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, 2010, and the Statements of 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, 2010, and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

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

Deloitte & Touche LLP[1]

[1] Chartered accountant auditor permit No. 18527

Montreal, Canada
May 10, 2010

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 10, 2010

RESERVE FORCE PENSION PLAN ACCOUNT

BALANCE SHEET

As at March 31

($ thousands)	2010	2009
ASSETS		
Investments (Note 3 (a))	**$ 241,523**	$ 130,550
Investment-related assets (Note 3 (a))	**3,131**	2,528
Other assets	**63**	36
TOTAL ASSETS	**$ 244,717**	$ 133,114
LIABILITIES		
Investment-related liabilities (Note 3 (a))	**$ 13,529**	$ 17,753
Accounts payable and other liabilities	**61**	72
Due to the Public Service Pension Plan Account	**114**	51
TOTAL LIABILITIES	**$ 13,704**	$ 17,876
NET ASSETS	**$ 231,013**	$ 115,238
Accumulated net loss from operations and comprehensive income	**$ 5,541**	$ (25,998)
Accumulated fund transfers	**225,472**	141,236
NET ASSETS	**$ 231,013**	$ 115,238

Commitments (Note 11)

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

On behalf of the board of Directors:

Paul Cantor
Chair of the Board

William A. MacKinnon
Chair of the Audit and Conflicts Committee

RESERVE FORCE PENSION PLAN ACCOUNT

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

For the year ended March 31

($ thousands)	2010	2009
INVESTMENT INCOME (LOSS) (Note 6)	**$ 31,854**	$ (25,172)
OPERATING EXPENSES (Note 7)	**$ 315**	$ 122
NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME	**$ 31,539**	$ (25,294)

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

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ thousands)	2010	2009
NET ASSETS, BEGINNING OF YEAR	**$ 115,238**	$ 55,019
Fund transfers (Note 5)	**84,236**	85,513
Net income (loss) from operations and comprehensive income	**31,539**	(25,294)
Increase in net assets for the year	**115,775**	60,219
NET ASSETS, END OF YEAR	**$ 231,013**	$ 115,238

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

RESERVE FORCE PENSION PLAN ACCOUNT

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

ORGANIZATION

The Public Sector Pension Investment Board (PSP Investments) is a crown corporation established under the *Public Sector Pension Investment Board Act* ("the Act") with a mandate to invest the net contributions of the Public Service, Canadian Forces, Royal Canadian Mounted Police and Reserve Force pension plans in financial markets.

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

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

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

VALUATION OF INVESTMENTS

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

Market prices or rates are used to determine fair value where an active market exists (such as a recognized securities exchange), as it is the best evidence of the fair value of an investment. If quoted market prices or rates are not available, then fair values are estimated using present value or other valuation techniques, using inputs existing at the end of the reporting period that are derived from observable market data.

Valuation techniques are generally applied to investments in the Private Equity, Real Estate and Infrastructure asset classes (collectively "Private Market Investments"), over-the-counter (OTC) derivatives as well as asset-backed term notes (ABTNs). The values derived from applying these techniques are impacted by the choice of valuation model and the underlying assumptions made concerning factors such as the amounts and timing of future cash flows, discount rates, volatility and credit risk. In certain cases, such assumptions are not supported by market observable data.

The valuation methods of each asset class are described in Notes 3 (a) and (b).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VALUATION OF CAPITAL DEBT FINANCING

PSP Investments' short-term capital debt financing is recorded at cost plus accrued interest, which approximates fair value. The fair value of PSP Investments' long-term capital debt financing is based on prices that are obtained from third-party pricing sources. It is measured using an interest rate curve with a spread consistent with PSP Investments' credit quality.

TRANSACTION COSTS

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

INVESTMENT MANAGEMENT FEES

Investment management fees are costs directly attributable to the external management of assets on behalf of PSP Investments. Investment management fees incurred for Private Market Investments are paid, as determined by the fund manager, either by the investment directly, through capital contributions by PSP Investments or offset against distributions received from the investment (Note 3 (a) (ii)). These amounts are recorded against investment income (loss). Investment management fees are also incurred for certain public equity investments and these amounts are paid, either directly by PSP Investments or offset against distributions received from pooled fund investments. In both cases, they are recorded against investment income (loss) (Note 6).

