
World Government Bonds	347	121
Canadian Fixed Income	142	214
Real Return Assets		
World Inflation-Linked Bonds	119	57
Real Estate	(566)	547
Infrastructure	81	19
Absolute Return [1]	(1,441)	(652)
Investment Income (Loss)	$ (6,884)	$ (143)

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

7. EXPENSES

(A) ALLOCATION OF EXPENSES

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

All other operating expenses, excluding the direct cost of investment activities listed above, for the year ended March 31, have been allocated as follows:

	2009	2008
Public Service Pension Plan Account	**72.6%**	72.6%
Canadian Forces Pension Plan Account	**20.1**	20.1
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.1**	0.1
Total	**100.0%**	100.0%

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

(B) OPERATING EXPENSES

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

($ thousands)	**2009**	2008
Salaries and benefits	**$ 35,055**	$ 25,107
Professional and consulting fees	**7,255**	14,889
Office supplies and equipment	**6,374**	4,997
Other operating expenses	**5,797**	4,549
Depreciation of fixed assets	**3,381**	2,315
Occupancy costs	**2,624**	1,832
Custodial fees	**910**	1,482
Remuneration earned by Directors	**661**	553
Travel and related expenses for Directors	**278**	117
Communication expenses	**68**	118
Total	**$ 62,403**	$ 55,959

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

8. CAPITAL DEBT FINANCING

As of March 31, 2009, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $1,579 million (2008 – $1,551 million) of short-term promissory notes outstanding with maturity dates between 28 and 364 days of issuance, of which $1,145 million (2008 – $1,127 million) has been allocated to the Public Service Pension Plan Account and included in Note 3 (a) as a short-term investment-related liability. As at March 31, 2009, PSP Capital Inc. has $1 billion (2008 – nil) of medium-term notes issued and outstanding, of which $725 million (2008 – nil) has been allocated to the Public Service Pension Plan Account. These medium-term notes bear interest of 4.57% per annum and have a maturity date of December 9, 2013; $600 million of these medium-term notes were issued on December 9, 2008 and $400 million were issued on February 24, 2009. These medium-term notes are included in Note 3 (a) as a long-term investment-related liability. As at March 31, 2009, the fair value, including accrued interest, of these medium-term notes is $1,054 million (2008 – nil), of which $764 million (2008 – nil) has been allocated to the Public Service Pension Plan Account. The maximum authorized by the Board of Directors for the short-term promissory notes and medium-term notes is $3 billion and $1 billion, respectively. The capital raised was used primarily to finance real estate and infrastructure investments and is unconditionally and irrevocably guaranteed by PSP Investments.

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

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

($ millions)	**2009**	2008
Short-term promissory notes	**$ 41**	$ 37
Medium-term notes	**7**	–
Total	**$ 48**	$ 37

9. CAPITAL MANAGEMENT

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

– To invest fund transfers, outlined in Note 5, in the best interests of the beneficiaries and contributors under the *Superannuation Acts*. The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plans established under the *Superannuation Acts*. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.

– To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc., and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 8 provides information on the capital debt financing and Note 4 (c) provides information on PSP Investments' liquidity. Additionally, as at March 31, 2009, PSP Investments has an operating line of credit of $10 million. As at March 31, 2009, no amounts have been withdrawn.

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

10. GUARANTEES AND INDEMNITY

PSP Investments provides indemnification to its Directors, its Officers and to certain PSP Investments representatives who are asked to serve the boards or like bodies of entities in which PSP Investments has made a substantial investment. As a result, but subject to the Act, PSP Investments may be required to indemnify these parties for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

As part of investment transactions, PSP Investments and its subsidiaries guaranteed letter of credit facilities. The beneficiaries of these letter of credit facilities have the ability to draw against these facilities to the extent that the contractual obligations, as defined in the related agreements, are not met. As at March 31, 2009, the maximum exposure of the plan was $11 million (2008 – $9 million).

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

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

11. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, 2009, the outstanding commitments for the Plan amounted to $5,494 million ($3,356 million for private equity investments, $1,301 million for real estate investments, $419 million for public market investments and $418 million for infrastructure investments).

Canadian Forces Pension Plan Account

AUDITORS' REPORT

To the Minister of National Defence

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Canadian Forces Pension Plan Account ("the Canadian Forces Pension Plan Account") as at March 31, 2009, and the Statements of Net Loss from Operations and Comprehensive Income and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's (PSP Investments) management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Canadian Forces Pension Plan Account as at March 31, 2009, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

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

Deloitte & Touche LLP[1]

[1] Chartered accountant auditor permit No. 18527

Montreal, Canada
May 11, 2009

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 11, 2009

Canadian Forces Pension Plan Account

BALANCE SHEET

As at March 31

($ millions)	2009	2008
ASSETS		
Investments (Note 3 (a))	**$ 7,684**	$ 8,477
Investment-related assets (Note 3 (a))	**148**	469
Other assets	**7**	4
TOTAL ASSETS	**$ 7,839**	$ 8,950
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 1,074**	$ 1,113
Accounts payable and accrued liabilities	**9**	6
Due to the Public Service Pension Plan Account (Note 7)	**6**	12
TOTAL LIABILITIES	**$ 1,089**	$ 1,131
NET ASSETS	**$ 6,750**	$ 7,819
Accumulated net income from operations and comprehensive income	**$ 96**	$ 2,018
Accumulated fund transfers	**6,654**	5,801
NET ASSETS	**$ 6,750**	$ 7,819

Commitments (Note 11)

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

On behalf of the Board of Directors:

Paul Cantor
Chair of the Board

Keith Martell
Chair of the Audit and Conflicts Committee

Canadian Forces Pension Plan Account

STATEMENT OF NET LOSS FROM OPERATIONS AND COMPREHENSIVE INCOME

For the year ended March 31

($ millions)	2009	2008
INVESTMENT LOSS (Note 6)	**$ (1,905)**	$ (40)
OPERATING EXPENSES (Note 7)	**$ 17**	$ 15
NET LOSS FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ (1,922)**	$ (55)

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

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2009	2008
NET ASSETS, BEGINNING OF YEAR (as previously reported)	**$ 7,819**	$ 7,033
Change in accounting policy – financial instruments	**–**	(1)
NET ASSETS, BEGINNING OF YEAR (as restated)	**$ 7,819**	$ 7,032
Fund transfers (Note 5)	**853**	842
Net loss from operations and comprehensive income	**(1,922)**	(55)
(Decrease) increase in net assets for the year	**(1,069)**	787
NET ASSETS, END OF YEAR	**$ 6,750**	$ 7,819

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) was formed pursuant to the *Public Sector Pension Investment Board Act* ("the Act") with a mandate to invest the net contributions of the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans in financial markets. At the end of March 2007, PSP Investments' mandate was expanded to include the investment of the net contributions of the Reserve Force pension plan. The first net contributions were received from the Reserve Force pension plan in April 2007.

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it from the Canadian Forces Pension Fund in respect of member service after April 1, 2000. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of the Canadian Forces Pension Fund. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and the requirements of the Act. PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value were included in investment income as net unrealized gains or losses in the year the change occurred (Note 6 (a)).

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS

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

Market prices or rates are used to determine fair value where an active market exists (such as a recognized stock exchange), as it is the best evidence of the fair value of an investment. If quoted market prices or rates are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the balance sheet dates. If available, market observable inputs are applied to valuation models.

Valuation techniques are generally applied to private equity, infrastructure and real estate investments as well as over-the-counter (OTC) derivatives. 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.

Fair values of investments are determined as follows:

(a) Cash & Cash equivalent investments are recorded at cost plus accrued interest, which approximate fair value, and are mostly comprised of cash, floating rate notes, term deposits and government short-term securities.

(b) Quoted market prices for public equities, using the bid price for long positions and the ask price for short positions, are used to present the fair value of these investments.

Unit values obtained from each of the funds' administrators, reflecting the market prices of the underlying securities, are used to present the fair value of pooled funds.

(c) Private equity and infrastructure investments are fair-valued at least annually.

The fair value for investments held directly by PSP Investments is determined using acceptable industry valuation methods such as earnings multiples, discounted cash flows analysis, price of recent investments and publicly traded comparables. Valuation techniques involve assumptions including discount rates and the projected length of cash flows. The valuation methodologies have been developed based on the *International Private Equity and Venture Capital Valuation Guidelines*.

In the case of investments in fund portfolios, fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

For each investment the relevant methodology is applied consistently over time.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

(d) The fair value of investments in real estate held directly by PSP Investments is determined at least annually, using acceptable industry valuation methods, such as discounted cash flows and comparable transactions. Valuation techniques involve various assumptions including capitalization rate and the projected cash flows and/or net operating income. The assumptions are supported by observable market data. Management uses the services of a third-party appraiser to determine the fair value of real estate investments. These valuations are prepared using professional appraisal standards, such as the Canadian Uniform Standards of Professional Appraisal Practice and the Uniform Standards of Professional Appraisal Practice in the United States of America.

In the case of investments in fund portfolios, fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

The fair value of real estate loans is estimated by discounting expected future cash flows using interest rates offered for similar loans to borrowers with similar credit ratings. Management may use the services of a third-party appraiser to determine the fair value of real estate loans.

For each investment the relevant methodology is applied consistently over time.

(e) Fixed income securities are valued at quoted market prices using the bid price for long positions and the ask price for short positions, where available. Where quoted market prices are not available, estimated values are calculated using either an appropriate interest rate curve with a spread associated with the credit quality of the issuer or other generally accepted pricing methodologies.

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

The fair value of credit derivatives, including credit default swaps and synthetic collateralized debt obligations, are also determined based on valuation techniques. Certain assumptions are made with respect to the probability of the event of default of the underlying securities, of its recovery rate and its corresponding impact on cash distributions. The instrument is then valued by discounting the expected cash flows by an appropriate discount factor.

VALUATION OF CAPITAL DEBT FINANCING

The fair value of PSP Investments' short-term capital debt financing includes the cost amount and accrued interest, which approximates fair value. The fair value of PSP Investments' long-term capital debt financing is determined based on quoted market prices.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

Investment management fees are costs directly attributable to the external management of funds on behalf of PSP Investments. Investment management fees incurred for the Private Equity, Real Estate and Infrastructure asset classes are paid, as determined by the fund manager, either by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment (Note 3 (a) (ii)). These amounts are recorded against investment income. Investment management fees are also incurred for certain public equity investments and these amounts are paid directly by PSP Investments and recorded against investment income (Note 6).

INCOME RECOGNITION

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

Investment income is made up of dividends, accrued interest income, realized gains and losses on the disposal of investments and unrealized gains and losses which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Dividend income is recognized on the ex-dividend date. Investment income from private market investments also includes the related distributions from pooled funds, limited partnerships as well as from direct and co-investments.

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

Amounts received from the Canadian Forces Pension Fund are recorded in its respective plan account.

INCOME TAXES

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

USE OF ESTIMATES

In preparing these financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of private equity, infrastructure and real estate investments, related income and expenses and note disclosures. Actual results may differ from estimates.

2. CHANGES IN ACCOUNTING POLICIES

NEW ACCOUNTING STANDARDS

On April 1, 2008, PSP Investments adopted the *Canadian Institute of Chartered Accountants (CICA) Handbook* Section 1535, “Capital Disclosures”, as well as Section 3862, “Financial Instruments – Disclosures” and Section 3863, “Financial Instruments – Presentation”.

Section 1535, “Capital Disclosures” specifies the disclosure of (i) an entity’s objectives, policies, and processes for managing capital, (ii) quantitative data about what the entity regards as capital, (iii) whether the entity has complied with any capital requirements, and (iv) if it has not complied, the consequences of such non-compliance. The adoption of this standard has no significant impact on PSP Investments’ financial statements other than additional note disclosure in Note 9.

Section 3862, “Financial Instruments – Disclosures” and Section 3863, “Financial Instruments – Presentation” replace Section 3861, “Financial Instruments – Disclosure and Presentation”. The new standards revise and enhance disclosures about the significance of financial instruments to the entity’s financial position and performance, the nature and extent of the risks arising from financial instruments and how the entity manages those risks. The adoption of this standard is disclosed in Note 4.

Additionally, in January 2009, the Emerging Issues Committee (EIC) of the CICA issued EIC-173 “Credit risk and the fair value of financial assets and financial liabilities” which requires that the fair value of financial instruments (including derivative financial instruments) take into account the counterparties’ credit risk for assets and PSP Investments’ credit risk for liabilities. The adoption of EIC-173 did not have a significant impact on PSP Investments’ financial statements.

FUTURE ACCOUNTING CHANGES

In February 2008, the Accounting Standards Board (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises will be converged with International Financial Reporting Standards (IFRS) effective January 1, 2011. PSP Investments will be required to report under IFRS for interim and annual financial statements effective April 1, 2011 with IFRS comparatives.

PSP Investments is currently evaluating the impact of the adoption of IFRS on its financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

($ millions)	2009		2008	
	Fair Value	**Cost**	Fair Value	Cost
Developed World Equity				
Canadian Equity	**$ 1,271**	**$ 1,540**	$ 1,530	$ 1,422
US Large Cap Equity	**143**	**197**	371	419
EAFE Large Cap Equity	**232**	**369**	400	425
Small Cap Developed World Equity	**148**	**199**	277	326
Emerging Markets Equity	**292**	**368**	369	324
Private Equity	**849**	**995**	812	784
Nominal Fixed Income				
Cash & Cash Equivalents	**615**	**665**	738	738
World Government Bonds	**152**	**134**	360	361
Canadian Fixed Income	**1,456**	**1,463**	1,751	1,839
Real Return Assets				
World Inflation-Linked Bonds	**39**	**39**	42	39
Real Estate	**1,421**	**1,284**	1,153	934
Infrastructure	**542**	**467**	276	271
Absolute Return	**524**	**548**	398	406
INVESTMENTS	**$ 7,684**	**$ 8,268**	$ 8,477	$ 8,288
Investment-Related Assets				
Amounts receivable from pending trades	**$ 51**	**$ 53**	$ 358	$ 357
Derivative-related receivables	**97**	**13**	111	17
Total Investment-Related Assets	**$ 148**	**$ 66**	$ 469	$ 374
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (101)**	**$ (101)**	$ (398)	$ (398)
Securities sold short	**(105)**	**(122)**	(146)	(150)
Derivative-related payables	**(342)**	**(19)**	(257)	(10)
Capital debt financing (Note 8)				
Short-term	**(316)**	**(316)**	(312)	(312)
Long-term	**(210)**	**(205)**	–	–
Total Investment-Related Liabilities	**$ (1,074)**	**$ (763)**	$ (1,113)	$ (870)
NET INVESTMENTS	**$ 6,758**	**$ 7,571**	$ 7,833	$ 7,792

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Developed World Equity, Small Cap Developed World Equity and Emerging Markets Equity

Developed World Equity, Small Cap Developed World Equity and Emerging Markets Equity (referred to as "Public Market Equities") include common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds, and securities convertible into common shares of publicly listed issuers.

