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, 2008 and the Statements of Net Income (Loss) and Accumulated Net Income 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, 2008 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, except for the change in the method of accounting for financial instruments as explained in Note 2 to the financial statements, on a basis consistent with that of the preceding year.

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

Deloitte & Touche LLP

Chartered Accountants

Montreal, Canada
May 2, 2008

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 2, 2008

Canadian Forces Pension Plan Account

BALANCE SHEET

As at March 31

($ millions)	2008	2007
ASSETS		
Investments (Note 3(a))	$ 8,477	$ 7,185
Investment-related assets (Note 3(a))	469	387
Other assets	4	2
TOTAL ASSETS	$ 8,950	$ 7,574
LIABILITIES		
Investment-related liabilities (Note 3(a))	$ 1,113	$ 529
Accounts payable and accrued liabilities	6	10
Due to the Public Service Pension Plan Account (Note 7)	12	2
	1,131	541
NET ASSETS	$ 7,819	$ 7,033
Accumulated net income from operations and comprehensive income	$ 2,018	$ 2,074
Accumulated fund transfers	5,801	4,959
NET ASSETS	$ 7,819	$ 7,033

Commitments (Note 10)

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

On behalf of the Board of Directors:

Paul Cantor
Chairman

Keith Martell
Director and Chair of the
Audit and Conflicts Committee

Canadian Forces Pension Plan Account

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

For the year ended March 31

($ millions)	2008	2007
INVESTMENT INCOME (LOSS) (Note 5)		
Interest, dividends and other income	$ 230	$ 206
Net realized gains	315	445
Change in unrealized appreciation (depreciation) in value of investments	(573)	46
	(28)	697
EXPENSES		
Operating expenses (Note 7)	15	10
External investment management fees	12	11
	27	21
NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME	(55)	676
Accumulated net income from operations and comprehensive income, beginning of year (as previously reported)	2,074	1,398
Change in accounting policy – financial instruments (Note 2)	(1)	–
Accumulated net income from operations and comprehensive income, beginning of year (as restated)	2,073	1,398
Accumulated net income from operations and comprehensive income, end of year	$ 2,018	$ 2,074

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

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2008	2007
NET ASSETS, BEGINNING OF YEAR (as previously reported)	$ 7,033	$ 5,619
Change in accounting policy – financial instruments (Note 2)	(1)	–
NET ASSETS, BEGINNING OF YEAR (as restated)	$ 7,032	$ 5,619
Fund transfers (Note 4)	842	738
Net income (loss) from operations and comprehensive income	(55)	676
Increase in net assets for the year	787	1,414
NET ASSETS, END OF YEAR	$ 7,819	$ 7,033

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

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 the last fiscal year, PSP Investments' mandate was expanded to include investing 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*.

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

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2008

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.

Fair values of investments are determined as follows:

(a) Cash equivalent investments are recorded at cost plus accrued interest, which approximates 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, reflecting the quoted market prices, using the bid price for long positions and the ask price for short positions of the underlying securities, are used to present the fair value of pooled funds.

(c) Private equity and infrastructure investments, where quoted market prices, using the bid price for long positions and the ask price for short positions, are not available, are fair-valued at least annually. The fair value for investments held directly is determined using acceptable industry valuation methods such as earnings multiples, price of recent investments, discounted cash flows analysis and industry benchmark valuations. In the case of investments held through a limited partnership, fair value is generally determined based on the value reported by the fund's General Partner using acceptable industry valuation methods.

(d) The fair value of investments in real estate is determined at least annually, using acceptable industry valuation methods, such as discounted cash flows and comparable transactions. Management may use the services of a third party appraiser to determine the fair value of real estate investments.

(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 over-the-counter (OTC), appropriate valuation techniques, such as discounted cash flows using current market yields, are used to determine fair value.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Transaction Costs

Transaction costs are incremental costs directly attributable to the acquisition or disposal of an investment. Transaction costs are expensed as incurred and recorded as a component of investment income.

Income Recognition

The investment income 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 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 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 certain of its subsidiaries are exempt from Part I tax under paragraph 149(1) (d) of the *Income Tax Act* (Canada).

Use of Estimates

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

2. CHANGES IN ACCOUNTING POLICIES

On April 1, 2007, PSP Investments adopted, without restatement of prior periods, the CICA accounting handbook Section 3855 – Financial Instruments – recognition and measurement, as well as Section 3861 – Financial Instruments – disclosure and presentation and Section 1530 – Comprehensive Income.

