RESERVE FORCE PENSION PLAN ACCOUNT
FINANCIAL STATEMENTS

Independent Auditors' Report

To the Minister of National Defence

Report on the Financial Statements

We have audited the accompanying financial statements of the Public Sector Pension Investment Board – Reserve Force Pension Plan Account (the Reserve Force Pension Plan Account), which comprise the balance sheet as at March 31, 2014, and the statement of net income from operations and comprehensive income and statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Reserve Force Pension Plan Account as at March 31, 2014, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

Report on Other Legal and Regulatory Requirements

As required by the *Financial Administration Act*, we report that, in our opinion, Canadian generally accepted accounting principles have been applied on a basis consistent with that of the preceding year.

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

Deloitte LLP[1]

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

May 15, 2014
Montréal, Canada

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

May 15, 2014
Ottawa, Canada

Balance Sheet

As at March 31

($ thousands)	2014	2013
ASSETS		
Investments (Note 3 (A))	**$504,897**	$431,940
Investment-related assets (Note 3 (A))	**9,616**	11,679
Other assets	**497**	270
	$515,010	$443,889
LIABILITIES		
Investment-related liabilities (Note 3 (A))	**$ 48,589**	$ 41,370
Accounts payable and other liabilities	**645**	572
Due to the Public Service Pension Plan Account	**370**	197
	$ 49,604	$ 42,139
NET ASSETS	**$465,406**	$401,750
Accumulated net income from operations and comprehensive income	**$154,834**	$ 91,178
Accumulated fund transfers	**310,572**	310,572
NET ASSETS	**$465,406**	$401,750

Commitments (Note 11)

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

On behalf of the Board of Directors:

Cheryl Barker
Interim Chair of the Board

William A. MacKinnon
Chair of the Audit Committee

Statement of Net Income from Operations and Comprehensive Income

For the years ended March 31

($ thousands)	2014	2013
INVESTMENT INCOME (NOTE 6)	**$ 64,798**	$ 38,506
OPERATING EXPENSES (NOTE 7)	**$ 1,142**	$ 1,029
NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ 63,656**	$ 37,477

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

Statement of Changes in Net Assets

For the years ended March 31

($ thousands)	2014	2013
NET ASSETS, BEGINNING OF YEAR	**$401,750**	$364,273
Fund transfers (Note 5)	**–**	–
Net income from operations and comprehensive income	**63,656**	37,477
Increase in net assets for the year	**63,656**	37,477
NET ASSETS, END OF YEAR	**$465,406**	$401,750

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

Notes to the Financial Statements

For the year ended March 31, 2014

ORGANIZATION

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

The fund for which amounts are currently transferred to PSP Investments by the Government of Canada (the "Fund") relates to pension obligations under the Plan for service on or after March 1, 2007 ("Post-2007 Service"). The account managed by PSP Investments for the Fund is herein referred to as the "Plan Account". PSP Investments maintains records of the net contributions for the Fund, as well as the allocation of its investments and the results of its operations for the Fund in the Plan Account.

PSP Investments is responsible for managing amounts that are transferred to it for the Fund in the best interests of the beneficiaries and contributors under the CFSA Regulations. The amounts are to be invested with a view of achieving a maximum rate of return, without undue risk of loss, having regard to the funding, policies and requirements of the Plan and the Plan's ability to meet its financial obligations.

Pursuant to the CFSA and the CFSA Regulations, the Government of Canada, which administers the Plan and the Fund, may at any time call upon the net assets of PSP Investments allocated to the Fund's Plan Account for amounts required for the purpose of paying benefits under the Plan in respect of Post-2007 Service or for the purpose of reducing any non-permitted surplus in the Fund.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it for the Fund in respect of Post-2007 Service. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities under the Plan. The financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, including those that meet the definition of a subsidiary and those over which PSP Investments exercises significant influence, in accordance with Accounting Guideline 18, "Investment Companies" (AcG-18). All changes in fair value are included in investment income (loss) as net unrealized gains (losses).

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

VALUATION OF INVESTMENTS

Investments, investment-related assets and investment-related liabilities are recorded at the date upon which PSP Investments becomes a party to the associated contractual provisions, and are carried at fair value. Purchases and sales are recorded as of the trade date. Fair value is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

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

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF INVESTMENTS (continued)

Valuation techniques are generally applied to investments in real estate, private equity, infrastructure and renewable resources, over-the-counter (OTC) derivatives and certain fixed income securities. The values derived from applying these techniques are impacted by the choice of valuation model and the underlying assumptions made concerning factors such as the amounts and timing of future cash flows, discount rates, volatility and credit risk. In certain cases, such assumptions are not supported by market observable data.

The valuation methods of the investments are described in Notes 3 (A) and 3 (B).

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

Investment management fees are directly attributable to the external management of assets on behalf of PSP Investments. Management fees incurred for investments in private markets and certain private debt portfolios are paid by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment. Management fees are also incurred for certain public markets and alternative investments and are paid either directly by PSP Investments or offset against distributions received from pooled fund investments. In both cases, they are recorded against investment income (loss).