(ii) Private Equity, Real Estate and Infrastructure

The private equity asset class is comprised of direct investments and fund portfolios in equity ownerships or investments with the risk and return characteristics of equity. They include investments in private companies, mezzanine debt and distressed debt. As at March 31, 2009, the total amount of financing included in the private equity portfolio for direct investments controlled by PSP Investments for the Plan is nil (2008 – nil).

The real estate asset class is comprised of direct ownerships in properties, third-party debts and fund investments in the real estate sector. The real estate investments are classified into two portfolios (an equity portfolio and a debt portfolio). The equity portfolio is comprised of direct ownerships in income-producing properties in office, retail, industrial, hospitality and residential sectors, as well as private funds and publicly traded securities invested in real estate assets. The debt portfolio is comprised of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, mezzanine loans and other structured investments where significant portions of the value are attributed to the underlying real estate assets. Real estate investments are made in accordance with the approved policies for leverage specifically applicable for this asset class. The real estate asset class is accounted for in the investment portfolio net of all third-party financings. As at March 31, 2009, the total amount of financing included in the real estate portfolio for direct investments controlled by PSP Investments for the Plan is approximately $750 million (2008 – $600 million).

Infrastructure investments are comprised of direct investments and fund portfolios in equity and debt instruments in public and private companies primarily engaged in the management, ownership or operation of assets in power, regulated businesses, transportation, telecom or social infrastructure. Infrastructure investments are made in accordance with the approved policies for leverage specifically applicable for this asset class. As at March 31, 2009, the total amount of financing included in the infrastructure portfolio for direct investments controlled by PSP Investments for the Plan is approximately $100 million (2008 – $70 million).

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

The fair value of certain direct investments in Private Equity and Infrastructure are determined using valuation techniques whereby certain assumptions cannot be fully supported by prices from observable current market transactions. Varying certain key elements of the valuation technique will have an impact on the fair value of the investments as at March 31, 2009. For example, increasing the discount rate by 50 bps would result in a decrease to the fair value of these investments of $47 million; decreasing the discount rate by 50 bps would result in an increase to the fair value of these investments of $77 million.

The Private Equity, Real Estate and Infrastructure asset classes are referred to as "Private Market Investments". The fair values of the majority of private market investments are reviewed at least annually, and any resulting adjustments are reflected as unrealized gains or losses in investment income. The fair value of private market investments that are invested in funds are determined based on the audited annual financial statements received from external investment managers.

Investment management fees, as disclosed in Note 1, are incurred for private market investments and generally vary between 0.2% and 5.5% of the total invested amount. Investment management fees of $39 million for the year ended March 31, 2009 (2008 – $24 million) were recorded against investment income.

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

Nominal Fixed Income includes Cash & Cash Equivalents and Bonds. Cash on hand and cash equivalents include the following instruments having a maximum term of one year or less: demand deposits, Treasury bills, short-term notes, bankers' acceptances, term deposits and guaranteed investment certificates. Floating rate notes are considered cash and cash equivalents provided the coupons reset more than once per year. Bonds include Canadian government bonds, Canadian provincial and territorial bonds, Canadian municipal and corporate bonds, as well as international sovereign bonds.

PSP Investments held third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007.

Subsequent to the liquidity disruption event, PSP Investments participated in a restructuring process with other investors. On August 16, 2007, a standstill agreement was entered into by a number of significant investors and financial institutions that transacted with the non-bank sponsored conduits. The Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper ("the Investors' Committee") was subsequently formed, consisting of an important number of major ABCP investors, to oversee the restructuring process during this standstill period.

As part of the Investors' Committee restructuring plan, the following asset categories were pooled together under three separate vehicles: (1) leveraged super senior (LSS) tranches of collateralized debt obligations and other assets (collectively referred to as "LSS/Hybrid Assets"); (2) Traditional Assets which include securitized assets (for example, credit card receivables and auto loans); and (3) Ineligible Assets which include assets with uncertain credit quality by reason of their exposure to US subprime mortgages or otherwise. Investors in ABCP received long-term floating rate notes (for each of the aforementioned investment vehicles) with maturities based upon the maturity of the underlying assets.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

Under the Investors' Committee restructuring plan, the LSS/Hybrid Assets were split into two separate and distinct master asset vehicles (MAV); the first, referred to as "MAV1", in which case investors elected to commit their pro rata share of a margin funding facility associated with their underlying assets; and the second, referred to as "MAV2", whereby investors are able to commit less than, or none of their pro rata share of a margin funding facility, in which case certain investors, foreign banks and Canadian banks will fund the remaining portion. PSP Investments participated in MAV1. Within the MAV1, the LSS/Hybrid assets were further restructured into different classes (Class A-1, Class A-2, Class B, Class C, Traditional Assets (TA) and Ineligible Assets (IA)) of floating rate notes in order to permit a credit rating to be obtained on two of these notes (Class A-1 and Class A-2). A third MAV, referred to as "MAV3", includes series secured solely by TA and IA notes. Additionally, the margin funding facilities in MAV1 and MAV2 are provided by third-party lenders, Canadian banks, asset providers, noteholders and the Federal and Provincial governments of Canada. These facilities are designed to reduce the risk that the newly formed vehicles will not be able to meet margin calls if future circumstances warrant them. The key parties to the restructuring have also agreed to enhance the transaction by including a moratorium which prevents collateral calls for a period of 18 months from the implementation and closing date of the restructuring.

As at January 21, 2009, the Investors' Committee implemented and closed the ABCP restructuring transaction. Pursuant to the terms of the restructuring, ABCP holders exchanged their investments for long-term floating rate notes. As at January 21, 2009, PSP Investments held ABCP with an overall face value of $1,962 million, of which $393 million has been allocated to the Plan. PSP Investments has adopted a valuation technique to determine the fair value of the long-term floating rate notes that were received.

Under the terms of the restructuring plan, PSP Investments has received $878 million of MAV1 Class A-1 notes, $590 million of MAV1 Class A-2 notes, $101 million of MAV1 Class B notes, $48 million of MAV1 Class C notes, $28 million of MAV1 TA tracking notes, $89 million of MAV1 IA tracking notes, $114 million of MAV3 TA tracking notes and $114 million of MAV3 IA tracking notes. The amounts that have been allocated to the Plan are as follows: $176 million of MAV1 Class A-1 notes, $118 million of MAV1 Class A-2 notes, $21 million of MAV1 Class B notes, $10 million of MAV1 Class C notes, $6 million of MAV1 TA tracking notes, $18 million of MAV1 IA tracking notes, $22 million of MAV3 TA tracking notes and $22 million of MAV3 IA tracking notes. In addition, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has provided funding facilities of a maximum amount of $969 million to support potential margin calls on the long-term floating rate notes.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

The MAV1 notes, excluding TA and IA notes, are expected to return approximately Banker's Acceptance (BA) plus 30 bps (before funding facility and administrative costs) and have an average maturity of eight years. The MAV1 and MAV3 TA tracking notes and the MAV1 and MAV3 IA tracking notes reflect the net return and maturity of the respective series' underlying assets (assumed to have a maturity of eight years). For the purpose of valuation, the restructured floating rate notes of MAV1, excluding TA and IA notes, were proxied to comparable eight-year floating rate notes as at January 21, 2009. The Class A-1 and Class A-2 notes are A-rated and the Class B and Class C notes are established at a credit rating of BB for valuation purposes, and accordingly, were proxied to floating rate notes with similar credit quality and terms. MAV1 and MAV3 TA tracking notes are assumed to be AAA-rated and to have a maturity of eight years and a return of BA + 40 bps. The TA tracking notes were proxied to comparable floating rate notes as at January 21, 2009. The MAV1 and MAV3 IA tracking notes contain principally assets that have exposure to US subprime loans and mortgages. A valuation of the IA tracking notes was performed based on the credit quality of the underlying assets. The implicit cost of the funding facilities, approximating 120 bps, reduces the expected yield of the long-term floating rate notes.

Based on the above valuation methodology, management's best estimate of the fair value of ABCP allocated to the Plan, prior to the exchange into long-term floating rate notes at January 21, 2009, is equal to approximately $194 million (March 31, 2008 – $306 million).

On March 31, 2009, PSP Investments measured the fair value of its new long-term floating rate notes. During this valuation, PSP Investments reviewed the assumptions made in its valuation technique, taking into consideration new information available as well as changes in the credit market environment. As at March 31, 2009, the fair value of the new long-term floating rate notes allocated to the Plan amounted to $207 million and the cumulative write-down on both the ABCP and new long-term floating rate notes allocated to the Plan amounted to $186 million, representing 47% of the original face value. The fair value calculation includes a negative amount of $19 million in respect of the funding facilities allocated to the Plan as at March 31, 2009.

The long-term floating rate notes allocated to the Plan are reported as Canadian fixed income under the investment portfolio (Note 3 (a)). The write-down on the ABCP is included as part of the absolute return on investment income in Note 6 (b).

The fair value of the long-term floating rate notes was established as a function of the information available as at March 31, 2009, which includes certain assumptions used in the valuation model such as interest rate spreads, assumed credit rating of restructured notes, expected returns of the restructured notes, as well as the maturity and liquidity of the restructured notes. Varying certain key elements of the valuation technique will have an impact on the fair value of the long-term floating rate notes allocated to the Plan as at March 31, 2009. For example, increasing interest rate spreads by 50 bps would result in a decrease to the fair value of the long-term floating rate notes allocated to the Plan by $12 million. The fair value of the long-term floating rate notes allocated to the Plan may change in future periods as a result of fluctuations in the major elements of the valuation methodology.

(iv) Absolute Return

In addition to the different asset classes outlined in the asset mix policy, PSP Investments employs a number of absolute return strategies, consisting of derivative financial products such as those described in Note 3 (b), whose objective is to generate positive returns regardless of market conditions.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

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

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

(i) Swaps

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

(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

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

($ millions)		2009		2008	
INVESTMENTS		**Notional Value**	**Fair Value**	Notional Value	Fair Value
Equity and Commodity Derivatives					
Futures		$ 126	$ –	$ 176	$ 1
Total Return Swaps		582	21	1,037	(8)
Variance Swaps		21	1	46	(1)
Warrants		–	–	8	2
Options:	Listed-purchased	–	–	38	2
	Listed-written	–	–	40	(1)
Currency Derivatives					
Forwards		4,123	(33)	2,885	(37)
Swaps		–	–	167	(14)
Options:	OTC-purchased	124	1	348	6
	OTC-written	31	(1)	184	(5)
Interest Rate Derivatives					
Bond forwards		70	–	556	–
Futures		–	–	287	–
Interest Rate Swaps		786	(1)	1,104	3
Total Return Swaps		705	11	677	3
Swaptions		501	–	1,451	–
Options:	Listed-purchased	–	–	174	–
	Listed-written	499	–	247	(1)
	OTC-written	300	–	–	–
Credit Derivatives: [1]					
	Purchased	13	10	12	6
	Sold	326	(254)	272	(102)
Total		$ 8,207	$ (245)	$ 9,709	$ (146)

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The fair value of derivative contracts, as at March 31, is represented by:

($ millions)	2009	2008
Derivative-related receivables	$ 97	$ 111
Derivative-related payables	(342)	(257)
Total	**$ (245)**	$ (146)

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

($ millions)	2009	2008
Under 1 year	$ 7,251	$ 6,952
1 to 5 years	834	2,360
Over 5 years	122	397
Total	**$ 8,207**	$ 9,709

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(C) INVESTMENT ASSET MIX

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

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

($ millions)	2009			2008		
Asset Class	Fair Value		Policy Portfolio Long-Term Target	Fair Value		Policy Portfolio Long-Term Target
Developed World Equity						
Canadian Equity	$ 1,763	26.1%	30.0%	$ 2,319	29.6%	30.0%
US Large Cap Equity	185	2.7	5.0	354	4.5	5.0
EAFE Large Cap Equity	208	3.1	5.0	368	4.7	5.0
Small Cap Developed World Equity	156	2.3	5.0	388	5.0	5.0
Emerging Markets Equity	424	6.3	7.0	548	7.0	7.0
Private Equity	838	12.4	10.0	798	10.2	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	15	0.2	2.0	107	1.4	2.0
World Government Bonds	421	6.2	5.0	452	5.8	5.0
Canadian Fixed Income	850	12.6	8.0	975	12.4	8.0
Real Return Assets						
World Inflation-Linked Bonds	478	7.1	5.0	444	5.7	5.0
Real Estate	930	13.8	10.0	810	10.3	10.0
Infrastructure	490	7.2	8.0	270	3.4	8.0
NET INVESTMENTS	$ 6,758	100.0%	100.0%	$ 7,833	100.0%	100.0%

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

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

3. INVESTMENTS (continued)

(D) SECURITIES LENDING

The Plan participates in securities lending programs whereby it lends securities in order to enhance portfolio returns. Any such securities lending requires collateral in cash, high-quality debt instruments or shares securities with a fair value equal to no less than 102% of the value of the securities lent. As at March 31, 2009, securities with an estimated fair value of $540 million (2008 – $1,024 million) were loaned out, while securities contractually receivable as collateral had an estimated fair value of $565 million (2008 – $1,064 million).

(E) SECURITIES COLLATERAL

The Plan deposited or pledged securities with a fair value of $208 million as collateral with various financial institutions as at March 31, 2009 (2008 – $83 million). Securities with a fair value of $21 million (2008 – $6 million) have been received from other counterparties as collateral. PSP Investments does not repledge any collateral held. All collateral deposited, pledged and received were held with counterparties who had a minimum credit rating of "A–" as at March 31, 2009. The terms and conditions are outlined in Note 4 (b) (i).