Section 3855 – Financial Instruments – recognition and measurement establishes criteria for the recognition, derecognition, measurement and classification of financial instruments. As an investment company, PSP Investments is largely exempt from this new standard. However, it is required to measure the fair value of its market quoted securities using the bid price for long positions and the ask price for short positions. In addition, all transaction costs associated with its assets or liabilities are required to be recognized immediately in net income. The effect of adopting the new standard is presented in the Consolidated Statement of Changes in Net Assets as a Change in accounting policy – financial instruments. Transaction costs incurred for the current year are presented net of investment income in Note 5(a)

Section 3861 – Financial Instruments – disclosure and presentation establishes standards for the presentation of financial instruments and specifies required disclosure as it relates to accounting and risk management policies, methods of fair valuation used and investment income disclosure. The application of the standard resulted in additional disclosure regarding the valuation of investments, income recognition and investment risk.

Section 1530 – Comprehensive Income establishes standards for the reporting and display of comprehensive income. Comprehensive income is comprised of net income and other comprehensive income. The new standard had no significant impact on PSP Investments' financial statements.

Future Accounting Changes

PSP Investments will adopt, starting April 1, 2008, Sections 3862 – Financial Instruments – disclosures and 3863 – Financial Instruments – presentation, which will replace Section 3861 – Financial Instruments – disclosure and presentation. The new standards will revise and enhance disclosure requirements about the nature and extent of the risks arising from financial instruments and how the entity manages those risks. The presentation requirements will remain unchanged.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2008

3. INVESTMENTS

(a) Investment Portfolio
The investment portfolio, before allocating the effect of derivative contracts and investment–related assets and liabilities, as at March 31, is as follows:

($ millions)	2008		2007	
Asset Class	Fair Value	Cost	Fair Value	Cost
Developed World Equity				
Canadian Equity	$ 1,503	$ 1,397	$ 1,311	$ 1,044
US Large Cap Equity	307	350	436	393
EAFE Large Cap Equity	371	395	346	282
Small Cap Developed World Equity	286	336	447	409
Emerging Markets Equity	372	327	379	309
Private Equity	821	794	334	334
Nominal Fixed Income				
Cash Equivalents	612	612	459	465
World Government Bonds	360	362	355	363
Canadian Fixed Income	1,662	1,746	1,712	1,714
Real Return Assets				
World Inflation-linked Bonds	29	27	59	57
Real Estate	1,065	846	820	725
Infrastructure	316	310	99	93
Absolute Return	773	786	428	415
INVESTMENTS	$ 8,477	$ 8,288	$ 7,185	$ 6,603
Investment-Related Assets				
Amounts receivable from pending trades	$ 358	$ 357	$ 328	$ 323
Derivative-related receivables	111	17	59	14
Total investment-related assets	$ 469	$ 374	$ 387	$ 337
Investment-Related Liabilities				
Amounts payable from pending trades	$ (398)	$ (398)	$ (282)	$ (283)
Securities sold short	(146)	(150)	(106)	(109)
Derivative-related payables	(257)	(10)	(39)	(12)
Capital debt financing (Note 8)	(312)	(312)	(102)	(102)
Total investment-related liabilities	$ (1,113)	$ (870)	$ (529)	$ (506)
NET INVESTMENTS	$ 7,833	$ 7,792	$ 7,043	$ 6,434

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2008

3. INVESTMENTS (continued)

(a) Investment Portfolio (continued)
As at March 31, 2008, PSP Investments holds approximately $1,972 million, of which $396 million has been allocated to the Plan, of third-party or non-bank sponsored asset backed commercial paper ("ABCP") that suffered a liquidity disruption in mid-August 2007. The maturity dates of these ABCPs range from August 13, 2007 to December 28, 2008. At the dates at which PSP Investments acquired the investments, the non-bank sponsored ABCP were rated R-1 (high) by DBRS Limited ("DBRS"), the highest credit rating for commercial paper. The ABCP last traded in the active market on or about August 13, 2007, and currently there are no market quotations available for the ABCP.