INCOME RECOGNITION

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

Investment income (loss) is made up of interest income, dividends, realized gains (losses) on the disposal of investments and unrealized gains (losses) which reflect the change in unrealized appreciation (depreciation) of investments held at the end of the year. Interest income is recognized as earned. Dividends are recognized on the ex-dividend date and are reflected as dividend income. Dividends paid on securities sold short are reflected as dividend expense. Additionally, other income includes the related distributions from pooled funds, limited partnerships as well as from direct and co-investments, all from Private Market Investments.

TRANSLATION OF FOREIGN CURRENCIES

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

FUND TRANSFERS

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

INCOME TAXES

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

USE OF ESTIMATES

In preparing these financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of Private Market Investments, ABTNs, derivatives, related income and expenses and note disclosures. Although estimates and assumptions reflect management's best judgement, actual results may differ from these estimates.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

2. CHANGES IN ACCOUNTING POLICIES

AMENDMENT TO ACCOUNTING STANDARD

In June 2009, the Canadian Institute of Chartered Accountants (CICA) amended Section 3862 "Financial Instruments – Disclosures" of the CICA Handbook. This amendment is effective for annual financial statements relating to fiscal years ending after September 30, 2009.

The amendment enhances disclosures about fair value measurements of financial instruments as well as the liquidity risk of derivative financial liabilities.

The principal disclosures introduced by this amendment require financial instruments measured at fair value to be categorized into one of three fair value hierarchy levels. Such categorization is based on the significance of the inputs used in measuring such value as well as disclosure of movements between levels of the fair value hierarchy.

Additional disclosures for liquidity risk call for a maturity analysis for derivative financial liabilities based on the way in which an entity manages its liquidity risk.

PSP Investments adopted the provisions of such amendments for its March 31, 2010 financial statements. Required disclosures are made in Note 3 (c) and Note 4 (c).

FUTURE CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

In February 2008, the Accounting Standards Board of Canada (AcSB) confirmed that Canadian GAAP for publicly accountable enterprises will converge with International Financial Reporting Standards (IFRS) effective January 1, 2011. In response to this change, PSP Investments has put in place a transition plan that would allow it to prepare and present its March 31, 2012 financial statements under IFRS.

In analyzing the various impacts of its transition to IFRS, PSP Investments concluded that the requirement to consolidate its controlled investments ranked as one of the most significant of such impacts.

In April 2010, the AcSB issued Section 4600 "Pension Plans" of the CICA Handbook requiring pension plans in Canada to follow this standard rather than convert to IFRS in the same fashion as other publicly accountable enterprises. Under Section 4600, pension plans would continue to account for and report their investments at fair value as was previously done under Section 4100 "Pension Plans" of the CICA Handbook. The provisions of Section 4600 apply to annual financial statements relating to fiscal years beginning on or after January 1, 2011.

Concurrent with the issuance of Section 4600, the AcSB issued an exposure draft that proposed a scope expansion to include entities, such as PSP Investments, that are separate from pension plans and whose sole purpose is to hold and invest assets received from one or more pension plans, but does not itself have a pension obligation. Pursuant to the exposure draft, PSP Investments would be exempt from the IFRS requirement to consolidate its controlled investments. The AcSB has indicated that it anticipates reaching a decision concerning the exposure draft in June 2010.

Management is currently monitoring the outcome of this exposure draft and evaluating its impact on PSP Investments' financial statements as well as the IFRS transition plan.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS

(A) INVESTMENT PORTFOLIO

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

($ thousands)	2010		2009	
Asset Class	**Fair Value**	**Cost**	Fair Value	Cost
World Equity				
Canadian Equity	**$ 51,705**	**$ 47,249**	$ 21,589	$ 27,345
Foreign Equity:				
US Large Cap Equity	**10,670**	**10,138**	2,442	3,273
EAFE Large Cap Equity	**10,321**	**10,683**	3,962	5,715
Small Cap Developed World Equity	**9,766**	**8,889**	2,491	3,149
Emerging Markets Equity	**12,594**	**10,686**	4,984	5,500
Private Equity	**26,224**	**26,786**	14,525	17,271
Nominal Fixed Income				
Cash, Cash Equivalents and Other [1]	**23,125**	**23,790**	10,476	11,344
World Government Bonds	**5,475**	**5,651**	2,588	2,069
Canadian Fixed Income	**35,444**	**34,345**	24,380	24,313
Real Return Assets				
World Inflation-Linked Bonds	**1,683**	**1,562**	669	415
Real Estate	**30,669**	**34,434**	24,245	24,882
Infrastructure	**11,791**	**12,278**	9,252	7,970
Absolute Return	**12,056**	**6,629**	8,947	6,415
INVESTMENTS	**$ 241,523**	**$ 233,120**	$ 130,550	$ 139,661
Investment-Related Assets				
Amounts receivable from pending trades	**$ 744**	**$ 744**	$ 874	$ 874
Derivative-related receivables	**2,387**	**27**	1,654	222
Total Investment-Related Assets	**$ 3,131**	**$ 771**	$ 2,528	$ 1,096
Investment-Related Liabilities				
Amounts payable from pending trades	**$ (2,288)**	**$ (2,288)**	$ (1,725)	$ (1,725)
Securities sold short	**(564)**	**(656)**	(1,211)	(1,512)
Derivative-related payables	**(2,075)**	**(13)**	(5,834)	(334)
Capital debt financing:				
Short-term	**(3,243)**	**(3,243)**	(5,386)	(5,386)
Long-term	**(5,359)**	**(5,122)**	(3,597)	(3,494)
Total Investment-Related Liabilities	**$ (13,529)**	**$ (11,322)**	$ (17,753)	$ (12,451)
NET INVESTMENTS	**$ 231,125**	**$ 222,569**	$ 115,325	$ 128,306

[1] Includes floating rate notes with maturities greater than one year with a fair value of $6,974 thousand for the Plan (2009 – $63 thousand).

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

(i) Canadian Equity and Foreign Equity

Canadian Equity and Foreign Equity include direct and indirect investments in common shares, American depository receipts, global depository receipts, participation notes, preferred shares, income trust units, exchange traded funds, and securities convertible into common shares of publicly listed issuers.

Valuation Techniques

Direct investments in Canadian and Foreign Equities are measured at fair value using quoted market prices, namely, the bid price. In the case of investments in pooled funds, fair value is measured by using unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(ii) Private Equity, Real Estate and Infrastructure

The Private Equity asset class is comprised of direct investments in companies and fund investments. They include investments in private companies, mezzanine debt and distressed debt. The Private Equity asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Private Equity asset class contracted by direct investments controlled by PSP Investments for the Plan is nil (2009 – nil).

The Real Estate asset class is comprised of direct investments in companies, in properties, third-party debts and fund investments in the real estate sector. Real Estate investments are classified into two portfolios (an equity portfolio and a debt portfolio). The equity portfolio is comprised of direct investments in properties and companies in the office, retail, industrial, hospitality and residential sectors, as well as private funds and publicly traded securities invested in real estate assets. The debt portfolio is comprised of third-party loans such as junior and senior debts, construction loans, bridge loans, income-participating loans, mezzanine loans and other structured investments (collectively "Real Estate Debt") where significant portions of the value are attributed to the underlying real estate assets. The Real Estate asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Real Estate asset class contracted by direct investments controlled by PSP Investments for the Plan is approximately $10,750 thousand (2009 – approximately $7,150 thousand).

The Infrastructure asset class is comprised of direct investments in companies and fund investments. They include investments in companies engaged in the management, ownership or operation of assets in power, regulated businesses, transportation, telecom or social infrastructure. The Infrastructure asset class is accounted for net of all third-party financings. As at March 31, 2010, the total amount of third-party financing included in the Infrastructure asset class contracted by direct investments controlled by PSP Investments for the Plan is approximately $500 thousand (2009 – approximately $500 thousand).

Investment management fees, as disclosed in Note 1, are incurred for Private Market Investments and generally vary between 0.1% and 2.1% of the total invested and/or committed amount. Investment management fees of $759 thousand for the year ended March 31, 2010 (2009 – $545 thousand) were recorded against investment income (loss).

Valuation Techniques

The fair value of Private Market Investments held directly by PSP Investments is determined at least annually, using acceptable industry valuation methods. For each investment, the relevant methodology is applied consistently over time.

For direct Private Markets Investments as well as investments in Real Estate Debt, management uses the services of third-party appraisers to determine the fair value. In selecting appraisers, management ensures their independence and that valuation methods used are consistent with professional appraisal standards. Such standards include the *International Private Equity and Venture Capital Valuation Guidelines*, the *Canadian Uniform Standards of Professional Appraisal Practice* and the *Uniform Standards of Professional Appraisal Practice* in the United States of America. In validating the work performed by appraisers, management ensures that the assumptions used correspond to financial information and forecasts of the underlying investment.