4. INVESTMENT RISK MANAGEMENT

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

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

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

Risk Management is responsible for overseeing the various risk management functions including, but not limited to, investment risk functions. Risk Management monitors these risks and reports to senior management on a continuous basis.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK

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

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

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

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

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

Active Risk Taken

(Relative VaR – $ millions)	**2009**	2008
Public Market Equities	**$ 158**	$ 83
Nominal Fixed Income	**–**	2
Real Return Assets	**213**	169
Absolute Return	**232**	41
Total Relative VaR (Undiversified)	**603**	295
Diversification Effect	**(332)**	(119)
Total Relative VaR	**$ 271**	$ 176

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

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

(i) Interest Rate Risk

Interest rate risk refers to the effect on the fair value of PSP Investments' net asset value due to fluctuations in interest rates. Changes in interest rates will directly affect the fair value of PSP Investments' assets. The most significant exposure to interest rate risk is the investment in bonds and real estate loans.

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

	Terms to Maturity					
($ millions)	Within 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	2009 Total	2008 Total
Government of Canada bonds	$ 255	$ 246	$ 48	$ 91	$ 640	$ 358
Provincial and Territorial bonds	60	82	54	99	295	260
Municipal bonds	2	4	10	1	17	24
Corporate bonds	25	119	82	278	504	1,109
Total Canadian Fixed Income	$ 342	$ 451	$ 194	$ 469	$ 1,456	$ 1,751
Total World Government Bonds	$ 2	$ 61	$ 49	$ 40	$ 152	$ 360
Total World Inflation-Linked Bonds	$ -	$ 4	$ 5	$ 30	$ 39	$ 42
Real Estate Loans [1]	$ 72	$ 73	$ –	$ 6	$ 151	$ 101
Grand Total	$ 416	$ 589	$ 248	$ 545	$ 1,798	$ 2,254

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(i) Interest Rate Risk (continued)

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

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

Additionally, accounts receivable from pending trades and Cash & Cash equivalents are considered short-term in nature, and, as a result, their exposure to interest rate risk would not be significant.

(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 exchange forward contracts, positions in foreign currencies. PSP Investments' policy is to hedge 50% of its foreign currency investments excluding emerging markets equity.

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

	2009		2008	
Currency (in Canadian $)	**Fair Value** **($ millions)**	**% of Total**	Fair Value ($ millions)	% of Total
US Dollar	**$ 924**	**52.9%**	$ 1,170	52.8%
Euro	**413**	**23.6**	461	20.8
British Pound	**104**	**5.9**	184	8.3
Yen	**78**	**4.5**	129	5.8
Hong Kong Dollar	**60**	**3.4**	49	2.2
New Taiwan Dollar	**35**	**2.0**	47	2.1
Korean Won	**33**	**1.9**	49	2.2
Australian Dollar	**33**	**1.9**	38	1.7
Brazilian Real	**13**	**0.7**	87	3.9
Others	**56**	**3.2**	4	0.2
Total	**$ 1,749**	**100.0%**	$ 2,218	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies of $1,421 million ($947 million US, €130 million and 87 million South African Rands (ZAR)) which are not included in the foreign currency exposure table.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

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

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

To monitor the evolution of credit risk, PSP Investments periodically produces a concentration report by credit rating of all credit-sensitive financial securities with the exception of securities held in pooled funds or for private market investments. Concentration tables are also produced by issuer, geographic area and industry.

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

	2009	2008
Investment grade (AAA to BBB–)	**88.7%**	86.5%
Below investment grade (BB+ and below)	**–**	0.3
Not rated:		
Rated by a single credit rating agency [1]	**8.5**	0.4
Not rated by credit rating agencies [2]	**2.8**	12.8
Total	**100.0%**	100.0%

[1] As at March 31, 2009, includes Class A-1 and Class A-2 ABCP holdings that were restructured and converted to floating rate long-term notes on January 21, 2009. These notes are A-rated by Dominion Bond Rating Service (DBRS) (Note 3 (a) (iii)).

[2] Includes Class A-1 and Class A-2 ABCP holdings that were not rated by DBRS as at March 31, 2008.

The breakdown of credit concentration risk does not include investments in distressed debt included in pooled funds in the amount of approximately $2 billion as at March 31, 2009 (2008 – $507 million). Such investments are excluded as they typically include debt securities of issuers close to default, and the investment in such securities are quasi-equity in nature.

As at March 31, 2009, PSP Investments also has a net notional exposure of $1.4 billion to collateralized debt obligations, of which 71% of the dollar exposure is rated "Investment grade", as well as funding facilities of a maximum amount of $969 million to support potential margin calls on the long-term floating rate notes (Note 3 (a) (iii)).

As at March 31, 2009, PSP Investments' maximum exposure to credit risk, not taking into consideration the excluded elements described above, amounts to approximately $11.0 billion (2008 – $13.6 billion).

(i) Counterparty Risk

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

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

Additionally, the CSA to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the event of the failure of the counterparty and requires PSP Investments to contribute further collateral when requested. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. Note 3 (e) provides information on the collateral deposited and received.

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

(C) LIQUIDITY RISK

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

PSP Investments has the ability to raise additional capital through the use of its capital debt program. This program allows PSP Investments to issue short-term promissory notes and medium-term notes to a maximum amount of $3 billion and $1 billion, respectively. Note 8 provides additional information on the usage of the capital debt program.

The terms to maturity of the notional amount of derivatives, including related payable amounts, are disclosed in Note 3 (b). All other significant financial liabilities have a term to maturity of one year or less.

5. FUND TRANSFERS

PSP Investments received fund transfers of $853 million for the year ended March 31, 2009 (2008 – $842 million) from the Canadian Forces Pension Fund. The transfers received are comprised of the net employer and employee contributions to the Canadian Forces pension plan in respect of member service after April 1, 2000.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

6. INVESTMENT INCOME (LOSS)

(A) INVESTMENT INCOME (LOSS)

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

($ millions)	2009	2008
Interest income	$ 94	$ 145
Dividend income	82	76
Other income	48	22
Security lending income	1	2
Interest expense (Note 8)	(13)	(10)
Transaction costs	(7)	(5)
External investment management fees [1]	(11)	(12)
	194	218
Net realized (losses) gains [2]	(1,245)	315
Net unrealized losses [3]	(854)	(573)
Investment Income (Loss)	**$ (1,905)**	$ (40)

[1] These are amounts incurred for public market investments and paid directly by PSP Investments (Note 1). Amounts incurred for Private Market Investments are disclosed in Note 3 (a) (ii).

[2] Includes foreign currency losses of $122 million for the year ended March 31, 2009 (2008 – $117 million).

[3] Includes unrealized gains of $37 million for the year ended March 31, 2009 for certain direct investments in Private Equity and Infrastructure determined using valuation techniques for which certain assumptions cannot be fully supported by prices from observable current market transactions.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

6. INVESTMENT INCOME (LOSS) (continued)

(B) INVESTMENT INCOME (LOSS) BY ASSET MIX

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

($ millions)	2009	2008
Developed World Equity		
Canadian Equity	$ (723)	$ 47
US Large Cap Equity	(90)	(94)
EAFE Large Cap Equity	(120)	(48)
Small Cap Developed World Equity	(99)	(128)
Emerging Markets Equity	(198)	34
Private Equity	(318)	53
Nominal Fixed Income		
Cash & Cash Equivalents	7	11
World Government Bonds	96	34
Canadian Fixed Income	39	58
Real Return Assets		
World Inflation-Linked Bonds	33	16
Real Estate	(156)	151
Infrastructure	22	6
Absolute Return [1]	(398)	(180)
Investment Income (Loss)	$ (1,905)	$ (40)

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

7. EXPENSES

(A) ALLOCATION OF EXPENSES

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

All other operating expenses, excluding the direct cost of investment activities listed above, for the year ended March 31, have been allocated as follows:

	2009	2008
Public Service Pension Plan Account	**72.6%**	72.6%
Canadian Forces Pension Plan Account	**20.1**	20.1
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.1**	0.1
Total	**100.0%**	100.0%

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

(B) OPERATING EXPENSES

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

($ thousands)	**2009**	2008
Salaries and benefits	**$ 9,706**	$ 6,952
Professional and consulting fees	**2,008**	4,122
Office supplies and equipment	**1,765**	1,383
Other operating expenses	**1,605**	1,259
Depreciation of fixed assets	**936**	641
Occupancy costs	**726**	507
Custodial fees	**252**	410
Remuneration earned by Directors	**183**	153
Travel and related expenses for Directors	**77**	33
Communication expenses	**19**	33
Total	**$ 17,277**	$ 15,493

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

8. CAPITAL DEBT FINANCING

As of March 31, 2009, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $1,579 million (2008 – $1,551 million) of short-term promissory notes outstanding with maturity dates between 28 and 364 days of issuance, of which $316 million (2008 – $312 million) has been allocated to the Canadian Forces Pension Plan Account and included in Note 3 (a) as a short-term investment-related liability. As at March 31, 2009, PSP Capital Inc. has $1 billion (2008 – nil) of medium-term notes issued and outstanding, of which $200 million (2008 – nil) has been allocated to the Canadian Forces Pension Plan Account. These medium-term notes bear interest of 4.57% per annum and have a maturity date of December 9, 2013; $600 million of these medium-term notes were issued on December 9, 2008 and $400 million were issued on February 24, 2009. These medium-term notes are included in Note 3 (a) as a long-term investment-related liability. As at March 31, 2009, the fair value, including accrued interest, of these medium-term notes is $1,054 million (2008 – nil), of which $210 million (2008 – nil) has been allocated to the Canadian Forces Pension Plan Account. The maximum authorized by the Board of Directors for the short-term promissory notes and medium-term notes is $3 billion and $1 billion, respectively. The capital raised was used primarily to finance real estate and infrastructure investments and is unconditionally and irrevocably guaranteed by PSP Investments.

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

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

($ millions)	2009	2008
Short-term promissory notes	$ 11	$ 10
Medium-term notes	2	–
Total	**$ 13**	$ 10

9. CAPITAL MANAGEMENT

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

– To invest fund transfers, outlined in Note 5, in the best interests of the beneficiaries and contributors under the *Superannuation Acts*. The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plans established under the *Superannuation Acts*. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.

– To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc., and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 8 provides information on the capital debt financing and Note 4 (c) provides information on PSP Investments' liquidity. Additionally, as at March 31, 2009, PSP Investments has an operating line of credit of $10 million. As at March 31, 2009, no amounts have been withdrawn.

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

10. GUARANTEES AND INDEMNITY

PSP Investments provides indemnification to its Directors, its Officers and to certain PSP Investments representatives who are asked to serve the boards or like bodies of entities in which PSP Investments has made a substantial investment. As a result, but subject to the Act, PSP Investments may be required to indemnify these parties for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

As part of investment transactions, PSP Investments and its subsidiaries guaranteed letter of credit facilities. The beneficiaries of these letter of credit facilities have the ability to draw against these facilities to the extent that the contractual obligations, as defined in the related agreements, are not met. As at March 31, 2009, the maximum exposure of the plan was $3 million (2008 – $2 million).

As at March 31, 2009, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan would assume the obligation up to $81 million plus interest and other related costs.

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

11. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, 2009, the outstanding commitments for the Plan amounted to $1,516 million ($926 million for private equity investments, $359 million for real estate investments, $116 million for public market investments and $115 million for infrastructure investments).

AUDITORS' REPORT

To the Minister of Public Safety

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Royal Canadian Mounted Police Pension Plan Account ("the Royal Canadian Mounted Police Pension Plan Account") as at March 31, 2009, and the Statements of Net Loss from Operations and Comprehensive Income and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's (PSP Investments) management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Royal Canadian Mounted Police Pension Plan Account as at March 31, 2009, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

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

Deloitte & Touche LLP[1]

[1] Chartered accountant auditor permit No. 18527

Montreal, Canada
May 11, 2009

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 11, 2009

BALANCE SHEET

As at March 31

($ millions)	2009	2008
ASSETS		
Investments (Note 3 (a))	**$ 2,751**	$ 3,020
Investment-related assets (Note 3 (a))	**53**	167
Other assets	**2**	1
TOTAL ASSETS	**$ 2,806**	$ 3,188
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 385**	$ 396
Accounts payable and accrued liabilities	**3**	1
Due to the Public Service Pension Plan Account (Note 7)	**2**	4
TOTAL LIABILITIES	**$ 390**	$ 401
NET ASSETS	**$ 2,416**	$ 2,787
Accumulated net income from operations and comprehensive income	**$ 36**	$ 721
Accumulated fund transfers	**2,380**	2,066
NET ASSETS	**$ 2,416**	$ 2,787

Commitments (Note 11)

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

On behalf of the Board of Directors:

Paul Cantor
Chair of the Board

Keith Martell
Chair of the Audit and Conflicts Committee

STATEMENT OF NET LOSS FROM OPERATIONS AND COMPREHENSIVE INCOME

For the year ended March 31

($ millions)	2009	2008
INVESTMENT LOSS (Note 6)	**$ (679)**	$ (13)
OPERATING EXPENSES (Note 7)	**6**	6
NET LOSS FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ (685)**	$ (19)

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

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2009	2008
NET ASSETS, BEGINNING OF YEAR (as previously reported)	**$ 2,787**	$ 2,525
Change in accounting policy – financial instruments	**–**	(1)
NET ASSETS, BEGINNING OF YEAR (as restated)	**$ 2,787**	$ 2,524
Fund transfers (Note 5)	**314**	282
Net loss from operations and comprehensive income	**(685)**	(19)
(Decrease) increase in net assets for the year	**(371)**	263
NET ASSETS, END OF YEAR	**$ 2,416**	$ 2,787

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) was formed pursuant to the *Public Sector Pension Investment Board Act* ("the Act") with a mandate to invest the net contributions of the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans in financial markets. At the end of March 2007, PSP Investments' mandate was expanded to include the investment of the net contributions of the Reserve Force pension plan. The first net contributions were received from the Reserve Force pension plan in April 2007.

