Reserve Force Pension Plan Account

AUDITORS' REPORT

To the Minister of National Defence

We have audited the Balance Sheet of the Public Sector Pension Investment Board – Reserve Force Pension Plan Account (the "Reserve Force Pension Plan Account") as at March 31, 2008 and the Statements of Net Income (Loss) and Accumulated Net Income (Loss) from Operations and Comprehensive Income and of Changes in Net Assets for the year then ended. These financial statements are the responsibility of the Public Sector Pension Investment Board's ("PSP Investments") management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Reserve Force Pension Plan Account as at March 31, 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.

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

Deloitte & Touche LLP

Chartered Accountants

Montreal, Canada
May 2, 2008

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 2, 2008

Reserve Force Pension Plan Account

BALANCE SHEET

As at March 31

($ thousands)	2008
ASSETS	
Investments (Note 3 (a))	$ 59,587
Investment-related assets (Note 3 (a))	3,296
Other assets	10
TOTAL ASSETS	$ 62,893
LIABILITIES	
Investment-related liabilities (Note 3 (a))	$ 7,803
Accounts payable and accrued liabilities	22
Due to the Public Service Pension Plan Account (Note 7)	49
	$ 7,874
NET ASSETS	$ 55,019
Accumulated net income (loss) from operations and comprehensive income	$ (704)
Accumulated fund transfers	55,723
NET ASSETS	$ 55,019

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

Reserve Force Pension Plan Account

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

For the year ended March 31

($ thousands)	2008
INVESTMENT INCOME (LOSS) (Note 5)	
Interest, dividends and other income	$ 1,333
Net realized gains	1,283
Change in unrealized appreciation (depreciation) in value of investments	(3,191)
	(575)
EXPENSES	
Operating expenses (Note 7)	77
External investment management fees	52
	129
NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME	(704)
Accumulated net income from operations and comprehensive income, beginning of year	–
Accumulated net income (loss) from operations and comprehensive income, end of year	$ (704)

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

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ thousands)	2008
NET ASSETS, BEGINNING OF YEAR	$ –
Fund transfers (Note 4)	55,723
Net income (loss) from operations and comprehensive income	(704)
Increase in net assets for the year	55,019
NET ASSETS, END OF YEAR	$ 55,019

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 Reserve Force Pension Fund was established by amendments to the *Canadian Forces Superannuation Act*, to receive contributions and make benefit payments in respect of member service after March 1, 2007. The net contributions are transferred by the Reserve Force Pension Fund to PSP Investments – Reserve Force Pension Plan Account for investment. PSP Investments maintains records of the pension fund's net contributions as well as the allocation of its investments and the results of its operations in the plan account.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

These financial statements present the financial position and operations of PSP Investments and its wholly-owned subsidiaries as they pertain to the investment of the net contributions transferred to it from the Reserve Force Pension Fund in respect of member service after March 1, 2007. Accordingly, they do not reflect all of the assets or the details of the pension contributions, payments and liabilities of the Reserve Force Pension Fund. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and the requirements of the *Act*. PSP Investments qualifies as an Investment Company and therefore reports its investments at fair value, in accordance with Accounting Guideline 18, *Investment Companies*.

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 Reserve Force Pension Plan Account ("The Plan").

Investment income is made up of dividends, accrued interest income, realized gains and losses on the disposal of investments and 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 Reserve Force 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.

2. 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:

($ thousands)	2008	
Asset Class	Fair Value	Cost
Developed World Equity		
Canadian Equity	$ 10,566	$ 11,970
US Large Cap Equity	2,158	2,507
EAFE Large Cap Equity	2,607	2,953
Small Cap Developed World Equity	2,009	2,631
Emerging Markets Equity	2,617	2,082
Private Equity	5,776	5,614
Nominal Fixed Income		
Cash Equivalents	4,287	4,413
World Government Bonds	2,532	2,160
Canadian Fixed Income	11,690	12,547
Real Return Assets		
World Inflation-linked Bonds	204	180
Real Estate	7,487	6,747
Infrastructure	2,222	2,193
Absolute Return	5,432	5,827
INVESTMENTS	$ 59,587	$ 61,824
Investment-Related Assets		
Amounts receivable from pending trades	$ 2,517	$ 2,670
Derivative-related receivables	779	127
Total investment-related assets	$ 3,296	$ 2,797
Investment-Related Liabilities		
Amounts payable for pending trades	$ (2,800)	$ (2,979)
Securities sold short	(1,027)	(1,121)
Derivative-related payables	(1,806)	(77)
Capital debt financing (Note 8)	(2,170)	(2,170)
Total investment-related liabilities	$ (7,803)	$ (6,347)
NET INVESTMENTS	$ 55,080	$ 58,274

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 $2,787 thousand 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 $1,232 thousand of MAV1 Class A-1 notes, $848 thousand of MAV1 Class A-2 notes, $146 thousand of MAV1 Class B notes, $69 thousand of MAV1 Class C notes, $202 thousand of MAV3 TA tracking notes and $290 thousand 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 $2,151 thousand, representing a write-down of approximately $636 thousand.

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 $99 thousand for the Plan; extending the maturity term by one year would increase the provision by $78 thousand 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:

($ thousands)		2008	
INVESTMENTS		Notional Value	Fair Value
Equity and Commodity Derivatives			
Futures [1]		$ 1,237	$ 12
Total Return Swaps [1]		7,293	(58)
Variance Swaps		325	(4)
Warrants		55	14
Options:	Listed-purchased	266	9
	Listed-written	279	(9)
Currency Derivatives			
Forwards		20,290	(259)
Swaps		1,178	(101)
Options:	OTC-purchased	2,445	46
	OTC-written	1,296	(38)
Interest Rate Derivatives			
Bond forwards		3,909	2
Futures [1]		2,016	–
Interest Rate Swaps		7,761	23
Total Return Swaps [1]		4,758	21
Swaptions		10,202	–
Options:	Listed-purchased	1,226	2
	Listed-written	1,736	(4)
Credit Derivatives			
Swaps:	Purchased	87	41
	Written	1,909	(724)
		$ 68,268	$ (1,027)

[1] 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 $13.3 million.

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:

($ thousands)	2008
Derivative-related receivables	$ 779
Derivative-related payables	(1,806)
	$ (1,027)

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

($ thousands)	2008
Under 1 year	$ 48,885
1 to 5 years	16,844
Over 5 years	2,540
	$ 68,269

(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:

($ thousands)	2008		
Asset Class	Fair Value		Policy Portfolio
Developed World Equity			
Canadian Equity	$ 16,308	29.6%	30.0%
US Large Cap Equity	2,491	4.5	5.0
EAFE Large Cap Equity	2,588	4.7	5.0
Small Cap Developed World Equity	2,728	5.0	5.0
Emerging Markets Equity	3,853	7.0	7.0
Private Equity	5,614	10.2	10.0
Nominal Fixed Income			
Cash Equivalents	2,186	4.0	2.0
World Government Bonds	3,177	5.8	5.0
Canadian Fixed Income	6,854	12.4	8.0
Real Return Assets			
World Inflation-linked Bonds	3,125	5.7	5.0
Real Estate	5,694	10.3	10.0
Infrastructure	1,897	3.4	8.0
Absolute Return	(1,435)	(2.6)	n.a.
NET INVESTMENTS	$ 55,080	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, are as follows:

	2008	
Currency	Fair Value	% of Total
(in Canadian $)	($ thousands)	
US Dollar	$ 8,228	52.8%
Euro	3,242	20.8
British Pound	1,297	8.3
Yen	904	5.8
Brazilian Real	610	3.9
Others	1,316	8.4
	$ 15,597	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 $10,131 thousand ($7,499 thousand US, €1,436 thousand and £49 thousand) 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 $3.3 million 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. An increase of 1% in interest rates would result in a decline in the value of the fixed income securities of 6.1%, or $411 thousand.