PSP Investments has been participating in a restructuring process with other investors. On August 16, 2007, a sixty-day standstill agreement (the "Montreal Accord") was entered into by a number of significant investors and banks that transacted with the non-bank sponsored conduits. On September 6, 2007, a Pan Canadian Committee (the "Investors' Committee") was formed, consisting of an important number of major ABCP investors, to oversee the restructuring process. On December 23, 2007, the Investors' Committee had approved an agreement in principle (the "Framework Agreement") to restructure the ABCP issued by 20 trusts covered by the Montreal Accord and to extend the standstill agreement to January 31, 2008. On March 17, 2008, the Investors' Committee announced that it had filed an application with the Ontario Superior Court of Justice under the *Companies' Creditors Arrangement Act* ("CCAA"), requesting that the court call a meeting of ABCP noteholders where they would vote on the Investors' Committee's plan to restructure 20 of the trusts covered by the Montreal Accord. Under CCAA provisions, the plan must be approved by a majority of voting noteholders in number (50% + 1 vote) and approved by 66 2/3% of noteholders in value. The vote took place on April 25, 2008 and the Investors' Committee's plan was approved.

The Investors' Committee restructuring plan will: (i) extend the maturity of the ABCP to provide for a maturity similar to that of the underlying assets (maturity ranges from 5 to 8.5 years); (ii) pool certain series of ABCP which are supported in whole or in part by underlying synthetic assets; (iii) mitigate the risk of margin call obligations existing under the current conduits related to leveraged synthetic assets; and (iv) support the liquidity needs of certain ABCP investors.

As part of the Investors' Committee restructuring plan, the following asset categories will be pooled together under three separate vehicles: (1) leveraged super senior ("LSS") tranches of collateralized debt obligations and other assets (collectively referred to as the "*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 and heightened volatility by reason of their exposure to US subprime mortgages or otherwise. Investors in ABCP will receive 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, 2008

3. INVESTMENTS (continued)

(a) Investment Portfolio (continued)

Under the Investors' Committee restructuring plan, the LSS/Hybrid Assets will be split into two separate and distinct master asset vehicles ("MAV"); the first, currently referred to as MAV1, in which case investors will self insure and separately commit to fund margin calls under existing leveraged super senior swaps up to their pro rata share; and the second, referred to as MAV2, whereby investors will be able to draw on a margin funding facility to be provided by certain investors, foreign banks and Canadian banks. PSP Investments will be participating in MAV1. Within the MAV1, the LSS/Hybrid assets will be further restructured into different classes (Class A-1, Class A-2, Class B and Class C) 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, will include series secured exclusively by Traditional Assets ("TA") or by Ineligible Assets ("IA").

PSP Investments has adopted a valuation technique to determine the fair value of ABCP holdings as at March 31, 2008. The valuation methodology attempts to value the ABCP under a number of scenarios and then applies a weighting factor to each of these based on probability of occurrence. The principal scenarios considered were one under a successful restructuring and another under which a failure to restructure occurs.

The successful restructuring scenario uses the restructured notes, as contemplated under the Framework Agreement, as a proxy measure to value the current ABCP holdings. A successful restructuring scenario would result in PSP Investments receiving a mix of Class A-1, Class A-2, Class B and Class C floating rate notes in connection with MAV1 and TA and IA tracking notes in connection with MAV3. Under the Investors' Committee restructuring plan, PSP Investments estimates that the Plan will receive $175 million of MAV1 Class A-1 notes, $120 million of MAV1 Class A-2 notes, $21 million of MAV1 Class B notes, $10 million of MAV1 Class C notes, $29 million of MAV3 TA tracking notes and $41 million of MAV3 IA tracking notes. The MAV1 notes are expected to return approximately Banker's Acceptance ("BA") + 30 bps. The TA tracking notes and the IA tracking notes will reflect the net return and maturity of the respective series' underlying assets. For the purpose of valuation, the restructured floating rate notes of MAV1 were proxied to comparable 7-year floating rate notes as at March 31, 2008. The Class A-1 and Class A-2 notes are expected to be AA-rated and the Class B and Class C notes, while not expected to be rated, were established at a credit rating of BBB for valuation purposes, and accordingly, were proxied to floating rate notes with similar credit quality and terms. TA tracking notes were assumed to be AAA-rated and to have a maturity of 9 years and a return of BA + 40 bps. The TA tracking notes were proxied to comparable floating rate notes as at March 31, 2008. The 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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(a) Investment Portfolio (continued)

Under scenarios in which the restructuring process is incomplete or inconclusive (failure to restructure scenario), the ABCP is assessed under two separate contexts; one being an orderly resolution of the assets and the second being a complete liquidation scenario. Under the failure to restructure scenario, management fair valued the two separate contexts. Management believes that the probability of this scenario occurring is unlikely and has consequently assigned a low probability of occurrence.