INCOME RECOGNITION

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

Investment income (loss) is made up of interest income, dividends, realized gains (losses) on the disposal of investments and unrealized gains (losses) which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Interest income is recognized as earned. Dividends are recognized on the ex-dividend date and are classified as dividend income. Private markets distributions from pooled funds, limited partnerships or from direct investments and co-investments are recognized as interest income, dividend income or realized gains (losses) as appropriate. Co-investments are investments in private entities where the investment is made in conjunction with an external manager with whom PSP Investments already has committed and delegated funds. Dividend expense related to securities sold short and securities lending income (net of fees on securities borrowed) are classified as other (net).

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

Amounts received for the Fund are recorded in the Plan Account.

INCOME TAXES

PSP Investments and the majority of its subsidiaries are exempt from Part I tax under paragraphs 149(1)*(d)* and 149(1)*(d.2)* of the *Income Tax Act* (Canada), respectively.

USE OF ESTIMATES

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

2 FUTURE CHANGES IN ACCOUNTING POLICIES

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

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

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

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

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

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

3 INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

	2014		2013	
($ thousands)	**Fair Value**	**Cost**	Fair Value	Cost
INVESTMENTS				
Public markets				
Canadian equity	**$ 45,323**	**$ 40,484**	$ 48,701	$ 49,225
Foreign equity	**137,835**	**100,775**	110,611	95,161
Private markets				
Real estate	**63,514**	**55,220**	57,532	52,807
Private equity	**40,149**	**23,959**	37,065	26,950
Infrastructure	**32,480**	**30,807**	23,538	24,626
Renewable resources	**5,890**	**5,149**	2,218	1,984
Fixed income				
Cash and money market securities	**19,219**	**19,219**	19,031	19,031
Government and corporate bonds	**84,904**	**81,854**	59,191	57,501
Inflation-linked bonds	**24,809**	**20,226**	23,108	19,718
Other fixed income securities	**35,801**	**30,834**	41,483	37,129
Alternative investments	**14,973**	**7,562**	9,462	3,123
	$504,897	**$416,089**	$431,940	$387,255
INVESTMENT-RELATED ASSETS				
Amounts receivable from pending trades	**$ 3,648**	**$ 3,648**	$ 5,921	$ 5,921
Interest receivable	**1,085**	**1,085**	805	805
Dividends receivable	**410**	**410**	352	352
Derivative-related receivables	**4,473**	**3,414**	4,601	1,501
	$ 9,616	**$ 8,557**	$ 11,679	$ 8,579
INVESTMENT-RELATED LIABILITIES				
Amounts payable from pending trades	**$ (4,710)**	**$ (4,710)**	$ (5,831)	$ (5,831)
Interest payable	**(133)**	**(133)**	(126)	(126)
Securities sold short	**(3,557)**	**(3,415)**	(2,475)	(2,454)
Securities sold under repurchase agreements	**(3,140)**	**(3,155)**	(3,215)	(3,217)
Derivative-related payables	**(6,019)**	**(2,855)**	(3,878)	(1,303)
Capital market debt financing (Note 8)	**(31,030)**	**(30,626)**	(25,845)	(25,532)
	$ (48,589)	**$ (44,894)**	$ (41,370)	$ (38,463)
NET INVESTMENTS	**$465,924**	**$379,752**	$402,249	$357,371

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Public Markets

Public markets consist of Canadian and foreign investments in the following securities: common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds units, pooled funds units, and securities convertible into common shares of publicly listed issuers.

Valuation Techniques

Direct investments in Canadian and foreign equities are measured at fair value using quoted market prices, namely, the bid price.

In the case of investments in pooled funds, fair value is measured using unit values obtained from each of the funds' administrators, which are derived from the fair value of the underlying investments in each pooled fund. Where necessary, the impact of restrictions on the sale or redemption of such investments is taken into consideration in determining fair value.

(ii) Private Markets

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

Real estate investments are comprised of direct equity positions in various private entities, fund investments, as well as properties in the real estate sector. Real estate investments focus on partnerships, companies and properties operating mainly in the retirement and residential, office, retail and industrial sectors, as well as private funds invested in real estate assets. Real estate investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of real estate contracted by direct investments controlled by PSP Investments for the Plan Account was $20,133 thousand (2013 – $19,000 thousand).

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

Infrastructure investments are comprised of direct equity positions, fund investments and co-investments in various private entities. Infrastructure investments focus on entities engaged in the management, ownership or operation of assets in energy, transportation and other regulated businesses. Infrastructure investments are accounted for net of all third-party financings. As at March 31, 2014, the total amount of third-party financing included as part of infrastructure contracted by direct investments controlled by PSP Investments for the Plan Account was $8,175 thousand (2013 – $1,461 thousand).