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

Valuation Techniques (continued)

For direct investments in Private Equity and Infrastructure, valuation methods used include discounted cash flows analysis, earnings multiples, prices of recent comparable transactions and publicly traded comparables. Assumptions used in such valuations include discount rates and projected cash flows, which are not fully supported by prices from market observable transactions.

For direct investments in Real Estate, valuation methods used include discounted cash flows as well as recent comparable transactions. Assumptions used in such valuations include capitalization rates, projected cash flows and/or net operating income, which are not fully supported by prices from market observable transactions.

The fair value of Real Estate Debt is determined using either a yield-based or collateral-based valuation technique. The yield-based valuation technique involves discounting expected future cash flows that incorporate assumptions with respect to interest rates offered for similar loans to borrowers with similar credit ratings. The collateral-based valuation technique involves assessing the recoverable value of the collateral in question, net of disposal fees.

In the case of Private Equity, Real Estate and Infrastructure fund investments, the fair value is generally determined based on the audited fair values reported by the fund's general partner using acceptable industry valuation methods.

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

Nominal Fixed Income includes Cash, Cash Equivalents and Other, Canadian Fixed Income and World Government Bonds. Cash Equivalents include short-term instruments having a maximum term to maturity of one year. Floating rate notes are included in Cash, Cash Equivalents and Other, provided the final maturity date does not exceed three years and the coupons reset more than once per year. Bonds reported as Nominal Fixed Income include Canadian government bonds, Canadian provincial and territorial bonds, Canadian municipal bonds and corporate bonds, as well as international sovereign bonds. World Inflation-Linked Bonds reported as Real Return Assets are fixed income securities that earn inflation adjusted returns.

PSP Investments holds ABTNs reported as Canadian Fixed Income in the investment portfolio. The ABTNs were received in exchange for third-party or non-bank sponsored asset-backed commercial paper (ABCP) that suffered a liquidity disruption in mid-August 2007 and were subsequently restructured in January 2009. The ABTNs had an original face value of $1,962 million, of which $5,934 thousand has been allocated to the Plan. During the year ended March 31, 2010, PSP Investments received $67 million of principal repayments on the ABTNs. During the year ended March 31, 2010, principal repayments on the ABTNs of $334 thousand has been allocated to the Plan.

PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has provided funding facilities of a maximum amount of $969 million to support potential margin calls on the ABTNs, of which $4,840 thousand was allocated to the Plan. As at March 31, 2010, the margin funding facilities had not been drawn upon. As part of the exchange of the non-bank ABCP for the ABTNs, it was agreed to include in the agreement a moratorium which prevents collateral calls for a period of 18 months ending July 21, 2010.

Management's best estimate of the fair value of PSP Investments' ABTNs allocated to the Plan as at March 31, 2010 is equal to $5,919 thousand (2009 – $3,145 thousand). The fair value of the ABTNs allocated to the Plan has been reduced by the impact of the funding facilities amounting to $325 thousand on March 31, 2010 (2009 – $321 thousand). PSP Investments recorded an increase of $3,108 thousand in the fair value of the ABTNs allocated to the Plan during the year ended March 31, 2010 (decrease of $638 thousand during the year ended March 31, 2009).

Valuation Techniques

Cash Equivalents are recorded at cost plus accrued interest, which approximate fair value.

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

3. INVESTMENTS (continued)

(A) INVESTMENT PORTFOLIO (continued)

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

Valuation Techniques (continued)

ABTNs are measured at fair value using comparable notes with similar credit quality and terms as a proxy, while taking into consideration the impact of the funding facilities. The valuation model used includes certain assumptions that are not fully supported by market observable data. Such assumptions include interest rate spreads, assumed credit rating (ranging from BB to AAA–), expected returns, an average maturity of seven years as well as liquidity estimates.

(iv) Absolute Return

In addition to the different asset classes outlined in the Statement of Investment Policies, Standards and Procedures (SIP&P), PSP Investments employs a number of absolute return strategies through units of externally managed pooled funds.

Valuation Techniques

The fair value of investments in pooled funds is measured by using the unit values obtained from each of the funds' administrators. Such unit values are derived from the fair value measurement of the underlying investments in each pooled fund.