Based on the above valuation methodology, management's best estimate of the fair value of the Plan's ABCP as at March 31, 2008, is equal to approximately $306 million, representing a write-down of approximately $90 million.

The ABCPs are reported as Canadian fixed income under the investment portfolio (Note 3(a)). The write-down in ABCP is included as part of the absolute return on investment income in Note 5(b).

The fair value was established as a function of the information available as at March 31, 2008, which includes certain assumptions used in the valuation model such as interest rate spreads, assumed credit rating of restructured notes, expected returns and maturity of restructured notes. Varying certain key elements of the valuation technique will have an impact on the write-down on ABCP as at March 31, 2008. For example, increasing interest rate spreads by 50 bps will increase the provision by $14 million for the Plan; extending the maturity term by one year would increase the provision by $11 million for the Plan. The fair value of ABCP may change in future periods as a result of fluctuations in the major elements of the valuation methodology.

(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.

Notional values are not recorded as assets and liabilities as they represent the face amount of the contract to which a rate or price is applied in order to calculate the exchange of cash flows. 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.

PSP Investments writes credit default derivatives and, hence, indirectly guarantees the underlying reference obligations. The maximum potential exposure is the notional amount of written credit default derivatives as shown in the table on the next page. No payments related to written credit default derivatives have been made to date.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2008

3. INVESTMENTS (continued)

(b) Derivative Financial Instruments (continued)
The following table summarizes the derivatives portfolio as at March 31:

($ millions)		2008		2007	
INVESTMENTS		Notional Value	Fair Value	Notional Value	Fair Value
Equity and Commodity Derivatives					
Futures [2]		$ 176	$ 1	$ 343	$ 1
Total Return Swaps [2]		1,037	(8)	863	10
Variance Swaps		46	(1)	137	–
Warrants		8	2	9	1
Options:	Listed-purchased	38	2	19	–
	Listed-written	40	(1)	24	(1)
	OTC-purchased [1]	–	–	146	15
	OTC-written	–	–	22	–
Currency Derivatives					
Forwards		2,885	(37)	2,228	–
Swaps		167	(14)	144	(2)
Options:	OTC-purchased	348	6	174	2
	OTC-written	184	(5)	27	–
Interest Rate Derivatives					
Bond forwards		556	–	426	1
Futures [2]		287	–	116	–
Interest Rate Swaps		1,104	3	386	1
Inflation Swaps		–	–	39	–
Total Return Swaps [2]		677	3	482	(3)
Swaptions		1,451	–	–	–
Options:	Listed-purchased	174	–	101	1
	Listed-written	247	(1)	101	(1)
Credit Derivatives					
Swaps:	Purchased	12	6	14	1
	Written	272	(102)	293	(6)
		$ 9,709	$ (146)	$ 6,094	$ 20

[1] The fair value of certain options excludes all cash, if any, that may have been deposited with a counterparty.

[2] As at March 31, 2008, some futures and total return swaps have been equitized by fixed income securities and other assets in the amount of $1.9 billion (2007 – $1.6 billion).

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2008

3. INVESTMENTS (continued)

(b) Derivative Financial Instruments (continued)
The fair value of derivative contracts, as at March 31, is represented by:

($ millions)	2008	2007
Derivative-related receivables	$ 111	$ 59
Derivative-related payables	(257)	(39)
	$ (146)	$ 20

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

($ millions)	2008	2007
Under 1 year	$ 6,952	$ 4,843
1 to 5 years	2,360	921
Over 5 years	397	330
	$ 9,709	$ 6,094

(c) Investment Asset Mix
The Statement of Investment Policies, Standards and Procedures ("SIP&P") sets out the manner in which the assets 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. Differences between the actual asset mix and the policy portfolio targets are due principally to target weights of certain asset classes which have yet to be attained. For instance, the infrastructure asset class has a policy portfolio target weight of 8.0% and an actual asset weight of only3.4%. This is offset by an overweight in the Canadian fixed income asset class.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2008

3. INVESTMENTS (continued)

(c) Investment Asset Mix (continued)
The net investments, as at March 31, are as follows:

($ millions)	2008			2007		
Asset Class	Fair Value		Policy Portfolio	Fair Value		Policy Portfolio
Developed World Equity						
Canadian Equity	$ 2,319	29.6%	30.0%	$ 2,078	29.5%	30.0%
US Large Cap Equity	354	4.5	5.0	503	7.1	5.0
EAFE Large Cap Equity	368	4.7	5.0	346	4.9	5.0
Small Cap Developed World Equity	388	5.0	5.0	591	8.4	7.0
Emerging Markets Equity	548	7.0	7.0	503	7.1	7.0
Private Equity	798	10.2	10.0	336	4.8	8.0
Nominal Fixed Income						
Cash Equivalents	311	4.0	2.0	78	1.1	2.0
World Government Bonds	452	5.8	5.0	335	4.8	5.0
Canadian Fixed Income	975	12.4	8.0	1,092	15.5	8.0
Real Return Assets						
World Inflation-linked Bonds	444	5.7	5.0	345	4.9	5.0
Real Estate	810	10.3	10.0	724	10.3	10.0
Infrastructure	270	3.4	8.0	96	1.4	8.0
Absolute Return	(204)	(2.6)	n.a.	16	0.2	n.a.
NET INVESTMENTS	$ 7,833	100.0%	100.0%	$ 7,043	100.0%	100.0%

The investments are classified by asset mix category based on the intent of the investment strategies of the underlying portfolio of PSP Investments.

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 in Note 3 (b), to enhance returns by changing the investment asset mix, enhancing equity and fixed income portfolio returns and managing foreign currency exposures.

(d) 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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(d) Investment Risk Management (continued)

Investment risk management is guided by a policy supported by guidelines and procedures. The policy, guidelines and procedures address such matters as the establishment of a risk budget and risk controls, concentration limits and the risk of valuation models.

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.

(e) 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.

The underlying net foreign currency exposures, as at March 31, were as follows:

	2008		2007	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
(in Canadian $)	($ millions)		($ millions)	
US Dollar	**$ 1,170**	**52.8%**	$ 1,254	53.7%
Euro	**461**	**20.8**	410	17.5
British Pound	**184**	**8.3**	162	6.9
Yen	**129**	**5.8**	141	6.1
Brazilian Real	**87**	**3.9**	55	2.3
Others	**187**	**8.4**	316	13.5
	$ 2,218	**100.0%**	$ 2,338	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies, in real estate, private equity, infrastructure and public market investments for an amount of $1,441 million ($1,067 million US, €204 million and £7 million) which are not included in the foreign currency exposure table above.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(f) Credit Risk

PSP Investments is exposed to the risk that a debt securities issuer could be unable to meet its financial obligation or that a derivative counterparty could default or become insolvent.

As at March 31, 2008, the Plan's highest concentration of credit risk is with the Government of Canada through holdings of $0.5 billion of Government of Canada issued securities. In order to minimize derivative contract credit risk, PSP Investments deals only with counterparties that are major financial institutions with a minimum credit rating of "A" as at the trade date, as supported by a recognized credit rating agency by utilizing an internal credit-limit monitoring process, as well as through the use of credit mitigation techniques such as master-netting arrangements (which provide for certain rights of offset) and obtaining collateral, including the use of credit-support annexes, where appropriate.

(g) 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. PSP Investments has a diversification strategy to mitigate risk whereby it invests in a diversified portfolio of investments based on the criteria established in its SIP&P. Derivative financial instruments, traded either on exchanges or over the counter, are also used to mitigate the impact of market risk.

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 interval to measure and report VaR. 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.

(h) 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.

As at March 31, 2008, the fixed income asset class was managed with an average duration of 6.1 years (2007 – 5.7 years). An increase of 1% in interest rates would result in a decline in the value of the fixed income securities of 6.1%, or $59 million.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2008

3. INVESTMENTS (continued)

(h) Interest Rate Risk (continued)
The terms to maturity of the bonds held in the Canadian fixed income asset class, as at March 31, 2008, are as follows:

	Terms to Maturity					
($ millions)	Within 1 Year	1 to 5 Years	6 to 10 Years	Over 10 Years	2008 Total	2007 Total
Government of Canada bonds	$ –	$ 224	$ 49	$ 84	$ 357	$ 439
Provincial and Territorial bonds	10	65	75	119	269	303
Municipal bonds	–	16	7	1	24	19
Corporate bonds	22	117	89	94	322	332
Total	$ 32	$ 422	$ 220	$ 298	$ 972	$ 1,093

(i) Liquidity Risk
Liquidity risk corresponds to PSP Investments' ability to meet its financial obligations. PSP Investments' cash position is monitored on a regular basis. As per the SIP&P, PSP Investments' liquidity requirements are expected to be minimal. 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 will either be publicly traded on a recognized exchange or traded over-the-counter. As at March 31, 2008, PSP Investments has the ability to raise additional capital through the use of its capital debt program.