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

Valuation Techniques

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

In cases where the services of third-party appraisers are used, management ensures their independence and that valuation methods used are consistent with professional appraisal standards. Such standards include the *International Private Equity and Venture Capital Valuation Guidelines*, the *Canadian Uniform Standards of Professional Appraisal Practice* and the *Uniform Standards of Professional Appraisal Practice* in the United States of America. In validating the work performed by appraisers, management ensures that the assumptions used correspond to financial information and forecasts of the underlying investment.

For direct investments in real estate, valuation methods used include discounted cash flows, prices of recent comparable transactions and the direct capitalization approach. Assumptions used in such valuations include discount rates, capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

For direct investments in private equity, direct investments and co-investments in infrastructure and in renewable resources, valuation methods used include discounted cash flows, earnings multiples, prices of recent comparable transactions and publicly traded comparables. Assumptions used in such valuations include discount rates and projected cash flows, which are not fully supported by prices from market observable transactions.

In the case of private equity, real estate and infrastructure fund investments as well as private equity co-investments, the annual fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(iii) Fixed Income

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

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

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

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

Asset-backed securities consist mainly of asset-backed term notes (ABTNs) and mortgage-backed securities. The ABTNs were received in exchange for third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007 and were subsequently restructured in January 2009. Potential margin calls on the ABTNs are supported by funding facilities, as described in Note 10.

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

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

Valuation Techniques

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

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

ABTNs are measured at fair value whereby management relies on the valuation work performed by a recognized third-party expert. Management ensures that the valuation conducted by such expert uses acceptable industry methods. Financial information used in the valuation of ABTNs includes interest rates, credit spreads and the underlying investments' terms to maturity. In addition to the values determined by the expert, management integrated certain assumptions in the fair value of ABTNs that are not fully supported by market observable data, such as liquidity estimates and the impact of the funding facilities described in Note 10.

The fair value of private debt portfolios in the real estate sector is obtained from third-party appraisers and is determined using either a yield-based or collateral-based valuation technique. The yield-based valuation technique involves discounting expected future cash flows that incorporate assumptions with respect to interest rates offered for similar loans to borrowers with similar credit ratings. The collateral-based valuation technique involves assessing the recoverable value of the collateral in question, net of disposal fees.

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

(iv) Alternative Investments

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

Valuation Techniques

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

3 INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(v) Amounts Receivable and Payable from Pending Trades

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

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

Valuation Techniques

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

(vi) Interest and Dividends Receivable

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

(vii) Interest Payable

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

(viii) Securities Sold Short

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

Valuation Techniques

Using ask prices as inputs, the fair value of securities sold short is measured using the same method as the similar long positions presented within public markets and fixed income.

(ix) Securities Sold under Repurchase Agreements

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

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

Obligations to repurchase the securities sold are accounted for as investment-related liabilities. Interest expense related to such obligations is reported in investment income (loss).

Valuation Techniques

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

(x) Derivative-Related Receivables and Payables

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

(xi) Capital Market Debt Financing

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

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are financial contracts that are settled at a future date. The value of such instruments is derived from changes in the value of the underlying assets, interest or exchange rates. Derivative financial instruments do not, typically, require an initial net investment. In certain cases, they require an initial net investment that is less than what would be required to hold the underlying position directly. Derivative financial instruments can be listed or traded OTC. OTC instruments consist of those that are bilaterally negotiated and settled, and those that are cleared (OTC-cleared) by a central clearing party (CCP).

PSP Investments uses derivative financial instruments to enhance returns or to replicate investments synthetically. Derivatives are also used to reduce the risk associated with existing investments.

PSP Investments uses the following types of derivative financial instruments:

(i) Swaps

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

(ii) Futures

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

(iii) Forwards

Forwards are contracts involving the sale by one party and the purchase by another party of a predefined amount of an underlying instrument, at a predefined price and at a predefined date in the future. Forwards are used to adjust exposures to specified assets without directly purchasing or selling the underlying assets.

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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

Valuation Techniques

Listed derivative financial instruments are recorded at fair value using quoted market prices with the bid price for long positions and the ask price for short positions. OTC-cleared derivatives are recorded at fair value using prices obtained from the CCP. OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. Although pricing models used are widely accepted and used by other market participants, in the case of collateralized debt obligations, the nature of such instruments requires more significant assumptions about the behavior of the default correlation. Such assumptions are not observable in the market.