(v) Amounts Receivable and Payable from Pending Trades

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

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

Valuation Techniques

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

(vi) Securities Sold Short

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

Valuation Techniques

Using ask prices as inputs, the fair value of securities sold short is measured using the same method as the similar long positions presented under Nominal Fixed Income, World Inflation-Linked Bonds, Canadian Equity and Foreign Equity.

(B) DERIVATIVE FINANCIAL INSTRUMENTS

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

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

(i) Swaps

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

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

(ii) Futures

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

(iii) Forwards

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

(iv) Options

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

(v) Warrants and Rights

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

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

(vi) Collateralized Debt Obligations

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

Valuation Techniques

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. Except for collateralized debt obligations, OTC derivatives are valued using appropriate valuation techniques, such as discounted cash flows using current market yields. The assumptions used include the statistical behaviour of the underlying instruments and the ability of the model to correlate with observed market transactions. For many pricing models there is no material subjectivity because the methodologies employed do not necessitate significant judgment and the pricing inputs are observed from actively quoted markets. Additionally, the pricing models used are widely accepted and used by other market participants.

The fair value of collateralized debt obligations are determined based on valuation techniques that use significant assumptions that are not all directly market observable. Such assumptions include default correlation data and recovery rate which are estimated by management. The instruments are then valued by discounting the expected cash flows using an appropriate discount factor.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Notional values of derivative financial instruments are not recorded as assets or liabilities as they represent the face amount of the contract. Notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions disclosed below, with the exception of credit derivatives [1]. Rather, they serve as the basis upon which the cash flows and the fair value of the contracts are determined.

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

($ millions)	**2010**				2009	
INVESTMENTS	**Notional Value**	**Fair Value – Assets**	**Fair Value – Liabilities**	**Fair Value – Net**	Notional Value	Fair Value
Equity and Commodity Derivatives						
Futures	**$ 565**	**$ –**	**$ –**	**$ –**	$ 2,143	$ –
Total Return Swaps	**17,602**	**578**	**(6)**	**572**	9,926	362
Variance Swaps	**–**	**–**	**–**	**–**	365	20
Warrants and Rights	**6**	**5**	**–**	**5**	3	3
Options: Listed-written	**26**	**–**	**–**	**–**	–	–
Currency Derivatives						
Forwards	**50,860**	**1,548**	**(139)**	**1,409**	70,363	(583)
Options: OTC-purchased	**3,267**	**20**	**–**	**20**	2,112	24
OTC-written	**853**	**–**	**(4)**	**(4)**	532	(7)
Interest Rate Derivatives						
Bond Forwards	**1,027**	**–**	**(11)**	**(11)**	1,191	–
Futures	**2,605**	**–**	**–**	**–**	–	–
Interest Rate Swaps	**19,498**	**121**	**(192)**	**(71)**	13,422	(14)
Total Return Swaps	**14,041**	**93**	**(68)**	**25**	12,029	188
Swaptions	**–**	**–**	**–**	**–**	8,551	–
Options: Listed-purchased	**2,120**	**–**	**–**	**–**	–	–
Listed-written	**5,817**	**–**	**(2)**	**(2)**	8,510	–
OTC-written	**–**	**–**	**–**	**–**	5,118	–
Credit Derivatives [1]:						
Purchased	**142**	**6**	**–**	**6**	218	177
Sold	**3,714**	**16**	**(1,653)**	**(1,637)**	5,569	(4,350)
Total	**$ 122,143**	**$ 2,387**	**$ (2,075)**	**$ 312**	$ 140,052	$ (4,180)

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

3. INVESTMENTS (continued)

(B) DERIVATIVE FINANCIAL INSTRUMENTS (continued)

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

($ thousands)	2010	2009
Less than 3 months	$ 45,948	$ 83,233
3 to 12 months	56,272	40,518
Over 1 year	19,923	16,301
Total	$ 122,143	$ 140,052

(C) FAIR VALUE MEASUREMENT

Financial instruments are classified according to the following hierarchy based on the significant inputs used in measuring their fair value.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

The following table shows the fair value of financial instruments, as at March 31, 2010 based on the methods described above:

($ thousands)	Level 1	Level 2	Level 3	No Level	Total Fair Value
World Equity					
Canadian Equity & Foreign Equity	$ 88,027	$ 7,029	$ –	$ –	$ 95,056
Private Equity	–	–	26,224	–	26,224
Nominal Fixed Income	674	56,952	6,418	–	64,044
Real Return Assets					
World Inflation-Linked Bonds	–	1,683	–	–	1,683
Real Estate	–	–	30,669	–	30,669
Infrastructure	–	–	11,791	–	11,791
Absolute Return	–	6,187	5,869	–	12,056
INVESTMENTS	$ 88,701	$ 71,851	$ 80,971	$ –	$ 241,523
Investment-Related Assets					
Amounts receivable from pending trades [1]	$ –	$ –	$ –	$ 744	$ 744
Derivative-related receivables	–	2,361	26	–	2,387
Total Investment-Related Assets	$ –	$ 2,361	$ 26	$ 744	$ 3,131
Investment-Related Liabilities					
Amounts payable from pending trades [1]	$ –	$ –	$ –	$ (2,288)	$ (2,288)
Securities sold short	(564)	–	–	–	(564)
Derivative-related payables	(2)	(444)	(1,629)	–	(2,075)
Capital debt financing:					
Short-term	–	(3,243)	–	–	(3,243)
Long-term	–	(5,359)	–	–	(5,359)
Total Investment-Related Liabilities	$ (566)	$ (9,046)	$ (1,629)	$ (2,288)	$ (13,529)
NET INVESTMENTS	$ 88,135	$ 65,166	$ 79,368	$ (1,544)	$ 231,125

[1] No fair value hierarchy classification is required for these items.

The classification of financial instruments in the levels of the hierarchy is established at the time of the initial valuation of the instrument and reviewed on each subsequent reporting period-end.

There have been no significant transfers between Level 1 and Level 2 during the current fiscal year.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(C) FAIR VALUE MEASUREMENT (continued)

Level 3 Reconciliation

The following table shows a reconciliation of all movements in the fair value of financial instruments categorized within Level 3 for the year ended March 31:

	2010					
($ thousands)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Opening Balance	$ 14,525	$ 3,847	$ 33,497	$ 2,329	$ (4,135)	$ 50,063
Purchases	23,369	–	21,913	5,479	8	50,769
Sales/Settlements	(15,025)	(1,411)	(25,061)	(102)	(3)	(41,602)
Total gains (losses) [1]	3,355	3,982	12,111	(1,837)	2,527	20,138
Transfers into or out of Level 3	–	–	–	–	–	–
Closing Balance	$ 26,224	$ 6,418	$ 42,460	$ 5,869	$ (1,603)	$ 79,368

Total gains (losses), for the year ended March 31, included in investment income (loss) are presented as follows:

	2010					
($ thousands)	World Equity	Nominal Fixed Income	Real Return Assets	Absolute Return	Derivative-related receivables/ payables (net)	Total
Total realized gains (losses)	$ 577	$ 2	$ 219	$ (1)	$ 1	$ 798
Total unrealized gains (losses)	$ 2,778	$ 3,980	$ 11,892	$ (1,836)	$ 2,526	$ 19,340
Total gains (losses) [1]	$ 3,355	$ 3,982	$ 12,111	$ (1,837)	$ 2,527	$ 20,138

[1] Included in Note 6 (a).

Level 3 Sensitivity Analysis

In the course of measuring fair value of financial instruments classified as Level 3, valuation techniques used incorporate assumptions that are based on non-observable data. Significant assumptions used for each asset class are described in Notes 3 (a) and (b). Although such assumptions reflect management's best judgment, the use of reasonably possible alternative assumptions could yield different fair value measures representing, at a minimum, a 3% increase/decrease in the fair value of financial instruments categorized as Level 3. This excludes private market fund investments as well as Real Estate Debt, where a sensitivity analysis is not possible given the underlying assumptions used are not available to PSP Investments. In the case of Private Market fund investments, the fair value is determined based on the audited financial statements of the fund's general partner as indicated in Note 3 (a). With respect to Real Estate Debt, the fair value is obtained from third-party appraisers as described in Note 3 (a).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