(j) 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, 2008, securities with an estimated fair value of $1,024 million (2007 – $842 million) were loaned out, while securities contractually receivable as collateral had an estimated fair value of $1,064 million (2007 – $880 million).

(k) Securities Collateral
The Plan deposited or pledged securities with a fair value of $83 million (2007 – $20 million) as collateral with various financial institutions. Securities with a fair value of $6 million (2007 – $94 million) have been received from various financial institutions as collateral.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2008

3. INVESTMENTS (continued)

(l) Private Market Investments
PSP Investments' real estate asset class is comprised of investments which are owned by either PSP Investments or its wholly-owned subsidiaries and managed by general partners or external advisors. The underlying investments comprise a diversified portfolio of income-producing properties, third party loans and public and private funds. The real estate asset class is accounted for in the investment portfolio net of all financings. The fair market value of financings in the real estate portfolio generally will not exceed 50% of the gross fair market value of the portfolio. As at March 31, 2008, the total amount of financing included in the real estate portfolio for direct investments controlled by PSP Investments is approximately $600 million.

PSP Investments' private equity asset class is comprised of interests in limited partnerships and in funds which are managed by general partners and investments which are owned by either PSP Investments or its wholly-owned subsidiaries. The underlying investments represent equity ownerships or investments with the risk and return characteristics of equity. As at March 31, 2008, the total amount of financing included in the private equity portfolio for direct investments controlled by PSP Investments is nil.

PSP Investments' infrastructure asset class is comprised of investments which are owned by either PSP Investments or its wholly-owned subsidiaries and managed by general partners or external advisors. The underlying investments comprise a diversified portfolio of infrastructure assets and publicly-traded securities. As at March 31, 2008, the total amount of financing included in the infrastructure portfolio for direct investments controlled by PSP Investments is approximately $70 million.

Investment management and performance incentive fees are generally incurred for the above private market investments and are paid either by the investment directly, through capital contributions from PSP Investments or offset against distributions received from the investment. Investment management fees in private market investments generally vary between 0.2% and 5.5% of the total invested amount. For the year ended March 31, 2008, investment management fees of $24 million (2007 – $13 million) were recorded either as part of the cost of the private market investments or against investment income.

The carrying values of the majority of private market investments, as disclosed in Note 1, are reviewed annually and any resulting adjustments are reflected as unrealized gains or losses in investment income.

4. FUND TRANSFERS

During the year, PSP Investments received fund transfers of $842 million (2007 – $738 million) from the Canadian Forces Pension Fund. The transfers received are comprised of net current 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, 2008

5. INVESTMENT INCOME

(a) Investment Income

Investment income, for the year ended March 31, before allocating net realized and unrealized gains on investments, is as follows:

($ millions)	2008	2007
Interest income	$ 135	$ 93
Dividend income	76	61
Other income	22	51
Security lending income	2	1
Transaction costs	(5)	–
	230	206
Net realized gains	315	445
Net unrealized gains (losses)	(573)	46
Investment income (loss)	$ (28)	$ 697

(b) Investment Income by Asset Mix

Investment income by asset mix, for the year ended March 31, after allocating net realized and unrealized gains and losses on investments, is as follows:

($ millions)	2008	2007
Developed World Equity		
Canadian Equity	$ 49	$ 261
US Large Cap Equity	(93)	46
EAFE Large Cap Equity	(48)	95
Small Cap Developed World	(126)	26
Emerging Markets Equity	36	79
Private Equity	53	(1)
Nominal Fixed Income		
Cash Equivalents	11	4
World Government Bonds	34	(9)
Canadian Fixed Income	58	57
Real Return Assets		
World Inflation-linked Bonds	16	(5)
Real Estate	151	131
Infrastructure	6	4
Absolute return	(175)	9
Investment income (loss)	$ (28)	$ 697