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

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

	2014				2013			
		Fair Value				Fair Value		
($ thousands)	Notional Value	Assets	Liabilities	Net	Notional Value	Assets	Liabilities	Net
Equity and commodity derivatives								
Futures	$ 6,964	$ –	$ –	$ –	$ 4,468	$ –	$ –	$ –
Total return swaps	67,383	1,056	(109)	947	52,455	878	(261)	617
Warrants and rights	27	30	–	30	11	1	–	1
Options:								
Listed-purchased	3,423	97	–	97	13,570	146	–	146
Listed-written	2,057	–	(85)	(85)	5,293	–	(81)	(81)
OTC-purchased	27,271	1,529	–	1,529	6,638	867	–	867
OTC-written	30,279	–	(1,751)	(1,751)	6,532	–	(768)	(768)
Currency derivatives								
Forwards	154,121	759	(2,245)	(1,486)	181,054	1,807	(1,761)	46
Futures	345	–	–	–	222	–	–	–
Swaps	17,668	45	(622)	(577)	5,612	125	(151)	(26)
Options:								
OTC-purchased	19,987	163	–	163	27,452	410	–	410
OTC-written	17,423	–	(79)	(79)	25,605	–	(354)	(354)
Interest rate derivatives								
Bond forwards	3,483	1	(3)	(2)	4,468	30	(34)	(4)
Futures	12,089	–	–	–	7,021	–	–	–
Interest rate swaps:								
OTC	58,920	196	(427)	(231)	61,049	119	(209)	(90)
OTC-cleared	41,604	–	–	–	–	–	–	–
Total return swaps	–	–	–	–	13	–	–	–
Swaptions	156,807	405	(346)	59	14,840	40	(29)	11
Options:								
Listed-purchased	131,612	88	–	88	26,688	20	–	20
Listed-written	138,021	–	(44)	(44)	26,226	–	(18)	(18)
OTC-purchased	50,506	76	–	76	9,299	50	–	50
OTC-written	74,753	–	(73)	(73)	14,697	–	(52)	(52)
Credit derivatives [1]								
OTC-purchased	10,608	5	(228)	(223)	10,107	89	(91)	(2)
OTC-sold	2,723	23	(7)	16	4,931	19	(69)	(50)
OTC-cleared-purchased	4,232	–	–	–	–	–	–	–
OTC-cleared-sold	6,384	–	–	–	–	–	–	–
Total	$ 1,038,690	$ 4,473	$ (6,019)	$ (1,546)	$ 508,251	$ 4,601	$ (3,878)	$ 723

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

3 INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The term to maturity based on notional value for the derivatives was as follows as at March 31, 2014:

($ thousands)

Less than 3 months	**$ 461,742**
3 to 12 months	**385,201**
Over 1 year	**191,747**
Total	**$ 1,038,690**

(C) FAIR VALUE MEASUREMENT

Investments, investment-related assets and investment-related liabilities are classified according to the following hierarchy based on the significant inputs used in measuring their fair value.

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

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

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2014:

($ thousands)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 42,049	$ 3,274	$ –	$ –	$ 45,323
Foreign equity	116,624	21,211	–	–	137,835
Private markets					
Real estate	–	–	63,514	–	63,514
Private equity	–	–	40,149	–	40,149
Infrastructure	–	–	32,480	–	32,480
Renewable resources	–	–	5,890	–	5,890
Fixed income					
Cash and money market securities	4,033	15,186	–	–	19,219
Government and corporate bonds	–	84,904	–	–	84,904
Inflation-linked bonds	–	24,809	–	–	24,809
Other fixed income securities	–	15,226	20,575	–	35,801
Alternative investments	–	5,591	9,382	–	14,973
	$162,706	$170,201	$171,990	$ –	$504,897
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 3,648	$ 3,648
Interest receivable	–	–	–	1,085	1,085
Dividends receivable	–	–	–	410	410
Derivative-related receivables	214	4,257	2	–	4,473
	$ 214	$ 4,257	$ 2	$ 5,143	$ 9,616
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (4,710)	$ (4,710)
Interest payable	–	–	–	(133)	(133)
Securities sold short	(3,557)	–	–	–	(3,557)
Securities sold under repurchase agreements	–	(3,140)	–	–	(3,140)
Derivative-related payables	(130)	(5,889)	–	–	(6,019)
Capital market debt financing	–	(31,030)	–	–	(31,030)
	$ (3,687)	$ (40,059)	$ –	$ (4,843)	$ (48,589)
NET INVESTMENTS	$159,233	$134,399	$171,992	$ 300	$465,924

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of investments, investment-related assets and investment-related liabilities, based on the methods previously described, as at March 31, 2013:

($ thousands)	Level 1	Level 2	Level 3	No Level [1]	Total Fair Value
INVESTMENTS					
Public markets					
Canadian equity	$ 48,701	$ –	$ –	$ –	$ 48,701
Foreign equity	90,907	19,704	–	–	110,611
Private markets					
Real estate	–	–	57,532	–	57,532
Private equity	–	–	37,065	–	37,065
Infrastructure	–	–	23,538	–	23,538
Renewable resources	–	–	2,218	–	2,218
Fixed income					
Cash and money market securities	3,321	15,710	–	–	19,031
Government and corporate bonds	–	59,191	–	–	59,191
Inflation-linked bonds	–	23,108	–	–	23,108
Other fixed income securities	–	17,943	23,540	–	41,483
Alternative investments	–	4,672	4,790	–	9,462
	$142,929	$140,328	$148,683	$ –	$431,940
INVESTMENT-RELATED ASSETS					
Amounts receivable from pending trades	$ –	$ –	$ –	$ 5,921	$ 5,921
Interest receivable	–	–	–	805	805
Dividends receivable	–	–	–	352	352
Derivative-related receivables	166	4,432	3	–	4,601
	$ 166	$ 4,432	$ 3	$ 7,078	$ 11,679
INVESTMENT-RELATED LIABILITIES					
Amounts payable from pending trades	$ –	$ –	$ –	$ (5,831)	$ (5,831)
Interest payable	–	–	–	(126)	(126)
Securities sold short	(2,475)	–	–	–	(2,475)
Securities sold under repurchase agreements	–	(3,215)	–	–	(3,215)
Derivative-related payables	(99)	(3,758)	(21)	–	(3,878)
Capital market debt financing	–	(25,845)	–	–	(25,845)
	$ (2,574)	$ (32,818)	$ (21)	$ (5,957)	$ (41,370)
NET INVESTMENTS	$140,521	$111,942	$148,665	$ 1,121	$402,249

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

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

During the year ended March 31, 2014, listed Canadian equity securities with a fair value of $3,158 thousand classified as Level 1 were transferred to a non-listed fund held by PSP Investments. Consequently, the securities were classified as Level 2 as at March 31, 2014 (no significant transfers during the year ended March 31, 2013).

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2014:

($ thousands)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Private markets	**$ 120,353**	**$ 35,044**	**$ (21,736)**	**$ –**	**$ 3,787**	**$ 5,980**	**$ (1,395)**	**$ 142,033**
Fixed income	**23,540**	**3,685**	**(6,184)**	**(1,439)**	**1,591**	**(618)**	**–**	**20,575**
Alternative investments	**4,790**	**4,450**	**(134)**	**–**	**9**	**267**	**–**	**9,382**
Derivative-related receivables/payables (net)	**(18)**	**42**	**(49)**	**–**	**7**	**20**	**–**	**2**
Total	**$ 148,665**	**$ 43,221**	**$ (28,103)**	**$ (1,439)**	**$ 5,394**	**$ 5,649**	**$ (1,395)**	**$ 171,992**

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

The following table shows a reconciliation of all movements related to investments, investment-related assets and investment-related liabilities categorized within Level 3 for the year ended March 31, 2013:

($ thousands)	Opening Balance	Purchases	Sales	Settlements	Realized Gains	Unrealized Gains (Losses)[1]	Transfer out of Level 3	Closing Balance
Public markets	$ 949	$ 6	$ (31)	$ –	$ 5	$ (115)	$ (814)	$ –
Private markets	103,242	26,478	(10,043)	–	1,146	(470)	–	120,353
Fixed income	22,517	7,420	(6,397)	(352)	1,079	(727)	–	23,540
Alternative investments	1,714	3,155	–	–	–	(79)	–	4,790
Derivative-related receivables/payables (net)	(60)	46	(54)	–	10	40	–	(18)
Total	$ 128,362	$ 37,105	$ (16,525)	$ (352)	$ 2,240	$ (1,351)	$ (814)	$ 148,665

[1] Includes Plan Account allocation adjustments.

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

3 INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (A) and (B). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 7% increase and 5% decrease (2013 – 4% increase and 4% decrease) in the fair value of financial instruments categorized as Level 3. This excludes private debt portfolios and fund investments of $65,217 thousand allocated to the Plan Account (2013 – $53,738 thousand), where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (A). With respect to private debt portfolios, the fair value is obtained from third-party appraisers as described in Note 3 (A).

(D) SECURITIES LENDING AND BORROWING PROGRAMS

PSP Investments participates in securities lending and borrowing programs whereby it lends and borrows securities in order to enhance portfolio returns. Lending and borrowing transactions under such programs do not transfer the risks or rewards of ownership of the securities to the counterparty. Consequently, PSP Investments does not derecognize securities lent or recognize securities borrowed.

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. PSP Investments and its counterparties are authorized to sell, repledge or otherwise use collateral held. The same securities or equivalent securities must be returned to the counterparty at the end of the contract, unless an event of default occurs. As at March 31, 2014, PSP Investments, on behalf of the Plan Account, has re-invested $11,990 thousand of collateral held (2013 – $11,701 thousand).

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

($ thousands)	2014	2013
Securities lending		
Securities lent	**$ 47,829**	$ 39,048
Collateral held[1]	**50,914**	41,126
Securities borrowing		
Securities borrowed	**3,557**	2,475
Collateral pledged[2]	**3,728**	2,485

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

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

(E) SECURITIES SOLD AND COLLATERAL PLEDGED UNDER REPURCHASE AGREEMENTS

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

On behalf of the Plan Account, PSP Investments pledged collateral under the repurchase agreements with a fair value of $3,137 thousand as at March 31, 2014 (2013 – $3,215 thousand).