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it from the Royal Canadian Mounted Police Pension Fund in respect of member service after April 1, 2000. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of the Royal Canadian Mounted Police Pension Fund. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and the requirements of the Act. PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value were included in investment income as net unrealized gains or losses in the year the change occurred (Note 6 (a)).

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS

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

Market prices or rates are used to determine fair value where an active market exists (such as a recognized stock exchange), as it is the best evidence of the fair value of an investment. If quoted market prices or rates are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the balance sheet dates. If available, market observable inputs are applied to valuation models.

Valuation techniques are generally applied to private equity, infrastructure and real estate investments as well as over-the-counter (OTC) derivatives. 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.

Fair values of investments are determined as follows:

(a) Cash & Cash equivalent investments are recorded at cost plus accrued interest, which approximate fair value, and are mostly comprised of cash, floating rate notes, term deposits and government short-term securities.

(b) Quoted market prices for public equities, using the bid price for long positions and the ask price for short positions, are used to present the fair value of these investments.

Unit values obtained from each of the funds' administrators, reflecting the market prices of the underlying securities, are used to present the fair value of pooled funds.

(c) Private equity and infrastructure investments are fair-valued at least annually.

The fair value for investments held directly by PSP Investments is determined using acceptable industry valuation methods such as earnings multiples, discounted cash flows analysis, price of recent investments and publicly traded comparables. Valuation techniques involve assumptions including discount rates and the projected length of cash flows. The valuation methodologies have been developed based on the *International Private Equity and Venture Capital Valuation Guidelines*.

In the case of investments in fund portfolios, fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

For each investment the relevant methodology is applied consistently over time.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

(d) The fair value of investments in real estate held directly by PSP Investments is determined at least annually, using acceptable industry valuation methods, such as discounted cash flows and comparable transactions. Valuation techniques involve various assumptions including capitalization rate and the projected cash flows and/or net operating income. The assumptions are supported by observable market data. Management uses the services of a third-party appraiser to determine the fair value of real estate investments. These valuations are prepared using professional appraisal standards, such as the Canadian Uniform Standards of Professional Appraisal Practice and the Uniform Standards of Professional Appraisal Practice in the United States of America.

In the case of investments in fund portfolios, fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

The fair value of real estate loans is estimated by discounting expected future cash flows using interest rates offered for similar loans to borrowers with similar credit ratings. Management may use the services of a third-party appraiser to determine the fair value of real estate loans.

For each investment the relevant methodology is applied consistently over time.

(e) Fixed income securities are valued at quoted market prices using the bid price for long positions and the ask price for short positions, where available. Where quoted market prices are not available, estimated values are calculated using either an appropriate interest rate curve with a spread associated with the credit quality of the issuer or other generally accepted pricing methodologies.

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

The fair value of credit derivatives, including credit default swaps and synthetic collateralized debt obligations, are also determined based on valuation techniques. Certain assumptions are made with respect to the probability of the event of default of the underlying securities, of its recovery rate and its corresponding impact on cash distributions. The instrument is then valued by discounting the expected cash flows by an appropriate discount factor.

VALUATION OF CAPITAL DEBT FINANCING

The fair value of PSP Investments' short-term capital debt financing includes the cost amount and accrued interest, which approximates fair value. The fair value of PSP Investments' long-term capital debt financing is determined based on quoted market prices.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

Investment management fees are costs directly attributable to the external management of funds on behalf of PSP Investments. Investment management fees incurred for the Private Equity, Real Estate and Infrastructure asset classes are paid, as determined by the fund manager, either by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment (Note 3 (a) (ii)). These amounts are recorded against investment income. Investment management fees are also incurred for certain public equity investments and these amounts are paid directly by PSP Investments and recorded against investment income (Note 6).

INCOME RECOGNITION

The investment income (loss) has been allocated proportionately based on the asset value held by the Royal Canadian Mounted Police Pension Plan Account ("the Plan").

Investment income is made up of dividends, accrued interest income, realized gains and losses on the disposal of investments and unrealized gains and losses which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Dividend income is recognized on the ex-dividend date. Investment income from private market investments also includes the related distributions from pooled funds, limited partnerships as well as from direct and co-investments.

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

Amounts received from the Royal Canadian Mounted Police Pension Fund are recorded in its respective plan account.

INCOME TAXES

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

USE OF ESTIMATES

In preparing these financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of private equity, infrastructure and real estate investments, related income and expenses and note disclosures. Actual results may differ from estimates.

2. CHANGES IN ACCOUNTING POLICIES

NEW ACCOUNTING STANDARDS

On April 1, 2008, PSP Investments adopted the *Canadian Institute of Chartered Accountants (CICA) Handbook* Section 1535, “Capital Disclosures”, as well as Section 3862, “Financial Instruments – Disclosures” and Section 3863, “Financial Instruments – Presentation”.

Section 1535, “Capital Disclosures” specifies the disclosure of (i) an entity’s objectives, policies, and processes for managing capital, (ii) quantitative data about what the entity regards as capital, (iii) whether the entity has complied with any capital requirements, and (iv) if it has not complied, the consequences of such non-compliance. The adoption of this standard has no significant impact on PSP Investments’ financial statements other than additional note disclosure in Note 9.

Section 3862, “Financial Instruments – Disclosures” and Section 3863, “Financial Instruments – Presentation” replace Section 3861, “Financial Instruments – Disclosure and Presentation”. The new standards revise and enhance disclosures about the significance of financial instruments to the entity’s financial position and performance, the nature and extent of the risks arising from financial instruments and how the entity manages those risks. The adoption of this standard is disclosed in Note 4.

Additionally, in January 2009, the Emerging Issues Committee (EIC) of the CICA issued EIC-173 “Credit risk and the fair value of financial assets and financial liabilities” which requires that the fair value of financial instruments (including derivative financial instruments) take into account the counterparties’ credit risk for assets and PSP Investments’ credit risk for liabilities. The adoption of EIC-173 did not have a significant impact on PSP Investments’ financial statements.

FUTURE ACCOUNTING CHANGES

In February 2008, the Accounting Standards Board (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises will be converged with International Financial Reporting Standards (IFRS) effective January 1, 2011. PSP Investments will be required to report under IFRS for interim and annual financial statements effective April 1, 2011 with IFRS comparatives.

PSP Investments is currently evaluating the impact of the adoption of IFRS on its financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

($ millions)	2009		2008	
	Fair Value	**Cost**	Fair Value	Cost
Developed World Equity				
Canadian Equity	$ 455	$ 545	$ 545	$ 502
US Large Cap Equity	52	70	132	149
EAFE Large Cap Equity	83	132	142	151
Small Cap Developed World Equity	53	70	98	115
Emerging Markets Equity	105	132	131	117
Private Equity	304	358	289	279
Nominal Fixed Income				
Cash & Cash Equivalents	220	238	263	261
World Government Bonds	54	50	128	130
Canadian Fixed Income	521	524	624	656
Real Return Assets				
World Inflation-Linked Bonds	14	15	15	14
Real Estate	508	461	411	333
Infrastructure	194	167	99	96
Absolute Return	188	194	143	144
INVESTMENTS	$ 2,751	$ 2,956	$ 3,020	$ 2,947
Investment-Related Assets				
Amounts receivable from pending trades	$ 18	$ 19	$ 127	$ 127
Derivative-related receivables	35	5	40	6
Total Investment-Related Assets	$ 53	$ 24	$ 167	$ 133
Investment-Related Liabilities				
Amounts payable from pending trades	$ (36)	$ (36)	$ (142)	$ (142)
Securities sold short	(38)	(44)	(52)	(53)
Derivative-related payables	(122)	(8)	(92)	(4)
Capital debt financing (Note 8)				
Short-term	(113)	(113)	(110)	(110)
Long-term	(76)	(74)	–	–
Total Investment-Related Liabilities	$ (385)	$ (275)	$ (396)	$ (309)
NET INVESTMENTS	$ 2,419	$ 2,705	$ 2,791	$ 2,771

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Developed World Equity, Small Cap Developed World Equity and Emerging Markets Equity

Developed World Equity, Small Cap Developed World Equity and Emerging Markets Equity (referred to as "Public Market Equities") include common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds, and securities convertible into common shares of publicly listed issuers.

(ii) Private Equity, Real Estate and Infrastructure

The private equity asset class is comprised of direct investments and fund portfolios in equity ownerships or investments with the risk and return characteristics of equity. They include investments in private companies, mezzanine debt and distressed debt. As at March 31, 2009, the total amount of financing included in the private equity portfolio for direct investments controlled by PSP Investments for the Plan is nil (2008 – nil).

The real estate asset class is comprised of direct ownerships in properties, third-party debts and fund investments in the real estate sector. The real estate investments are classified into two portfolios (an equity portfolio and a debt portfolio). The equity portfolio is comprised of direct ownerships in income-producing properties in office, retail, industrial, hospitality and residential sectors, as well as private funds and publicly traded securities invested in real estate assets. The debt portfolio is comprised of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, mezzanine loans and other structured investments where significant portions of the value are attributed to the underlying real estate assets. Real estate investments are made in accordance with the approved policies for leverage specifically applicable for this asset class. The real estate asset class is accounted for in the investment portfolio net of all third-party financings. As at March 31, 2009, the total amount of financing included in the real estate portfolio for direct investments controlled by PSP Investments for the Plan is approximately 270 million (2008 – $200 million).

Infrastructure investments are comprised of direct investments and fund portfolios in equity and debt instruments in public and private companies primarily engaged in the management, ownership or operation of assets in power, regulated businesses, transportation, telecom or social infrastructure. Infrastructure investments are made in accordance with the approved policies for leverage specifically applicable for this asset class. As at March 31, 2009, the total amount of financing included in the infrastructure portfolio for direct investments controlled by PSP Investments for the Plan is approximately $50 million (2008 – $30 million).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

The fair value of certain direct investments in Private Equity and Infrastructure are determined using valuation techniques whereby certain assumptions cannot be fully supported by prices from observable current market transactions. Varying certain key elements of the valuation technique will have an impact on the fair value of the investments as at March 31, 2009. For example, increasing the discount rate by 50 bps would result in a decrease to the fair value of these investments of $17 million; decreasing the discount rate by 50 bps would result in an increase to the fair value of these investments of $28 million.

The Private Equity, Real Estate and Infrastructure asset classes are referred to as "Private Market Investments". The fair values of the majority of private market investments are reviewed at least annually, and any resulting adjustments are reflected as unrealized gains or losses in investment income. The fair value of private market investments that are invested in funds are determined based on the audited annual financial statements received from external investment managers.

Investment management fees, as disclosed in Note 1, are incurred for private market investments and generally vary between 0.2% and 5.5% of the total invested amount. Investment management fees of $14 million for the year ended March 31, 2009 (2008 – $8 million) were recorded against investment income.

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

Nominal Fixed Income includes Cash & Cash Equivalents and Bonds. Cash on hand and cash equivalents include the following instruments having a maximum term of one year or less: demand deposits, Treasury bills, short-term notes, bankers' acceptances, term deposits and guaranteed investment certificates. Floating rate notes are considered cash and cash equivalents provided the coupons reset more than once per year. Bonds include Canadian government bonds, Canadian provincial and territorial bonds, Canadian municipal and corporate bonds, as well as international sovereign bonds.

PSP Investments held third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007.

Subsequent to the liquidity disruption event, PSP Investments participated in a restructuring process with other investors. On August 16, 2007, a standstill agreement was entered into by a number of significant investors and financial institutions that transacted with the non-bank sponsored conduits. The Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper ("the Investors' Committee") was subsequently formed, consisting of an important number of major ABCP investors, to oversee the restructuring process during this standstill period.

As part of the Investors' Committee restructuring plan, the following asset categories were pooled together under three separate vehicles: (1) leveraged super senior (LSS) tranches of collateralized debt obligations and other assets (collectively referred to as "LSS/Hybrid Assets"); (2) Traditional Assets which include securitized assets (for example, credit card receivables and auto loans); and (3) Ineligible Assets which include assets with uncertain credit quality by reason of their exposure to US subprime mortgages or otherwise. Investors in ABCP received long-term floating rate notes (for each of the aforementioned investment vehicles) with maturities based upon the maturity of the underlying assets.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

Under the Investors' Committee restructuring plan, the LSS/Hybrid Assets were split into two separate and distinct master asset vehicles (MAV); the first, referred to as "MAV1", in which case investors elected to commit their pro rata share of a margin funding facility associated with their underlying assets; and the second, referred to as "MAV2", whereby investors are able to commit less than, or none of their pro rata share of a margin funding facility, in which case certain investors, foreign banks and Canadian banks will fund the remaining portion. PSP Investments participated in MAV1. Within the MAV1, the LSS/Hybrid assets were further restructured into different classes (Class A-1, Class A-2, Class B, Class C, Traditional Assets (TA) and Ineligible Assets (IA)) of floating rate notes in order to permit a credit rating to be obtained on two of these notes (Class A-1 and Class A-2). A third MAV, referred to as "MAV3", includes series secured solely by TA and IA notes. Additionally, the margin funding facilities in MAV1 and MAV2 are provided by third-party lenders, Canadian banks, asset providers, noteholders and the Federal and Provincial governments of Canada. These facilities are designed to reduce the risk that the newly formed vehicles will not be able to meet margin calls if future circumstances warrant them. The key parties to the restructuring have also agreed to enhance the transaction by including a moratorium which prevents collateral calls for a period of 18 months from the implementation and closing date of the restructuring.

As at January 21, 2009, the Investors' Committee implemented and closed the ABCP restructuring transaction. Pursuant to the terms of the restructuring, ABCP holders exchanged their investments for long-term floating rate notes. As at January 21, 2009, PSP Investments held ABCP with an overall face value of $1,962 million, of which $141 million has been allocated to the Plan. PSP Investments has adopted a valuation technique to determine the fair value of the long-term floating rate notes that were received.