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				
($ thousands)	Within 1 Year	1 to 5 Years	6 to 10 Years	Over 10 Years	2008 Total
Government of Canada bonds	$ –	$ 1,577	$ 346	$ 591	$ 2,514
Provincial and Territorial bonds	71	458	527	838	1,894
Municipal bonds	–	112	51	7	170
Corporate bonds	153	825	632	666	2,276
Total	$ 224	$ 2,972	$ 1,556	$ 2,102	$ 6,854

(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 $7,000 thousand were loaned out, while securities contractually receivable as collateral had an estimated fair value of $7,000 thousand.

(k) Securities Collateral

The Plan deposited or pledged securities with a fair value of $581 thousand as collateral with various financial institutions. Securities with a fair value of $44 thousand 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 $4,100 thousand.

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 $500 thousand.

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 $174 thousand 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 $55,723 thousand from the Reserve Force Pension Fund. The transfers received are comprised of net current employer and employee contributions to the Reserve Force pension plan in respect of member service after March 1, 2007.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 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:

($ thousands)		2008
Interest income	$	953
Dividend income		246
Other income		154
Security lending income		13
Transaction costs		(33)
		1,333
Net realized gains		1,283
Net unrealized gains (losses)		(3,191)
Investment income (loss)	$	(575)

(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:

($ thousands)		2008
Developed World Equity		
Canadian Equity	$	342
US Large Cap Equity		(656)
EAFE Large Cap Equity		(335)
Small Cap Developed World		(885)
Emerging Markets Equity		256
Private Equity		370
Nominal Fixed Income		
Cash Equivalents		79
World Government Bonds		236
Canadian Fixed Income		416
Real Return Assets		
World Inflation-linked Bonds		112
Real Estate		1,065
Infrastructure		40
Absolute return		(1,615)
Investment income (loss)	$	(575)

Investment income includes foreign currency realized losses of $827 thousand and foreign currency unrealized losses of $529 thousand.

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	
	Portfolio Returns %	Benchmark Returns %
Developed World Equity		
Canadian Equity	(0.6)	(0.1)
US Large Cap Equity	(21.8)	(16.3)
EAFE Large Cap Equity	(14.2)	(14.6)
Small Cap Developed World	(23.7)	(21.1)
Emerging Markets Equity	4.6	4.9
Private Equity	9.8	5.2
Nominal Fixed Income		
Cash Equivalents	3.8	4.5
World Government Bonds	8.3	8.4
Canadian Fixed Income	6.3	6.2
Real Return Assets		
World Inflation-linked Bonds	7.6	7.5
Real Estate	22.1	7.1
Infrastructure	3.3	n.a.
Total Return	(1.5)	0.0

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 year ended March 31, 2008.

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 return for 2008, the actual infrastructure portfolio returns of 3.3% is used. A benchmark return has been established for the private equity asset class effective April 1, 2007.

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
Public Service Pension Plan Account	72.6%
Canadian Forces Pension Plan Account	20.1
Royal Canadian Mounted Police Pension Plan Account	7.2
Reserve Force Pension Plan Account	0.1
	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
Salaries and benefits	$	35
Professional and consulting fees		21
Office supplies and equipment		7
Other operating expenses		6
Depreciation of fixed assets		3
Occupancy costs		2
Custodial fees		2
Remuneration earned by Directors		1
	$	77

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 of short term promissory notes outstanding with maturity dates within 32 to 364 days of issuance, of which $2,170 thousand has been allocated to the Reserve Force Pension Plan Account and included in Note 3 (a) as investment-related liability. As at March 31, 2008, there are no medium term notes issued and outstanding. The maximum authorized by the Board of the Directors for the short term and medium term notes is $3 billion and $1 billion, respectively. The capital raised was used primarily to finance real estate and infrastructure investments and is unconditionally and irrevocably guaranteed by PSP Investments.

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

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 $71 thousand.

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 $1,001 thousand 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 $10,970 thousand ($6,147 thousand for private equity investments, $2,876 thousand for real estate investments, $1,208 thousand for a public market investment and $739 thousand for infrastructure investments).