4 INVESTMENT RISK MANAGEMENT

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

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

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

(A) MARKET RISK

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

Market risk management focuses on the following two key components:

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

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

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

Measurement of Market Risk

The Value-at-Risk (VaR) is one of the methods used to measure market risk and is reported on a quarterly basis. It is not the maximum potential loss, but rather the maximum loss not exceeded with a given confidence level, over a given period of time. PSP Investments uses a Historical VaR model incorporating ten years' worth of market returns scaled to a twelve-month holding period at a 95% confidence level. For investments that are not actively traded, the calculation of VaR uses securities with similar risk attributes as a proxy.

In measuring Policy Portfolio risk, VaR represents the absolute loss expected from the Policy Portfolio (Policy Portfolio VaR). Whereas in terms of measuring the active risk, VaR reflects the loss relative to the Policy Portfolio benchmark (Active VaR).

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

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

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

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

Stress Testing

Although VaR is a widely accepted risk measure, it is complemented by other risk measurement methodologies that provide greater insight on market risk. PSP Investments uses stress testing and scenario analysis to examine the impact on financial results of abnormally large movements in risk factors. Stress testing and scenario analysis are used to test a portfolio's sensitivity to various risk factors and key model assumptions. These methods also use historically stressed periods to evaluate how a current portfolio reacts under such circumstances. Stress testing and scenario analysis are also deployed to assess new product performance.

(i) Interest Rate Risk

Interest rate risk refers to the risk that fluctuations in interest rates will directly affect the fair value of the Plan Account's net asset values.

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

($ thousands)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Other	Total
Government bonds	$ 8,851	$ 26,556	$ 9,014	$ 13,236	$ –	$ 57,657
Corporate bonds	3,324	15,072	6,983	1,868	–	27,247
Inflation-linked bonds	15	6,062	6,951	11,781	–	24,809
Asset-backed securities	55	8,015	123	–	–	8,193
Private debt portfolios:						
Directly held	868	2,409	–	–	–	3,277
Held through funds [1]	–	–	–	–	9,770	9,770
Total investments with significant exposure to interest rate risk	**$ 13,113**	**$ 58,114**	**$ 23,071**	**$ 26,885**	**$ 9,770**	**$130,953**
Other investments [2]	**$ –**	**$ –**	**$ –**	**$ –**	**$ 33,780**	**$ 33,780**
Total fixed income	**$ 13,113**	**$ 58,114**	**$ 23,071**	**$ 26,885**	**$ 43,550**	**$164,733**

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

[2] Consists of $19,219 thousand in cash and money market securities and $14,561 thousand in floating rate notes, which, due to their nature, are not significantly exposed to interest rate risk.

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

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

4 INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts or cross currency swaps, positions in foreign currencies. In October 2013, PSP Investments amended its policy to fully hedge foreign currency investments in government and corporate bonds, inflation-linked bonds, certain other fixed income securities, as well as investments in real estate, infrastructure and renewable resources. PSP Investments' previous policy was to hedge a target of 50% of its foreign currency investments in non-emerging countries. Additional factors are considered when implementing the hedging target for investments in emerging countries, namely, total relative exposure and cost effectiveness.

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

(in thousands of Canadian $)	**2014**		2013	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$122,224**	**61.0 %**	$ 80,727	53.3 %
Euro	**17,225**	**8.6**	13,584	9.0
British Pound	**9,229**	**4.6**	11,233	7.4
Japanese Yen	**7,812**	**3.9**	6,036	4.0
Hong Kong Dollar	**6,512**	**3.3**	5,461	3.6
Korean Won	**6,508**	**3.2**	4,093	2.7
Brazilian Real	**6,276**	**3.1**	6,363	4.2
Swiss Franc	**3,959**	**2.0**	2,016	1.3
Taiwanese New Dollar	**3,043**	**1.5**	2,469	1.6
Australian Dollar	**2,520**	**1.3**	4,982	3.3
Indian Rupee	**2,335**	**1.2**	1,863	1.2
South African Rand	**1,948**	**1.0**	1,604	1.1
Swedish Krona	**1,314**	**0.6**	382	0.3
Colombian Peso	**1,217**	**0.6**	919	0.6
Mexican Peso	**1,049**	**0.5**	1,280	0.9
Others	**7,162**	**3.6**	8,330	5.5
Total	**$200,333**	**100.0 %**	$151,342	100.0 %

As at March 31, 2014, PSP Investments and its subsidiaries also had commitments, denominated in foreign currencies of $59,673 thousand (US$50,023 thousand, €1,289 thousand, £142 thousand, R110 thousand South African Rands, R$1,405 thousand Brazilian Reals, $305,832 thousand Colombian pesos and ₹74,057 thousand Indian Rupees) for the Plan Account which were not included in the foreign currency exposure table.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

PSP Investments is exposed to credit risk, that is, the risk that the issuer of a debt security or that the counterparty to a derivative contract, to a securities lending and borrowing transaction or to securities sold under repurchase agreements, is unable to meet its financial obligations.