Under the terms of the restructuring plan, PSP Investments has received $878 million of MAV1 Class A-1 notes, $590 million of MAV1 Class A-2 notes, $101 million of MAV1 Class B notes, $48 million of MAV1 Class C notes, $28 million of MAV1 TA tracking notes, $89 million of MAV1 IA tracking notes, $114 million of MAV3 TA tracking notes and $114 million of MAV3 IA tracking notes. The amounts that have been allocated to the Plan are as follows: $63 million of MAV1 Class A-1 notes, $42 million of MAV1 Class A-2 notes, $7 million of MAV1 Class B notes, $3 million of MAV1 Class C notes, $2 million of MAV1 TA tracking notes, $6 million of MAV1 IA tracking notes, $9 million of MAV3 TA tracking notes and $9 million of MAV3 IA tracking notes. In addition, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has provided funding facilities of a maximum amount of $969 million to support potential margin calls on the long-term floating rate notes.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

The MAV1 notes, excluding TA and IA notes, are expected to return approximately Banker's Acceptance (BA) plus 30 bps (before funding facility and administrative costs) and have an average maturity of eight years. The MAV1 and MAV3 TA tracking notes and the MAV1 and MAV3 IA tracking notes reflect the net return and maturity of the respective series' underlying assets (assumed to have a maturity of eight years). For the purpose of valuation, the restructured floating rate notes of MAV1, excluding TA and IA notes, were proxied to comparable eight-year floating rate notes as at January 21, 2009. The Class A-1 and Class A-2 notes are A-rated and the Class B and Class C notes are established at a credit rating of BB for valuation purposes, and accordingly, were proxied to floating rate notes with similar credit quality and terms. MAV1 and MAV3 TA tracking notes are assumed to be AAA-rated and to have a maturity of eight years and a return of BA + 40 bps. The TA tracking notes were proxied to comparable floating rate notes as at January 21, 2009. The MAV1 and MAV3 IA tracking notes contain principally assets that have exposure to US subprime loans and mortgages. A valuation of the IA tracking notes was performed based on the credit quality of the underlying assets. The implicit cost of the funding facilities, approximating 120 bps, reduces the expected yield of the long-term floating rate notes.

Based on the above valuation methodology, management's best estimate of the fair value of ABCP allocated to the Plan, prior to the exchange into long-term floating rate notes at January 21, 2009, is equal to approximately $70 million (March 31, 2008 – $109 million).

On March 31, 2009, PSP Investments measured the fair value of its new long-term floating rate notes. During this valuation, PSP Investments reviewed the assumptions made in its valuation technique, taking into consideration new information available as well as changes in the credit market environment. As at March 31, 2009, the fair value of the new long-term floating rate notes allocated to the Plan amounted to $74 million and the cumulative write-down on both the ABCP and new long-term floating rate notes allocated to the Plan amounted to $67 million, representing 47% of the original face value. The fair value calculation includes a negative amount of $7 million in respect of the funding facilities allocated to the Plan as at March 31, 2009.

The long-term floating rate notes allocated to the Plan are reported as Canadian fixed income under the investment portfolio (Note 3 (a)). The write-down on the ABCP is included as part of the absolute return on investment income in Note 6 (b).

The fair value of the long-term floating rate notes was established as a function of the information available as at March 31, 2009, which includes certain assumptions used in the valuation model such as interest rate spreads, assumed credit rating of restructured notes, expected returns of the restructured notes, as well as the maturity and liquidity of the restructured notes. Varying certain key elements of the valuation technique will have an impact on the fair value of the long-term floating rate notes allocated to the Plan as at March 31, 2009. For example, increasing interest rate spreads by 50 bps would result in a decrease to the fair value of the long-term floating rate notes allocated to the Plan by $4 million. The fair value of the long-term floating rate notes allocated to the Plan may change in future periods as a result of fluctuations in the major elements of the valuation methodology.

(iv) Absolute Return

In addition to the different asset classes outlined in the asset mix policy, PSP Investments employs a number of absolute return strategies, consisting of derivative financial products such as those described in Note 3 (b), whose objective is to generate positive returns regardless of market conditions.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

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

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

(i) Swaps

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

(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

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

($ millions)	2009		2008	
INVESTMENTS	**Notional Value**	**Fair Value**	Notional Value	Fair Value
Equity and Commodity Derivatives				
Futures	**$ 45**	**$ –**	$ 63	$ 1
Total Return Swaps	**208**	**8**	370	(3)
Variance Swaps	**8**	**–**	16	–
Warrants	**–**	**–**	3	1
Options: Listed-purchased	**–**	**–**	13	–
Listed-written	**–**	**–**	14	–
Currency Derivatives				
Forwards	**1,476**	**(12)**	1,028	(13)
Swaps	**–**	**–**	60	(5)
Options: OTC-purchased	**44**	**1**	124	2
OTC-written	**11**	**–**	66	(2)
Interest Rate Derivatives				
Bond forwards	**25**	**–**	198	–
Futures	**–**	**–**	102	–
Interest Rate Swaps	**282**	**–**	393	1
Total Return Swaps	**252**	**4**	241	1
Swaptions	**179**	**–**	517	–
Options: Listed-purchased	**–**	**–**	62	–
Listed-written	**179**	**–**	88	–
OTC-written	**107**	**–**	–	–
Credit Derivatives: [1]				
Purchased	**5**	**4**	4	2
Sold	**117**	**(92)**	97	(37)
Total	**$ 2,938**	**$ (87)**	$ 3,459	$ (52)

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

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The fair value of derivative contracts, as at March 31, is represented by:

($ millions)	2009	2008
Derivative-related receivables	$ 35	$ 40
Derivative-related payables	(122)	(92)
Total	**$ (87)**	$ (52)

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

($ millions)	2009	2008
Under 1 year	$ 2,596	$ 2,477
1 to 5 years	298	841
Over 5 years	44	141
Total	**$ 2,938**	$ 3,459

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(C) INVESTMENT ASSET MIX

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

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

($ millions)	2009			2008		
Asset Class	**Fair Value**		**Policy Portfolio Long-Term Target**	Fair Value		Policy Portfolio Long-Term Target
Developed World Equity						
Canadian Equity	**$ 631**	**26.1%**	**30.0%**	$ 826	29.6%	30.0%
US Large Cap Equity	**66**	**2.7**	**5.0**	127	4.5	5.0
EAFE Large Cap Equity	**75**	**3.1**	**5.0**	131	4.7	5.0
Small Cap Developed World Equity	**56**	**2.3**	**5.0**	138	5.0	5.0
Emerging Markets Equity	**152**	**6.3**	**7.0**	195	7.0	7.0
Private Equity	**300**	**12.4**	**10.0**	284	10.2	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	**5**	**0.2**	**2.0**	39	1.4	2.0
World Government Bonds	**151**	**6.2**	**5.0**	161	5.8	5.0
Canadian Fixed Income	**304**	**12.6**	**8.0**	346	12.4	8.0
Real Return Assets						
World Inflation-Linked Bonds	**171**	**7.1**	**5.0**	159	5.7	5.0
Real Estate	**333**	**13.8**	**10.0**	289	10.3	10.0
Infrastructure	**175**	**7.2**	**8.0**	96	3.4	8.0
NET INVESTMENTS	**$ 2,419**	**100.0%**	**100.0%**	$ 2,791	100.0%	100.0%

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(D) SECURITIES LENDING

The Plan participates in securities lending programs whereby it lends securities in order to enhance portfolio returns. Any such securities lending requires collateral in cash, high-quality debt instruments or shares securities with a fair value equal to no less than 102% of the value of the securities lent. As at March 31, 2009, securities with an estimated fair value of $194 million (2008 – $365 million) were loaned out, while securities contractually receivable as collateral had an estimated fair value of $202 million (2008 – $379 million).

(E) SECURITIES COLLATERAL

The Plan deposited or pledged securities with a fair value of $75 million as collateral with various financial institutions as at March 31, 2009 (2008 – $29 million). Securities with a fair value of $8 million (2008 – $2 million) have been received from other counterparties as collateral. PSP Investments does not repledge any collateral held. All collateral deposited, pledged and received were held with counterparties who had a minimum credit rating of "A–" as at March 31, 2009. The terms and conditions are outlined in Note 4 (b) (i).

4. INVESTMENT RISK MANAGEMENT

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

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

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

Risk Management is responsible for overseeing the various risk management functions including, but not limited to, investment risk functions. Risk Management monitors these risks and reports to senior management on a continuous basis.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK

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

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

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

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

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

Active Risk Taken

(Relative VaR – $ millions)	**2009**	2008
Public Market Equities	**$ 56**	$ 30
Nominal Fixed Income	**–**	1
Real Return Assets	**76**	60
Absolute Return	**83**	15
Total Relative VaR (Undiversified)	**215**	106
Diversification Effect	**(119)**	(42)
Total Relative VaR	**$ 96**	$ 64

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

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

(i) Interest Rate Risk

Interest rate risk refers to the effect on the fair value of PSP Investments' net asset value due to fluctuations in interest rates. Changes in interest rates will directly affect the fair value of PSP Investments' assets. The most significant exposure to interest rate risk is the investment in bonds and real estate loans.

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

	Terms to Maturity					
($ millions)	Within 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	2009 Total	2008 Total
Government of Canada bonds	$ 92	$ 88	$ 16	$ 32	$ 228	$ 128
Provincial and Territorial bonds	22	30	19	35	106	93
Municipal bonds	1	2	4	–	7	9
Corporate bonds	9	42	29	100	180	394
Total Canadian Fixed Income	$ 124	$ 162	$ 68	$ 167	$ 521	$ 624
Total World Government Bonds	$ –	$ 22	$ 18	$ 14	$ 54	$ 128
Total World Inflation-Linked Bonds	$ –	$ 1	$ 2	$ 11	$ 14	$ 15
Real Estate Loans [1]	$ 26	$ 26	$ –	$ 2	$ 54	$ 36
Grand Total	$ 150	$ 211	$ 88	$ 194	$ 643	$ 803

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

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(i) Interest Rate Risk (continued)

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

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

Additionally, accounts receivable from pending trades and Cash & Cash equivalents are considered short-term in nature, and, as a result, their exposure to interest rate risk would not be significant.

(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 exchange forward contracts, positions in foreign currencies. PSP Investments' policy is to hedge 50% of its foreign currency investments excluding emerging markets equity.

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

	2009		2008	
Currency (in Canadian $)	**Fair Value ($ millions)**	**% of Total**	Fair Value ($ millions)	% of Total
US Dollar	**$ 331**	**52.9%**	$ 417	52.8%
Euro	**148**	**23.6**	164	20.8
British Pound	**37**	**5.9**	66	8.3
Yen	**28**	**4.5**	46	5.8
Hong Kong Dollar	**22**	**3.4**	18	2.2
New Taiwan Dollar	**12**	**2.0**	17	2.1
Korean Won	**12**	**1.9**	18	2.2
Australian Dollar	**12**	**1.9**	13	1.7
Brazilian Real	**5**	**0.7**	31	3.9
Others	**19**	**3.2**	1	0.2
Total	**$ 626**	**100.0%**	$ 791	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies of $509 million ($339 million US, €47 million and 31 million South African Rands (ZAR)) which are not included in the foreign currency exposure table.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

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

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

To monitor the evolution of credit risk, PSP Investments periodically produces a concentration report by credit rating of all credit-sensitive financial securities with the exception of securities held in pooled funds or for private market investments. Concentration tables are also produced by issuer, geographic area and industry.

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

	2009	2008
Investment grade (AAA to BBB–)	**88.7%**	86.5%
Below investment grade (BB+ and below)	**–**	0.3
Not rated:		
Rated by a single credit rating agency [1]	**8.5**	0.4
Not rated by credit rating agencies [2]	**2.8**	12.8
Total	**100.0%**	100.0%

[1] As at March 31, 2009, includes Class A-1 and Class A-2 ABCP holdings that were restructured and converted to floating rate long-term notes on January 21, 2009. These notes are A-rated by Dominion Bond Rating Service (DBRS) (Note 3 (a) (iii)).

[2] Includes Class A-1 and Class A-2 ABCP holdings that were not rated by DBRS as at March 31, 2008.

The breakdown of credit concentration risk does not include investments in distressed debt included in pooled funds in the amount of approximately $2 billion as at March 31, 2009 (2008 – $507 million). Such investments are excluded as they typically include debt securities of issuers close to default, and the investment in such securities are quasi-equity in nature.

As at March 31, 2009, PSP Investments also has a net notional exposure of $1.4 billion to collateralized debt obligations, of which 71% of the dollar exposure is rated "Investment grade", as well as funding facilities of a maximum amount of $969 million to support potential margin calls on the long-term floating rate notes (Note 3 (a) (iii)).

As at March 31, 2009, PSP Investments' maximum exposure to credit risk, not taking into consideration the excluded elements described above, amounts to approximately $11.0 billion (2008 – $13.6 billion).

(i) Counterparty Risk

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

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

Additionally, the CSA to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the event of the failure of the counterparty and requires PSP Investments to contribute further collateral when requested. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. Note 3 (e) provides information on the collateral deposited and received.

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

(C) LIQUIDITY RISK

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

PSP Investments has the ability to raise additional capital through the use of its capital debt program. This program allows PSP Investments to issue short-term promissory notes and medium-term notes to a maximum amount of $3 billion and $1 billion, respectively. Note 8 provides additional information on the usage of the capital debt program.

The terms to maturity of the notional amount of derivatives, including related payable amounts, are disclosed in Note 3 (b). All other significant financial liabilities have a term to maturity of one year or less.

5. FUND TRANSFERS

PSP Investments received fund transfers of $314 million for the year ended March 31, 2009 (2008 – $282 million) from the Royal Canadian Mounted Police Pension Fund. The transfers received are comprised of the net employer and employee contributions to the Royal Canadian Mounted Police pension plan in respect of member service after April 1, 2000.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

6. INVESTMENT INCOME (LOSS)

(A) INVESTMENT INCOME (LOSS)

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

($ millions)	2009	2008
Interest income	$ 34	$ 52
Dividend income	29	26
Other income	17	8
Security lending income	1	–
Interest expense (Note 8)	(6)	(4)
Transaction costs	(4)	(2)
External investment management fees [1]	(4)	(4)
	67	76
Net realized (losses) gains [2]	(440)	109
Net unrealized losses [3]	(306)	(198)
Investment Income (Loss)	**$ (679)**	$ (13)

[1] These are amounts incurred for public market investments and paid directly by PSP Investments (Note 1). Amounts incurred for Private Market Investments are disclosed in Note 3 (a) (ii).

[2] Includes foreign currency losses of $44 million for the year ended March 31, 2009 (2008 – $42 million).