3. INVESTMENTS (continued)

(D) INVESTMENT ASSET MIX

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

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

	2010			2009		
($ thousands)	Fair Value		Policy Portfolio Long-Term Target	Fair Value		Policy Portfolio Long-Term Target
World Equity						
Canadian Equity	$ 67,657	29.2%	30.0%	$ 30,079	26.1%	30.0%
Foreign Equity:						
US Large Cap Equity	10,544	4.6	5.0	3,161	2.7	5.0
EAFE Large Cap Equity	10,205	4.4	5.0	3,559	3.1	5.0
Small Cap Developed World Equity	9,873	4.3	5.0	2,666	2.3	5.0
Emerging Markets Equity	14,920	6.5	7.0	7,241	6.3	7.0
Private Equity	27,096	11.7	10.0	14,300	12.4	10.0
Nominal Fixed Income						
Cash & Cash Equivalents [1]	9,451	4.1	2.0	250	0.2	2.0
World Government Bonds	10,626	4.6	5.0	7,181	6.2	5.0
Canadian Fixed Income	24,124	10.4	8.0	14,511	12.6	8.0
Real Return Assets						
World Inflation-Linked Bonds	10,714	4.6	5.0	8,153	7.1	5.0
Real Estate	25,562	11.1	10.0	15,878	13.8	10.0
Infrastructure	10,353	4.5	8.0	8,346	7.2	8.0
NET INVESTMENTS	$ 231,125	100.0%	100.0%	$ 115,325	100.0%	100.0%

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

3. INVESTMENTS (continued)

(E) SECURITIES LENDING & BORROWING PROGRAMS

PSP Investments participates in securities lending and borrowing programs whereby it lends and borrows securities in order to enhance portfolio returns.

The securities lending and borrowing programs require collateral in cash, high-quality debt instruments or securities. Collateral transactions are conducted under terms that are usual and customary in standard securities lending and borrowing programs. In the absence of an event of default, the same securities or equivalent securities must be returned to the counterparty at the end of the contract. PSP Investments does not repledge any collateral held.

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

($ thousands)	**2010**	2009
Securities Lending		
Securities lent	**$ 20,003**	$ 9,217
Collateral contractually receivable [1]	**20,873**	9,647
Securities Borrowing		
Securities borrowed	**564**	1,211
Collateral contractually payable [2]	**595**	1,240

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

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

4. INVESTMENT RISK MANAGEMENT

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

A risk governance structure that includes required reporting on risk to all levels in 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 senior management and an independent internal auditor reporting directly to the Audit and Conflicts Committee.

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

(A) MARKET RISK

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

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

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

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

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

The following table shows the total Relative VaR allocated to the Plan and the diversification effect as at March 31 based on the economic intent of the investment strategies of the underlying assets. The diversification effect captures the effect of holding different types of assets which may react differently in various types of situations and thus having the effect of reducing overall Relative VaR.

Active Risk Taken

(Relative VaR – $ thousands)	**2010**	2009
World Equity	**$ 3,436**	$ 2,689
Real Return Assets	**4,335**	3,634
Absolute Return	**2,053**	3,958
Total Relative VaR (Undiversified)	**9,824**	10,281
Diversification Effect	**(4,914)**	(5,664)
Total Relative VaR	**$ 4,910**	$ 4,617

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

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

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(i) Interest Rate Risk

Interest rate risk refers to the risk that fluctuations in interest rates will directly affect the fair value of the Plan's net asset values. The most significant exposure to interest rate risk is related to the investment in bonds, ABTNs and Real Estate Debt.

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

	Terms to Maturity					
($ thousands)	Less than 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	2010 Total	2009 Total
Government of Canada bonds	$ 925	$ 8,142	$ 1,711	$ 1,872	$ 12,650	$ 10,423
Provincial and Territorial bonds	907	2,881	1,540	2,651	7,979	5,052
Municipal bonds	20	112	251	38	421	286
Corporate bonds	1,283	3,034	2,250	1,908	8,475	5,474
ABTNs	–	224	–	5,695	5,919	3,145
Total Canadian Fixed Income	$ 3,135	$ 14,393	$ 5,752	$ 12,164	$ 35,444	$ 24,380
Total World Government Bonds	$ 42	$ 2,369	$ 1,641	$ 1,423	$ 5,475	$ 2,588
Total World Inflation-Linked Bonds	$ –	$ 407	$ 388	$ 888	$ 1,683	$ 669
Real Estate Debt [1]	$ 1,373	$ 875	$ –	$ 163	$ 2,411	$ 2,566
Grand Total	$ 4,550	$ 18,044	$ 7,781	$ 14,638	$ 45,013	$ 30,203

[1] Real Estate Debt is a components of the Real Estate asset class disclosed in Note 3 (a).