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

As at March 31, 2014, the Plan Account's maximum exposure to credit risk amounted to approximately $149 million (2013 – approximately $137 million). This amount excludes investments in distressed debt in the amount of approximately $7.8 million as at March 31, 2014 (2013 – approximately $7.2 million). The maximum exposure to credit risk also excludes collateralized debt obligations, collateral held as disclosed in Notes 3 (D), 3 (E) and 4 (B) and the impact of guarantees and indemnities disclosed in Note 10.

As at March 31, 2014, the Plan Account had a net notional exposure of $274 thousand (2013 – $633 thousand) to various tranches of collateralized debt obligations, of which approximately 53% (2013 – approximately 67%) of the underlying dollar exposure was rated "Investment grade", as well as funding facilities, as described in Note 10, to support potential margin calls on the ABTNs.

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

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

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

Counterparty Risk

Counterparty risk represents the credit risk from current and potential exposure related to transactions involving derivative contracts, securities lending and borrowing as well as securities sold under repurchase agreements. In order to minimize counterparty risk, PSP Investments requires that counterparties provide adequate collateral and meet its credit rating requirements. PSP Investments frequently monitors the credit rating of its counterparties as determined by recognized credit rating agencies. With respect to derivative contracts, PSP Investments has the ability to terminate all trades with most counterparties whose credit rating is downgraded below its requirements.

For OTC derivatives, PSP Investments' policy also requires the use of the International Swaps and Derivative Association (ISDA) Master Agreement with all counterparties to derivative contracts. The ISDA Master Agreement provides the contractual framework within which dealing activities across a full range of OTC products are conducted. In the case of OTC-cleared derivatives, the CCP regulates trading activities between parties under terms that are customary to such transactions.

4 INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

Counterparty Risk (continued)

As a credit mitigation technique, the ISDA Master Agreement contractually binds counterparties to close-out netting provisions in the case of default by one of the counterparties. Additionally, the Credit Support Annex (CSA) to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the case of default of the counterparty. The CSA also requires PSP Investments to contribute further collateral when requested. All collateral transactions under the CSA are in high-quality debt instruments or securities. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold. In certain cases, counterparties are authorized to sell, repledge or otherwise use collateral held. Similarly, in the case of OTC-cleared derivatives, the CCP requires collateral in cash, high quality debt instruments or securities and is authorized to sell, repledge or otherwise use collateral held. On behalf of the Plan Account, PSP Investments pledged securities with a fair value of $2,880 thousand as collateral with respect to derivative contracts at March 31, 2014 (2013 – $379 thousand), $133 thousand of which are with respect to OTC-cleared derivatives (2013 – nil). Securities with a fair value of $174 thousand were received from counterparties as collateral at March 31, 2014 (2013 – $764 thousand). PSP Investments does not sell, repledge or otherwise use any collateral held with respect to derivative contracts.

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

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

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

(C) LIQUIDITY RISK

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

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

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

4 INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

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

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities [1]				
Amounts payable from pending trades	$ (4,710)	$ –	$ –	$ (4,710)
Interest payable	(121)	(12)	–	(133)
Securities sold short	(3,557)	–	–	(3,557)
Securities sold under repurchase agreements	(3,140)	–	–	(3,140)
Capital market debt financing	(16,397)	(3,937)	(10,696)	(31,030)
Accounts payable and other liabilities	(415)	–	(230)	(645)
Total	$ (28,340)	$ (3,949)	$ (10,926)	$ (43,215)

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial instruments				
Derivative-related receivables	$ 2,058	$ 1,569	$ 846	$ 4,473
Derivative-related payables [1]	(2,312)	(2,172)	(1,535)	(6,019)
Total	$ (254)	$ (603)	$ (689)	$ (1,546)

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

5 FUND TRANSFERS

PSP Investments did not receive any fund transfers from the Government of Canada for the year ended March 31, 2014 (2013 – no transfers) for the Fund, recorded in the Plan Account.

6 INVESTMENT INCOME

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

($ thousands)	2014	2013
Interest income	$ 5,500	$ 4,366
Dividend income	7,002	6,412
Interest expense (Note 8)	(504)	(549)
Transaction costs	(490)	(271)
External investment management fees [1]	(161)	(201)
Other (net)	(164)	(96)
	11,183	9,661
Net realized gains [2]	12,321	12,071
Net unrealized gains [3]	41,294	16,774
Investment income	$ 64,798	$ 38,506

[1] Consists of amounts incurred for investments in public markets that are paid directly by PSP Investments. This excludes fees related to certain pooled fund investments classified under alternative investments primarily related to performance, in the amount of $276 thousand for the year ended March 31, 2014 (2013 – $113 thousand).