Investment income includes foreign currency realized losses of $118 million (2007 – $26 million) and foreign currency unrealized losses of $75 million (2007 – $88 million).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

6. INVESTMENT PERFORMANCE

Portfolio and benchmark returns, for the year ended March 31, are as follows:

	2008		2007	
	Portfolio Returns %	Benchmark Returns %	Portfolio Returns %	Benchmark Returns %
Developed World Equity				
Canadian Equity	**2.6**	**3.2**	14.3	14.2
US Large Cap Equity	**(21.3)**	**(15.6)**	8.7	10.6
EAFE Large Cap Equity	**(12.9)**	**(13.5)**	16.6	18.9
Small Cap Developed World	**(23.0)**	**(20.5)**	5.5	6.1
Emerging Markets Equity	**7.2**	**7.9**	18.8	19.3
Private Equity	**10.1**	**3.7**	(0.6)	n.a.
Nominal Fixed Income				
Cash Equivalents	**3.9**	**4.6**	4.2	4.2
World Government Bonds	**6.6**	**6.7**	(1.5)	(1.5)
Canadian Fixed Income	**5.9**	**5.8**	5.4	5.5
Real Return Assets				
World Inflation-linked Bonds	**6.1**	**6.0**	(1.4)	(1.6)
Real Estate	**21.9**	**7.6**	36.5	6.7
Infrastructure	**3.8**	**n.a.**	5.5	n.a.
Total Return	**(0.3)**	**1.2**	11.3	10.1

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 for the years ended March 31, 2008 and March 31, 2007.

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 benchmark return aggregates the asset class benchmark returns according to the weights under the actual asset mix at the beginning of every fiscal year. The actual portfolio cash flows are reflected in the benchmark to neutralize the asset allocation effect. The return of the infrastructure asset class is not being measured against any benchmark during the ramp-up period as disclosed in PSP Investments' SIP&P. However, for purposes of calculating the total benchmark returns for 2008 and 2007, the actual infrastructure portfolio returns of 3.8% and 5.5%, respectively, are used. A benchmark return has been established for the private equity asset class effective April 1, 2007. In the prior fiscal year, the actual portfolio returns for the private equity class were used as the measure for total benchmark returns.

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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

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:

	2008	2007
Public Service Pension Plan Account	**72.6%**	72.4%
Canadian Forces Pension Plan Account	**20.1**	20.4
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.1**	n.a.
	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 consist of the following for the year ended March 31:

($ thousands)	2008	2007
Salaries and benefits	**$ 6,952**	$ 5,798
Professional and consulting fees	**4,122**	1,841
Office supplies and equipment	**1,383**	1,161
Other operating expenses	**1,259**	625
Depreciation of fixed assets	**641**	310
Occupancy costs	**507**	370
Custodial fees	**410**	335
Remuneration earned by Directors	**153**	146
Communication expenses	**33**	24
Travel and related expenses for Directors	**33**	36
	$ 15,493	$ 10,646

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

8. PSP CAPITAL INC.

As at March 31, 2008, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $1,551 million (2007 – $503 million) of short term promissory notes outstanding with maturity dates within 32 to 364 days of issuance, of which $312 million (2007 – $102 million) has been allocated to the Canadian Forces Pension Plan Account and included in Note 3 a) as investment- related liability. The maximum authorized by the Board of the Directors for the short term and medium term notes is $3 billion and $1 billion, respectively. As at March 31, 2008, there are no medium term notes issued and outstanding. The capital raised was used primarily to finance real estate and infrastructure investments and is unconditionally and irrevocably guaranteed by PSP Investments.

Interest expense on short term promissory notes was $51 million for the year ended March 31, 2008 (2007 – $17 million).

The operating expenses incurred by PSP Capital Inc. were allocated to each plan account as described in Note 7 (a) and includes interest expenses on the short term promissory notes of $10 million (2007 – $3 million).

9. 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 at March 31, 2008, 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 short term promissory notes issued by its wholly-owned subsidiary, PSP Capital Inc.

10. 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, 2008, the outstanding commitments in private equity-related, real estate-related, infrastructure-related and public market-related investments amounted to $1,560 million ($874 million for private equity investments, $409 million for real estate investments, $172 million for a public market investment and $105 million for infrastructure investments).