[3] Includes unrealized gains of $13 million for the year ended March 31, 2009 for certain direct investments in Private Equity and Infrastructure determined using valuation techniques for which certain assumptions cannot be fully supported by prices from observable current market transactions.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

6. INVESTMENT INCOME (LOSS) (continued)

(B) INVESTMENT INCOME (LOSS) BY ASSET MIX

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

($ millions)	2009	2008
Developed World Equity		
Canadian Equity	$ (256)	$ 17
US Large Cap Equity	(32)	(33)
EAFE Large Cap Equity	(42)	(17)
Small Cap Developed World Equity	(35)	(46)
Emerging Markets Equity	(70)	12
Private Equity	(115)	19
Nominal Fixed Income		
Cash & Cash Equivalents	3	4
World Government Bonds	34	12
Canadian Fixed Income	13	21
Real Return Assets		
World Inflation-Linked Bonds	11	6
Real Estate	(57)	54
Infrastructure	9	2
Absolute Return [1]	(142)	(64)
Investment Income (Loss)	$ (679)	$ (13)

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

7. EXPENSES

(A) ALLOCATION OF EXPENSES

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

All other operating expenses, excluding the direct cost of investment activities listed above, for the year ended March 31, have been allocated as follows:

	2009	2008
Public Service Pension Plan Account	**72.6%**	72.6%
Canadian Forces Pension Plan Account	**20.1**	20.1
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.1**	0.1
Total	**100.0%**	100.0%

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

(B) OPERATING EXPENSES

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

($ thousands)	**2009**	2008
Salaries and benefits	**$ 3,458**	$ 2,490
Professional and consulting fees	**716**	1,477
Office supplies and equipment	**629**	495
Other operating expenses	**572**	451
Depreciation of fixed assets	**333**	230
Occupancy costs	**259**	182
Custodial fees	**89**	147
Remuneration earned by Directors	**66**	55
Travel and related expenses for Directors	**27**	12
Communication expenses	**6**	12
Total	**$ 6,155**	$ 5,551

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

8. CAPITAL DEBT FINANCING

As of March 31, 2009, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $1,579 million (2008 – $1,551 million) of short-term promissory notes outstanding with maturity dates between 28 and 364 days of issuance, of which $113 million (2008 – $110 million) has been allocated to the Royal Canadian Mounted Police Pension Plan Account and included in Note 3 (a) as a short-term investment-related liability. As at March 31, 2009, PSP Capital Inc. has $1 billion (2008 – nil) of medium-term notes issued and outstanding, of which $72 million (2008 – nil) has been allocated to the Royal Canadian Mounted Police Pension Plan Account. These medium-term notes bear interest of 4.57% per annum and have a maturity date of December 9, 2013; $600 million of these medium-term notes were issued on December 9, 2008 and $400 million were issued on February 24, 2009. These medium-term notes are included in Note 3 (a) as a long-term investment-related liability. As at March 31, 2009, the fair value, including accrued interest, of these medium-term notes is $1,054 million (2008 – nil), of which $76 million (2008 – nil) has been allocated to the Royal Canadian Mounted Police Pension Plan Account. The maximum authorized by the Board of Directors for the short-term promissory notes and medium-term notes is $3 billion and $1 billion, respectively. The capital raised was used primarily to finance real estate and infrastructure investments and is unconditionally and irrevocably guaranteed by PSP Investments.

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

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

($ millions)	**2009**	2008
Short-term promissory notes	**$ 5**	$ 4
Medium-term notes	**1**	–
Total	**$ 6**	$ 4

9. CAPITAL MANAGEMENT

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

– To invest fund transfers, outlined in Note 5, in the best interests of the beneficiaries and contributors under the *Superannuation Acts*. The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plans established under the *Superannuation Acts*. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.

– To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc., and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 8 provides information on the capital debt financing and Note 4 (c) provides information on PSP Investments' liquidity. Additionally, as at March 31, 2009, PSP Investments has an operating line of credit of $10 million. As at March 31, 2009, no amounts have been withdrawn.

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

10. GUARANTEES AND INDEMNITY

PSP Investments provides indemnification to its Directors, its Officers and to certain PSP Investments representatives who are asked to serve the boards or like bodies of entities in which PSP Investments has made a substantial investment. As a result, but subject to the Act, PSP Investments may be required to indemnify these parties for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

As part of investment transactions, PSP Investments and its subsidiaries guaranteed letter of credit facilities. The beneficiaries of these letter of credit facilities have the ability to draw against these facilities to the extent that the contractual obligations, as defined in the related agreements, are not met. As at March 31, 2009, the maximum exposure of the plan was $1 million (2008 – $1 million).

As at March 31, 2009, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan would assume the obligation up to $29 million plus interest and other related costs.

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

11. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, 2009, the outstanding commitments for the Plan amounted to $542 million ($331 million for private equity investments, $129 million for real estate investments, $41 million for public market investments and $41 million for infrastructure investments).

AUDITORS' REPORT

To the Minister of National Defence

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Reserve Force Pension Plan Account ("the Reserve Force Pension Plan Account") as at March 31, 2009, and the Statements of Net Loss from Operations and Comprehensive Income and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's (PSP Investments) management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Reserve Force Pension Plan Account as at March 31, 2009, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

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

Deloitte & Touche LLP[1]

[1] Chartered accountant auditor permit No. 18527

Montreal, Canada
May 11, 2009

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 11, 2009

Reserve Force Pension Plan Account

BALANCE SHEET

As at March 31

($ thousands)	2009	2008
ASSETS		
Investments (Note 3 (a))	**$131,137**	$ 59,587
Investment-related assets (Note 3 (a))	**2,528**	3,296
Other assets	**36**	10
TOTAL ASSETS	**$133,701**	$ 62,893
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 18,340**	$ 7,803
Accounts payable and accrued liabilities	**72**	22
Due to the Public Service Pension Plan Account (Note 7)	**51**	49
TOTAL LIABILITIES	**$ 18,463**	$ 7,874
NET ASSETS	**$115,238**	$ 55,019
Accumulated net loss from operations and comprehensive income	**$ (25,998)**	$ (704)
Accumulated fund transfers	**141,236**	55,723
NET ASSETS	**$115,238**	$ 55,019

Commitments (Note 11)

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

On behalf of the Board of Directors:

Paul Cantor
Chair of the Board

Keith Martell
Chair of the Audit and Conflicts Committee

STATEMENT OF NET LOSS FROM OPERATIONS AND COMPREHENSIVE INCOME

For the year ended March 31

($ thousands)	2009	2008
INVESTMENT LOSS (Note 6)	**$ (25,172)**	$ (627)
OPERATING EXPENSES (Note 7)	**$ 122**	$ 77
NET LOSS FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ (25,294)**	$ (704)

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

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ thousands)	2009	2008
NET ASSETS, BEGINNING OF YEAR	**$ 55,019**	$ –
Fund transfers (Note 5)	**85,513**	55,723
Net loss from operations and comprehensive income	**(25,294)**	(704)
Increase in net assets for the year	**60,219**	55,019
NET ASSETS, END OF YEAR	**$ 115,238**	$ 55,019

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) was formed pursuant to the *Public Sector Pension Investment Board Act* ("the Act") with a mandate to invest the net contributions of the Public Service, Canadian Forces and Royal Canadian Mounted Police pension plans in financial markets. At the end of March 2007, PSP Investments' mandate was expanded to include the investment of the net contributions of the Reserve Force pension plan. The first net contributions were received from the Reserve Force pension plan in April 2007.

The Reserve Force Pension Fund was established by amendments to the *Canadian Forces Superannuation Act*, to receive contributions and make benefit payments in respect of member service after March 1, 2007. The net contributions are transferred, by the Reserve Force Pension Fund, to PSP Investments – Reserve Force Pension Plan Account for investment. PSP Investments maintains records of the pension fund's net contributions, as well as the allocation of its investments and the results of its operations in the plan account.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it from the Reserve Force Pension Fund in respect of member service after March 1, 2007. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of the Reserve Force Pension Fund. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and the requirements of the Act. PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value were included in investment income as net unrealized gains or losses in the year the change occurred (Note 6 (a)).

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS

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

Market prices or rates are used to determine fair value where an active market exists (such as a recognized stock exchange), as it is the best evidence of the fair value of an investment. If quoted market prices or rates are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the balance sheet dates. If available, market observable inputs are applied to valuation models.

Valuation techniques are generally applied to private equity, infrastructure and real estate investments as well as over-the-counter (OTC) derivatives. 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.

Fair values of investments are determined as follows:

(a) Cash & Cash equivalent investments are recorded at cost plus accrued interest, which approximate fair value, and are mostly comprised of cash, floating rate notes, term deposits and government short-term securities.

(b) Quoted market prices for public equities, using the bid price for long positions and the ask price for short positions, are used to present the fair value of these investments.

Unit values obtained from each of the funds' administrators, reflecting the market prices of the underlying securities, are used to present the fair value of pooled funds.

(c) Private equity and infrastructure investments are fair-valued at least annually.

The fair value for investments held directly by PSP Investments is determined using acceptable industry valuation methods such as earnings multiples, discounted cash flows analysis, price of recent investments and publicly traded comparables. Valuation techniques involve assumptions including discount rates and the projected length of cash flows. The valuation methodologies have been developed based on the *International Private Equity and Venture Capital Valuation Guidelines*.

In the case of investments in fund portfolios, fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

For each investment the relevant methodology is applied consistently over time.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

(d) The fair value of investments in real estate held directly by PSP Investments is determined at least annually, using acceptable industry valuation methods, such as discounted cash flows and comparable transactions. Valuation techniques involve various assumptions including capitalization rate and the projected cash flows and/or net operating income. The assumptions are supported by observable market data. Management uses the services of a third-party appraiser to determine the fair value of real estate investments. These valuations are prepared using professional appraisal standards, such as the Canadian Uniform Standards of Professional Appraisal Practice and the Uniform Standards of Professional Appraisal Practice in the United States of America.

In the case of investments in fund portfolios, fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

The fair value of real estate loans is estimated by discounting expected future cash flows using interest rates offered for similar loans to borrowers with similar credit ratings. Management may use the services of a third-party appraiser to determine the fair value of real estate loans.

For each investment the relevant methodology is applied consistently over time.

(e) Fixed income securities are valued at quoted market prices using the bid price for long positions and the ask price for short positions, where available. Where quoted market prices are not available, estimated values are calculated using either an appropriate interest rate curve with a spread associated with the credit quality of the issuer or other generally accepted pricing methodologies.

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

The fair value of credit derivatives, including credit default swaps and synthetic collateralized debt obligations, are also determined based on valuation techniques. Certain assumptions are made with respect to the probability of the event of default of the underlying securities, of its recovery rate and its corresponding impact on cash distributions. The instrument is then valued by discounting the expected cash flows by an appropriate discount factor.

VALUATION OF CAPITAL DEBT FINANCING

The fair value of PSP Investments' short-term capital debt financing includes the cost amount and accrued interest, which approximates fair value. The fair value of PSP Investments' long-term capital debt financing is determined based on quoted market prices.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

Investment management fees are costs directly attributable to the external management of funds on behalf of PSP Investments. Investment management fees incurred for the Private Equity, Real Estate and Infrastructure asset classes are paid, as determined by the fund manager, either by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment (Note 3 (a) (ii)). These amounts are recorded against investment income. Investment management fees are also incurred for certain public equity investments and these amounts are paid directly by PSP Investments and recorded against investment income (Note 6).

INCOME RECOGNITION

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

Investment income is made up of dividends, accrued interest income, realized gains and losses on the disposal of investments and unrealized gains and losses which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Dividend income is recognized on the ex-dividend date. Investment income from private market investments also includes the related distributions from pooled funds, limited partnerships as well as from direct and co-investments.

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

Amounts received from the Reserve Force Pension Fund are recorded in its respective plan account.

INCOME TAXES

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

USE OF ESTIMATES

In preparing these financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of private equity, infrastructure and real estate investments, related income and expenses and note disclosures. Actual results may differ from estimates.

2. CHANGES IN ACCOUNTING POLICIES

NEW ACCOUNTING STANDARDS

On April 1, 2008, PSP Investments adopted the *Canadian Institute of Chartered Accountants (CICA) Handbook* Section 1535, “Capital Disclosures”, as well as Section 3862, “Financial Instruments – Disclosures” and Section 3863, “Financial Instruments – Presentation”.

Section 1535, “Capital Disclosures” specifies the disclosure of (i) an entity’s objectives, policies, and processes for managing capital, (ii) quantitative data about what the entity regards as capital, (iii) whether the entity has complied with any capital requirements, and (iv) if it has not complied, the consequences of such non-compliance. The adoption of this standard has no significant impact on PSP Investments’ financial statements other than additional note disclosure in Note 9.

Section 3862, “Financial Instruments – Disclosures” and Section 3863, “Financial Instruments – Presentation” replace Section 3861, “Financial Instruments – Disclosure and Presentation”. The new standards revise and enhance disclosures about the significance of financial instruments to the entity’s financial position and performance, the nature and extent of the risks arising from financial instruments and how the entity manages those risks. The adoption of this standard is disclosed in Note 4.

Additionally, in January 2009, the Emerging Issues Committee (EIC) of the CICA issued EIC-173 “Credit risk and the fair value of financial assets and financial liabilities” which requires that the fair value of financial instruments (including derivative financial instruments) take into account the counterparties’ credit risk for assets and PSP Investments’ credit risk for liabilities. The adoption of EIC-173 did not have a significant impact on PSP Investments’ financial statements.

FUTURE ACCOUNTING CHANGES

In February 2008, the Accounting Standards Board (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises will be converged with International Financial Reporting Standards (IFRS) effective January 1, 2011. PSP Investments will be required to report under IFRS for interim and annual financial statements effective April 1, 2011 with IFRS comparatives.