This also excludes management fees related to investments in private markets and other fixed income securities that are not paid directly by PSP Investments. Such fees, which generally vary between 0.1% and 2.0 % of the total invested and/or committed amount, totalled $765 thousand for the year ended March 31, 2014 (2013 – $669 thousand).

[2] Includes realized foreign currency losses of $7,628 thousand for the year ended March 31, 2014 (2013 – realized foreign currency losses of $1,088 thousand).

[3] Includes unrealized foreign currency gains of $21,105 thousand for the year ended March 31, 2014 (2013 – unrealized foreign currency gains of $1,074 thousand).

7 EXPENSES

(A) ALLOCATION OF EXPENSES

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

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

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

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

(B) OPERATING EXPENSES

Operating expenses allocated to this Plan Account, for the years ended March 31, consisted of the following:

($ thousands)	2014	2013
Salaries and benefits	$ 728	$ 684
Professional and consulting fees	127	66
Office supplies and equipment	114	105
Other operating expenses	43	44
Depreciation of fixed assets	73	73
Occupancy costs	36	35
Custodial fees	15	16
Remuneration earned by Directors	4	4
Travel and related expenses for Directors	1	1
Communication expenses	1	1
Total	$ 1,142	$ 1,029

8 CAPITAL MARKET DEBT FINANCING

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

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

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

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

($ thousands)	2014 Capital amounts payable at maturity	2014 Fair Value	2013 Capital amounts payable at maturity	2013 Fair Value
Short-term Canadian Dollar promissory notes, bearing interest between 0.99% and 1.19% and maturing within 7 and 364 days of issuance (March 31, 2013 – 31 and 191 days)	$ 7,138	$ 7,128	$ 4,555	$ 4,548
Short-term US Dollar promissory notes, bearing interest between 0.11% and 0.30% and maturing within 35 and 365 days of issuance (March 31, 2013 – 29 and 189 days)	11,466	11,462	5,364	5,362
Medium-term notes Series 1, bearing interest of 4.57% per annum and matured on December 9, 2013	–	–	5,280	5,402
Medium-term notes Series 2, bearing interest of 2.94% per annum and maturing on December 3, 2015	3,480	3,573	3,696	3,834
Medium-term notes Series 3, bearing variable interest of 3-month CDOR + 39 basis points and maturing on February 16, 2015	1,740	1,744	1,848	1,856
Medium-term notes Series 4, bearing interest of 2.26% per annum and maturing on February 16, 2017	4,474	4,566	4,752	4,843
Medium-term notes Series 5, bearing interest of 3.03% per annum and maturing on October 22, 2020	2,485	2,557	–	–
Total	**$ 30,783**	**$ 31,030**	$ 25,495	$ 25,845

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

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

($ thousands)	2014	2013
Short-term promissory notes	$ 72	$ 57
Medium-term notes	432	492
Total	**$ 504**	$ 549

9 CAPITAL MANAGEMENT

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

- To invest fund transfers, outlined in Note 5, in the best interests of the beneficiaries and contributors under the *Superannuation Act*s. The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, having regard to the funding, policies and requirements of the Plans established under the *Superannuation Act*s and the ability of the Plans to meet their financial obligations. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.
- To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc. and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 8 provides information on the capital market debt financing and Note 4 (C) provides information on PSP Investments' liquidity.

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

10 GUARANTEES AND INDEMNITIES

PSP Investments provides indemnification to its Directors, its Officers, its Vice Presidents and to certain PSP Investments representatives who are asked to serve on boards of directors (or like bodies) or investment advisory boards (or like bodies) of entities in which PSP Investments or its wholly-owned subsidiaries have made an investment or have a financial interest. As a result, but subject to the Act, PSP Investments may be required to indemnify these representatives for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties, unless the liability of such a representative relates to a failure to act honestly and in good faith. To date, PSP Investments has not received any claims or made any payment for such indemnities.

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

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

PSP Capital Inc. provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $4,840 thousand has been allocated to the Plan Account. As at March 31, 2014, the margin funding facilities have not been drawn upon since inception.

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

As at March 31, 2014, PSP Investments agreed to guarantee and, in some cases, provide indemnification for the performance of certain investees under contractual agreements. The majority of these agreements are borrowing arrangements. In the event a default occurs under such agreements, which is of limited recourse in certain cases, the Plan Account could assume obligations of up to $6,080 thousand (2013 – $5,275 thousand) plus applicable interest and other related costs. The arrangements mature between January 2014 and September 2028.

Additionally, PSP Investments and its subsidiaries issued letters of credit totalling $82 million as at March 31, 2014 (2013 – $41 million), of which $410 thousand has been allocated to the Plan Account (2013 – $218 thousand) in relation to investment transactions.

11 COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. The portion of PSP Investments' commitments that would be assumed by the Plan Account was as follows as at March 31, 2014:

($ thousands)

Real estate	$ 5,943
Private equity	20,243
Infrastructure	12,589
Renewable resources	3,978
Other fixed income securities	10,342
Alternative investments	9,073
Total	**$ 62,168**