PSP Investments is currently evaluating the impact of the adoption of IFRS on its financial statements.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

3. INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

($ thousands)	2009		2008	
	Fair Value	**Cost**	Fair Value	Cost
Developed World Equity				
Canadian Equity	**$ 21,687**	**$ 27,448**	$ 10,761	$ 12,525
US Large Cap Equity	**2,442**	**3,273**	2,610	3,364
EAFE Large Cap Equity	**3,962**	**5,715**	2,811	3,164
Small Cap Developed World Equity	**2,524**	**3,162**	1,943	2,612
Emerging Markets Equity	**4,984**	**5,500**	2,595	2,143
Private Equity	**14,492**	**17,258**	5,709	5,537
Nominal Fixed Income				
Cash & Cash Equivalents	**10,496**	**11,341**	5,168	5,182
World Government Bonds	**2,588**	**2,069**	2,530	2,199
Canadian Fixed Income	**24,849**	**24,768**	12,313	12,857
Real Return Assets				
World Inflation-Linked Bonds	**669**	**415**	293	95
Real Estate	**24,245**	**24,882**	8,108	7,260
Infrastructure	**9,252**	**7,970**	1,944	1,902
Absolute Return	**8,947**	**6,415**	2,802	2,984
INVESTMENTS	**$ 131,137**	**$ 140,216**	$ 59,587	$ 61,824
Investment-Related Assets				
Amounts receivable from pending trades	**$ 874**	**$ 900**	$ 2,517	$ 2,670
Derivative-related receivables	**1,654**	**222**	779	127
Total Investment-Related Assets	**$ 2,528**	**$ 1,122**	$ 3,296	$ 2,797
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (1,725)**	**$ (1,728)**	$ (2,800)	$ (2,979)
Securities sold short	**(1,798)**	**(2,090)**	(1,027)	(1,121)
Derivative-related payables	**(5,834)**	**(334)**	(1,806)	(77)
Capital debt financing (Note 8)				
Short-term	**(5,386)**	**(5,386)**	(2,170)	(2,170)
Long-term	**(3,597)**	**(3,494)**	–	–
Total Investment-Related Liabilities	**$ (18,340)**	**$ (13,032)**	$ (7,803)	$ (6,347)
NET INVESTMENTS	**$ 115,325**	**$ 128,306**	$ 55,080	$ 58,274

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Developed World Equity, Small Cap Developed World Equity and Emerging Markets Equity

Developed World Equity, Small Cap Developed World Equity and Emerging Markets Equity (referred to as "Public Market Equities") include common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds, and securities convertible into common shares of publicly listed issuers.

(ii) Private Equity, Real Estate and Infrastructure

The private equity asset class is comprised of direct investments and fund portfolios in equity ownerships or investments with the risk and return characteristics of equity. They include investments in private companies, mezzanine debt and distressed debt. As at March 31, 2009, the total amount of financing included in the private equity portfolio for direct investments controlled by PSP Investments for the Plan is nil (2008 – nil).

The real estate asset class is comprised of direct ownerships in properties, third-party debts and fund investments in the real estate sector. The real estate investments are classified into two portfolios (an equity portfolio and a debt portfolio). The equity portfolio is comprised of direct ownerships in income-producing properties in office, retail, industrial, hospitality and residential sectors, as well as private funds and publicly traded securities invested in real estate assets. The debt portfolio is comprised of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, mezzanine loans and other structured investments where significant portions of the value are attributed to the underlying real estate assets. Real estate investments are made in accordance with the approved policies for leverage specifically applicable for this asset class. The real estate asset class is accounted for in the investment portfolio net of all third-party financings. As at March 31, 2009, the total amount of financing included in the real estate portfolio for direct investments controlled by PSP Investments for the Plan is approximately $12,800 thousand (2008 – $4,100 thousand).

Infrastructure investments are comprised of direct investments and fund portfolios in equity and debt instruments in public and private companies primarily engaged in the management, ownership or operation of assets in power, regulated businesses, transportation, telecom or social infrastructure. Infrastructure investments are made in accordance with the approved policies for leverage specifically applicable for this asset class. As at March 31, 2009, the total amount of financing included in the infrastructure portfolio for direct investments controlled by PSP Investments for the Plan is approximately $1,900 thousand (2008 – $500 thousand).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

The fair value of certain direct investments in Private Equity and Infrastructure are determined using valuation techniques whereby certain assumptions cannot be fully supported by prices from observable current market transactions. Varying certain key elements of the valuation technique will have an impact on the fair value of the investments as at March 31, 2009. For example, increasing the discount rate by 50 bps would result in a decrease to the fair value of these investments of $805 thousand; decreasing the discount rate by 50 bps would result in an increase to the fair value of these investments of $1,321 thousand.

The Private Equity, Real Estate and Infrastructure asset classes are referred to as "Private Market Investments". The fair values of the majority of private market investments are reviewed at least annually, and any resulting adjustments are reflected as unrealized gains or losses in investment income. The fair value of private market investments that are invested in funds are determined based on the audited annual financial statements received from external investment managers.

Investment management fees, as disclosed in Note 1, are incurred for private market investments and generally vary between 0.2% and 5.5% of the total invested amount. Investment management fees of $659 thousand for the year ended March 31, 2009 (2008 – $174 thousand) were recorded against investment income.

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

Nominal Fixed Income includes Cash & Cash Equivalents and Bonds. Cash on hand and cash equivalents include the following instruments having a maximum term of one year or less: demand deposits, Treasury bills, short-term notes, bankers' acceptances, term deposits and guaranteed investment certificates. Floating rate notes are considered cash and cash equivalents provided the coupons reset more than once per year. Bonds include Canadian government bonds, Canadian provincial and territorial bonds, Canadian municipal and corporate bonds, as well as international sovereign bonds.

PSP Investments held third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007.

Subsequent to the liquidity disruption event, PSP Investments participated in a restructuring process with other investors. On August 16, 2007, a standstill agreement was entered into by a number of significant investors and financial institutions that transacted with the non-bank sponsored conduits. The Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper ("the Investors' Committee") was subsequently formed, consisting of an important number of major ABCP investors, to oversee the restructuring process during this standstill period.

As part of the Investors' Committee restructuring plan, the following asset categories were pooled together under three separate vehicles: (1) leveraged super senior (LSS) tranches of collateralized debt obligations and other assets (collectively referred to as "LSS/Hybrid Assets"); (2) Traditional Assets which include securitized assets (for example, credit card receivables and auto loans); and (3) Ineligible Assets which include assets with uncertain credit quality by reason of their exposure to US subprime mortgages or otherwise. Investors in ABCP received long-term floating rate notes (for each of the aforementioned investment vehicles) with maturities based upon the maturity of the underlying assets.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

Under the Investors' Committee restructuring plan, the LSS/Hybrid Assets were split into two separate and distinct master asset vehicles (MAV); the first, referred to as "MAV1", in which case investors elected to commit their pro rata share of a margin funding facility associated with their underlying assets; and the second, referred to as "MAV2", whereby investors are able to commit less than, or none of their pro rata share of a margin funding facility, in which case certain investors, foreign banks and Canadian banks will fund the remaining portion. PSP Investments participated in MAV1. Within the MAV1, the LSS/Hybrid assets were further restructured into different classes (Class A-1, Class A-2, Class B, Class C, Traditional Assets (TA) and Ineligible Assets (IA)) of floating rate notes in order to permit a credit rating to be obtained on two of these notes (Class A-1 and Class A-2). A third MAV, referred to as "MAV3", includes series secured solely by TA and IA notes. Additionally, the margin funding facilities in MAV1 and MAV2 are provided by third-party lenders, Canadian banks, asset providers, noteholders and the Federal and Provincial governments of Canada. These facilities are designed to reduce the risk that the newly formed vehicles will not be able to meet margin calls if future circumstances warrant them. The key parties to the restructuring have also agreed to enhance the transaction by including a moratorium which prevents collateral calls for a period of 18 months from the implementation and closing date of the restructuring.

As at January 21, 2009, the Investors' Committee implemented and closed the ABCP restructuring transaction. Pursuant to the terms of the restructuring, ABCP holders exchanged their investments for long-term floating rate notes. As at January 21, 2009, PSP Investments held ABCP with an overall face value of $1,962 million, of which $5,934 thousand has been allocated to the Plan. PSP Investments has adopted a valuation technique to determine the fair value of the long-term floating rate notes that were received.

Under the terms of the restructuring plan, PSP Investments has received $878 million of MAV1 Class A-1 notes, $590 million of MAV1 Class A-2 notes, $101 million of MAV1 Class B notes, $48 million of MAV1 Class C notes, $28 million of MAV1 TA tracking notes, $89 million of MAV1 IA tracking notes, $114 million of MAV3 TA tracking notes and $114 million of MAV3 IA tracking notes. The amounts that have been allocated to the Plan are as follows: $2,655 thousand of MAV1 Class A-1 notes, $1,785 thousand of MAV1 Class A-2 notes, $305 thousand of MAV1 Class B notes, $145 thousand of MAV1 Class C notes, $85 thousand of MAV1 TA tracking notes, $269 thousand of MAV1 IA tracking notes, $345 thousand of MAV3 TA tracking notes and $345 thousand of MAV3 IA tracking notes. In addition, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has provided funding facilities of a maximum amount of $969 million to support potential margin calls on the long-term floating rate notes.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

The MAV1 notes, excluding TA and IA notes, are expected to return approximately Banker's Acceptance (BA) plus 30 bps (before funding facility and administrative costs) and have an average maturity of eight years. The MAV1 and MAV3 TA tracking notes and the MAV1 and MAV3 IA tracking notes reflect the net return and maturity of the respective series' underlying assets (assumed to have a maturity of eight years). For the purpose of valuation, the restructured floating rate notes of MAV1, excluding TA and IA notes, were proxied to comparable eight-year floating rate notes as at January 21, 2009. The Class A-1 and Class A-2 notes are A-rated and the Class B and Class C notes are established at a credit rating of BB for valuation purposes, and accordingly, were proxied to floating rate notes with similar credit quality and terms. MAV1 and MAV3 TA tracking notes are assumed to be AAA-rated and to have a maturity of eight years and a return of BA + 40 bps. The TA tracking notes were proxied to comparable floating rate notes as at January 21, 2009. The MAV1 and MAV3 IA tracking notes contain principally assets that have exposure to US subprime loans and mortgages. A valuation of the IA tracking notes was performed based on the credit quality of the underlying assets. The implicit cost of the funding facilities, approximating 120 bps, reduces the expected yield of the long-term floating rate notes.

Based on the above valuation methodology, management's best estimate of the fair value of ABCP allocated to the Plan, prior to the exchange into long-term floating rate notes at January 21, 2009, is equal to approximately $2,936 thousand (March 31, 2008 – $2,151 thousand).

On March 31, 2009, PSP Investments measured the fair value of its new long-term floating rate notes. During this valuation, PSP Investments reviewed the assumptions made in its valuation technique, taking into consideration new information available as well as changes in the credit market environment. As at March 31, 2009, the fair value of the new long-term floating rate notes allocated to the Plan amounted to $3,145 thousand and the cumulative write-down on both the ABCP and new long-term floating rate notes allocated to the Plan amounted to $2,789 thousand, representing 47% of the original face value. The fair value calculation includes a negative amount of $321 thousand in respect of the funding facilities allocated to the Plan as at March 31, 2009.

The long-term floating rate notes allocated to the Plan are reported as Canadian fixed income under the investment portfolio (Note 3 (a)). The write-down on the ABCP is included as part of the absolute return on investment income in Note 6 (b).

The fair value of the long-term floating rate notes was established as a function of the information available as at March 31, 2009, which includes certain assumptions used in the valuation model such as interest rate spreads, assumed credit rating of restructured notes, expected returns of the restructured notes, as well as the maturity and liquidity of the restructured notes. Varying certain key elements of the valuation technique will have an impact on the fair value of the long-term floating rate notes allocated to the Plan as at March 31, 2009. For example, increasing interest rate spreads by 50 bps would result in a decrease to the fair value of the long-term floating rate notes allocated to the Plan by $205 thousand. The fair value of the long-term floating rate notes allocated to the Plan may change in future periods as a result of fluctuations in the major elements of the valuation methodology.

(iv) Absolute Return

In addition to the different asset classes outlined in the asset mix policy, PSP Investments employs a number of absolute return strategies, consisting of derivative financial products such as those described in Note 3 (b), whose objective is to generate positive returns regardless of market conditions.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

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

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

(i) Swaps

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

(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

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

($ thousands)		**2009**		2008	
INVESTMENTS		**Notional Value**	**Fair Value**	Notional Value	Fair Value
Equity and Commodity Derivatives					
Futures		**$ 2,143**	**$ -**	$ 1,237	$ 12
Total Return Swaps		**9,926**	**362**	7,293	(58)
Variance Swaps		**365**	**20**	325	(4)
Warrants		**3**	**3**	55	14
Options:	Listed-purchased	**–**	**–**	266	9
	Listed-written	**–**	**–**	279	(9)
Currency Derivatives					
Forwards		**70,363**	**(583)**	20,290	(259)
Swaps		**–**	**–**	1,178	(101)
Options:	OTC-purchased	**2,112**	**24**	2,445	46
	OTC-written	**532**	**(7)**	1,296	(38)
Interest Rate Derivatives					
Bond forwards		**1,191**	**–**	3,909	2
Futures		**–**	**–**	2,016	–
Interest Rate Swaps		**13,422**	**(14)**	7,761	23
Total Return Swaps		**12,029**	**188**	4,758	21
Swaptions		**8,551**	**–**	10,202	–
Options:	Listed-purchased	**–**	**–**	1,226	2
	Listed-written	**8,510**	**–**	1,736	(4)
	OTC-written	**5,118**	**–**	–	–
Credit Derivatives: [1]					
	Purchased	**218**	**177**	87	41
	Sold	**5,569**	**(4,350)**	1,909	(724)
Total		**$ 140,052**	**$ (4,180)**	$ 68,268	$ (1,027)

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The fair value of derivative contracts, as at March 31, is represented by:

($ thousands)	2009	2008
Derivative-related receivables	$ 1,654	$ 779
Derivative-related payables	(5,834)	(1,806)
Total	**$ (4,180)**	$ (1,027)

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

($ thousands)	2009	2008
Under 1 year	$ 123,748	$ 48,884
1 to 5 years	14,229	16,844
Over 5 years	2,075	2,540
Total	**$ 140,052**	$ 68,268

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(C) INVESTMENT ASSET MIX

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

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

($ thousands)	2009			2008		
Asset Class	Fair Value		Policy Portfolio Long-Term Target	Fair Value		Policy Portfolio Long-Term Target
Developed World Equity						
Canadian Equity	$ 30,079	26.1%	30.0%	$ 16,308	29.6%	30.0%
US Large Cap Equity	3,161	2.7	5.0	2,491	4.5	5.0
EAFE Large Cap Equity	3,559	3.1	5.0	2,588	4.7	5.0
Small Cap Developed World Equity	2,666	2.3	5.0	2,728	5.0	5.0
Emerging Markets Equity	7,241	6.3	7.0	3,853	7.0	7.0
Private Equity	14,300	12.4	10.0	5,614	10.2	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	250	0.2	2.0	751	1.4	2.0
World Government Bonds	7,181	6.2	5.0	3,177	5.8	5.0
Canadian Fixed Income	14,511	12.6	8.0	6,854	12.4	8.0
Real Return Assets						
World Inflation-Linked Bonds	8,153	7.1	5.0	3,125	5.7	5.0
Real Estate	15,878	13.8	10.0	5,694	10.3	10.0
Infrastructure	8,346	7.2	8.0	1,897	3.4	8.0
NET INVESTMENTS	$ 115,325	100.0%	100.0%	$ 55,080	100.0%	100.0%

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

3. INVESTMENTS (continued)

(D) SECURITIES LENDING

The Plan participates in securities lending programs whereby it lends securities in order to enhance portfolio returns. Any such securities lending requires collateral in cash, high-quality debt instruments or shares securities with a fair value equal to no less than 102% of the value of the securities lent. As at March 31, 2009, securities with an estimated fair value of $9,217 thousand (2008 – $7,000 thousand) were loaned out, while securities contractually receivable as collateral had an estimated fair value of $9,647 thousand (2008 – $7,000 thousand).

(E) SECURITIES COLLATERAL

The Plan deposited or pledged securities with a fair value of $3,555 thousand as collateral with various financial institutions as at March 31, 2009 (2008 – $581 thousand). Securities with a fair value of $361 thousand (2008 – $44 thousand) have been received from other counterparties as collateral. PSP Investments does not repledge any collateral held. All collateral deposited, pledged and received were held with counterparties who had a minimum credit rating of "A–" as at March 31, 2009. The terms and conditions are outlined in Note 4 (b) (i).

4. INVESTMENT RISK MANAGEMENT

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

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

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

Risk Management is responsible for overseeing the various risk management functions including, but not limited to, investment risk functions. Risk Management monitors these risks and reports to senior management on a continuous basis.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK

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

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

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

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

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

Active Risk Taken

(Relative VaR – $ thousands)	**2009**	2008
Public Market Equities	**$ 2,689**	$ 585
Nominal Fixed Income	**–**	14
Real Return Assets	**3,634**	1,191
Absolute Return	**3,958**	288
Total Relative VaR (Undiversified)	**10,281**	2,078
Diversification Effect	**(5,664)**	(835)
Total Relative VaR	**$ 4,617**	$ 1,243

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

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

(i) Interest Rate Risk

Interest rate risk refers to the effect on the fair value of PSP Investments' net asset value due to fluctuations in interest rates. Changes in interest rates will directly affect the fair value of PSP Investments' assets. The most significant exposure to interest rate risk is the investment in bonds and real estate loans.

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

	Terms to Maturity					
($ thousands)	Within 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	2009 Total	2008 Total
Government of Canada bonds	$ 4,361	$ 4,190	$ 812	$ 1,549	$ 10,912	$ 2,520
Provincial and Territorial bonds	1,031	1,406	918	1,689	5,044	1,830
Municipal bonds	41	75	171	14	301	168
Corporate bonds	427	2,023	1,392	4,750	8,592	7,795
Total Canadian Fixed Income	$ 5,860	$ 7,694	$ 3,293	$ 8,002	$ 24,849	$ 12,313
Total World Government Bonds	$ 31	$ 1,041	$ 838	$ 678	$ 2,588	$ 2,530
Total World Inflation-Linked Bonds	$ -	$ 61	$ 85	$ 523	$ 669	$ 293
Real Estate Loans [1]	$ 1,225	$ 1,242	$ –	$ 99	$ 2,566	$ 712
Grand Total	$ 7,116	$ 10,038	$ 4,216	$ 9,302	$ 30,672	$ 15,848

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(i) Interest Rate Risk (continued)

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

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

Additionally, accounts receivable from pending trades and Cash & Cash equivalents are considered short-term in nature, and, as a result, their exposure to interest rate risk would not be significant.

(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 exchange forward contracts, positions in foreign currencies. PSP Investments' policy is to hedge 50% of its foreign currency investments excluding emerging markets equity.

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

	2009		2008	
Currency (in Canadian $)	**Fair Value ($ thousands)**	**% of Total**	Fair Value ($ thousands)	% of Total
US Dollar	**$ 15,778**	**52.9%**	$ 8,228	52.8%
Euro	**7,051**	**23.6**	3,242	20.8
British Pound	**1,769**	**5.9**	1,297	8.3
Yen	**1,326**	**4.5**	904	5.8
Hong Kong Dollar	**1,023**	**3.4**	348	2.2
New Taiwan Dollar	**595**	**2.0**	326	2.1
Korean Won	**568**	**1.9**	346	2.2
Australian Dollar	**562**	**1.9**	266	1.7
Brazilian Real	**222**	**0.7**	610	3.9
Others	**949**	**3.2**	30	0.2
Total	**$ 29,843**	**100.0%**	$ 15,597	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies of $24,255 thousand ($16,164 thousand US, €2,221 thousand, £7 thousand and 1,478 thousand South African Rands (ZAR)) which are not included in the foreign currency exposure table.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

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

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

To monitor the evolution of credit risk, PSP Investments periodically produces a concentration report by credit rating of all credit-sensitive financial securities with the exception of securities held in pooled funds or for private market investments. Concentration tables are also produced by issuer, geographic area and industry.

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

	2009	2008
Investment grade (AAA to BBB–)	**88.7%**	86.5%
Below investment grade (BB+ and below)	**–**	0.3
Not rated:		
Rated by a single credit rating agency [1]	**8.5**	0.4
Not rated by credit rating agencies [2]	**2.8**	12.8
Total	**100.0%**	100.0%

[1] As at March 31, 2009, includes Class A-1 and Class A-2 ABCP holdings that were restructured and converted to floating rate long-term notes on January 21, 2009. These notes are A-rated by Dominion Bond Rating Service (DBRS) (Note 3 (a) (iii)).

[2] Includes Class A-1 and Class A-2 ABCP holdings that were not rated by DBRS as at March 31, 2008.

The breakdown of credit concentration risk does not include investments in distressed debt included in pooled funds in the amount of approximately $2 billion as at March 31, 2009 (2008 – $507 million). Such investments are excluded as they typically include debt securities of issuers close to default, and the investment in such securities are quasi-equity in nature.

As at March 31, 2009, PSP Investments also has a net notional exposure of $1.4 billion to collateralized debt obligations, of which 71% of the dollar exposure is rated "Investment grade", as well as funding facilities of a maximum amount of $969 million to support potential margin calls on the long-term floating rate notes (Note 3 (a) (iii)).

As at March 31, 2009, PSP Investments' maximum exposure to credit risk, not taking into consideration the excluded elements described above, amounts to approximately $11.0 billion (2008 – $13.6 billion).

(i) Counterparty Risk

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

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

Additionally, the CSA to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the event of the failure of the counterparty and requires PSP Investments to contribute further collateral when requested. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. Note 3 (e) provides information on the collateral deposited and received.

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

(C) LIQUIDITY RISK

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

PSP Investments has the ability to raise additional capital through the use of its capital debt program. This program allows PSP Investments to issue short-term promissory notes and medium-term notes to a maximum amount of $3 billion and $1 billion, respectively. Note 8 provides additional information on the usage of the capital debt program.

The terms to maturity of the notional amount of derivatives, including related payable amounts, are disclosed in Note 3 (b). All other significant financial liabilities have a term to maturity of one year or less.

5. FUND TRANSFERS

PSP Investments received fund transfers of $85,513 thousand for the year ended March 31, 2009 (2008 – $55,723 thousand) from the Reserve Force Pension Fund. The transfers received are comprised of the net employer and employee contributions to the Reserve Force pension plan in respect of member service after March 1, 2007.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

6. INVESTMENT INCOME (LOSS)

(A) INVESTMENT INCOME (LOSS)

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

($ thousands)	2009	2008
Interest income	$ 1,175	$ 1,024
Dividend income	1,047	246
Other income	617	154
Security lending income	17	13
Interest expense (Note 8)	(227)	(71)
Transaction costs	(77)	(33)
External investment management fees [1]	(125)	(52)
	2,427	1,281
Net realized (losses) gains [2]	(17,810)	1,283
Net unrealized losses [3]	(9,789)	(3,191)
Investment Income (Loss)	**$ (25,172)**	$ (627)

[1] These are amounts incurred for public market investments and paid directly by PSP Investments (Note 1). Amounts incurred for Private Market Investments are disclosed in Note 3 (a) (ii).

[2] Includes foreign currency losses of $1,555 thousand for the year ended March 31, 2009 (2008 – $826 thousand).

[3] Includes unrealized gains of $628 thousand for the year ended March 31, 2009 for certain direct investments in Private Equity and Infrastructure determined using valuation techniques for which certain assumptions cannot be fully supported by prices from observable current market transactions.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

6. INVESTMENT INCOME (LOSS) (continued)

(B) INVESTMENT INCOME (LOSS) BY ASSET MIX

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

($ thousands)	2009	2008
Developed World Equity		
Canadian Equity	**$ (9,071)**	$ 336
US Large Cap Equity	**(1,091)**	(660)
EAFE Large Cap Equity	**(1,414)**	(337)
Small Cap Developed World Equity	**(1,246)**	(893)
Emerging Markets Equity	**(2,146)**	247
Private Equity	**(5,178)**	370
Nominal Fixed Income		
Cash & Cash Equivalents	**68**	79
World Government Bonds	**1,396**	236
Canadian Fixed Income	**643**	416
Real Return Assets		
World Inflation-Linked Bonds	**628**	112
Real Estate	**(2,739)**	1,064
Infrastructure	**424**	39
Absolute Return [1]	**(5,446)**	(1,636)
Investment Income (Loss)	**$ (25,172)**	$ (627)

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

7. EXPENSES

(A) ALLOCATION OF EXPENSES

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

All other operating expenses, excluding the direct cost of investment activities listed above, for the year ended March 31, have been allocated as follows:

	2009	2008
Public Service Pension Plan Account	**72.6%**	72.6%
Canadian Forces Pension Plan Account	**20.1**	20.1
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.1**	0.1
Total	**100.0%**	100.0%

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

(B) OPERATING EXPENSES

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

($ thousands)	**2009**	2008
Salaries and benefits	**$ 68**	$ 35
Professional and consulting fees	**14**	21
Office supplies and equipment	**12**	7
Other operating expenses	**12**	6
Depreciation of fixed assets	**7**	3
Occupancy costs	**5**	2
Custodial fees	**2**	2
Remuneration earned by Directors	**1**	1
Travel and related expenses for Directors	**1**	–
Total	**$ 122**	$ 77

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

8. CAPITAL DEBT FINANCING

As of March 31, 2009, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $1,579 million (2008 – $1,551 million) of short-term promissory notes outstanding with maturity dates between 28 and 364 days of issuance, of which $5,386 thousand (2008 – $2,170 thousand) has been allocated to the Reserve Force Pension Plan Account and included in Note 3 (a) as a short-term investment-related liability. As at March 31, 2009, PSP Capital Inc. has $1 billion (2008 – nil) of medium-term notes issued and outstanding, of which $3,412 thousand (2008 – nil) has been allocated to the Reserve Force Pension Plan Account. These medium-term notes bear interest of 4.57% per annum and have a maturity date of December 9, 2013; $600 million of these medium-term notes were issued on December 9, 2008 and $400 million were issued on February 24, 2009. These medium-term notes are included in Note 3 (a) as a long-term investment-related liability. As at March 31, 2009, the fair value, including accrued interest, of these medium-term notes is $1,054 million (2008 – nil), of which $3,597 thousand (2008 – nil) has been allocated to the Reserve Force Pension Plan Account. The maximum authorized by the Board of Directors for the short-term promissory notes and medium-term notes is $3 billion and $1 billion, respectively. The capital raised was used primarily to finance real estate and infrastructure investments and is unconditionally and irrevocably guaranteed by PSP Investments.

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

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

($ thousands)	**2009**	2008
Short-term promissory notes	**$ 193**	$ 71
Medium-term notes	**34**	–
Total	**$ 227**	$ 71

9. CAPITAL MANAGEMENT

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

– To invest fund transfers, outlined in Note 5, in the best interests of the beneficiaries and contributors under the *Superannuation Acts*. The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plans established under the *Superannuation Acts*. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.

– To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc., and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 8 provides information on the capital debt financing and Note 4 (c) provides information on PSP Investments' liquidity. Additionally, as at March 31, 2009, PSP Investments has an operating line of credit of $10 million. As at March 31, 2009, no amounts have been withdrawn.

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2009

10. GUARANTEES AND INDEMNITY

PSP Investments provides indemnification to its Directors, its Officers and to certain PSP Investments representatives who are asked to serve the boards or like bodies of entities in which PSP Investments has made a substantial investment. As a result, but subject to the Act, PSP Investments may be required to indemnify these parties for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

As part of investment transactions, PSP Investments and its subsidiaries guaranteed letter of credit facilities. The beneficiaries of these letter of credit facilities have the ability to draw against these facilities to the extent that the contractual obligations, as defined in the related agreements, are not met. As at March 31, 2009, the maximum exposure of the plan was $50 thousand (2008 – $21 thousand).

As at March 31, 2009, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan would assume the obligation up to $1,375 thousand plus interest and other related costs.

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

11. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, 2009, the outstanding commitments for the Plan amounted to $25,859 thousand ($15,796 thousand for private equity investments, $6,125 thousand for real estate investments, $1,972 thousand for public market investments and $1,966 thousand for infrastructure investments).

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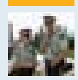

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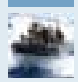

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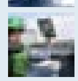

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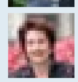

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