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

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

Additionally, the exposure to interest rate risk for short-term instruments and amounts receivable from pending trades would not be significant due to their short-term nature.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(A) MARKET RISK (continued)

(ii) Foreign Currency Risk

PSP Investments and its subsidiaries are exposed to currency risk through holdings of securities, units in pooled funds and units in limited partnerships of non-Canadian assets. Fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or a negative effect on the fair value of the investments. To mitigate this risk, PSP Investments may take, through foreign forward contracts, positions in foreign currencies. PSP Investments' policy is to hedge 50% of its foreign currency investments excluding Emerging Markets Equity.

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

	2010		2009	
Currency (in thousands of Canadian $)	**Fair Value**	**% of Total**	Fair Value	% of Total
US Dollar	**$ 31,343**	**51.2%**	$ 15,778	52.9%
Euro	**9,066**	**14.8**	7,051	23.6
British Pound	**3,883**	**6.4**	1,769	5.9
Brazilian Real	**3,342**	**5.5**	222	0.7
Hong Kong Dollar	**2,527**	**4.1**	1,023	3.4
Japanese Yen	**2,143**	**3.5**	1,326	4.5
Korean Won	**1,753**	**2.9**	568	1.9
New Taiwan Dollar	**997**	**1.6**	595	2.0
South African Rand	**786**	**1.3**	317	1.1
Australian Dollar	**756**	**1.2**	562	1.9
Indian Rupee	**749**	**1.2**	289	1.0
Turkish Lira	**545**	**0.9**	206	0.7
Others	**3,285**	**5.4**	137	0.4
Total	**$ 61,175**	**100.0%**	$ 29,843	100.0%

PSP Investments and its subsidiaries also have commitments, denominated in foreign currencies of $24,875 thousand ($20,380 thousand US, €2,896 thousand, £6 thousand and 1,559 thousand South African Rands (ZAR)) for the Plan which are not included in the foreign currency exposure table.

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK

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

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

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

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

	2010	2009
Investment grade (AAA to BBB–)	**89.9%**	88.7%
Below investment grade (BB+ and below)	**–**	–
Not rated:		
Rated by a single credit rating agency	**8.5**	8.5
Not rated by credit rating agencies	**1.6**	2.8
Total	**100.0%**	100.0%

The breakdown of credit concentration risk for the Plan does not include investments in distressed debt included in pooled funds in the amount of $9,989 thousand as at March 31, 2010 (2009 — $6,825 thousand). Such investments typically include debt securities of issuers close to default, and the investment in such securities are quasi-equity in nature.

As at March 31, 2010, the Plan also has a net notional exposure of $3,067 thousand to collateralized debt obligations, of which approximately 64% of the dollar exposure is rated "Investment grade", as well as funding facilities of a maximum amount of $4,840 thousand to support potential margin calls on the ABTNs (Note 3 (a) (iii)).

As at March 31, 2010, the Plan's maximum exposure to credit risk, excluding collateral held and the investments in distressed debt and collateralized debt obligations described above, amounts to $64,927 thousand (2009 — $37,536 thousand).

(i) Counterparty Risk

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

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

4. INVESTMENT RISK MANAGEMENT (continued)

(B) CREDIT RISK (continued)

(i) Counterparty Risk (continued)

Additionally, the CSA to the ISDA Master Agreement enables PSP Investments to realize any collateral placed with it in the event of the failure of the counterparty and requires PSP Investments to contribute further collateral when requested. The CSA also regulates the exchange of collateral when the credit exposure to a counterparty exceeds a predetermined threshold.

On behalf of the Plan, PSP Investments deposited or pledged securities with a fair value of $1,043 thousand as collateral with various financial institutions as at March 31, 2010 (2009 – $3,535 thousand) while securities with a fair value of $892 thousand (2009 – $361 thousand) were received from other counterparties as collateral. PSP Investments does not repledge any collateral held. All collateral deposited, pledged and received were held with counterparties who had a minimum credit rating of "A–" as at March 31, 2010.

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

(C) LIQUIDITY RISK

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

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

The terms to maturity of the notional amount of derivatives, including related payable amounts, are disclosed in Note 3 (b).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

4. INVESTMENT RISK MANAGEMENT (continued)

(C) LIQUIDITY RISK (continued)

Financial Liabilities

The following tables present the fair value of non-derivative-related financial liabilities as well as derivative-related financial assets and liabilities, aggregated according to their maturities as at March 31, 2010.

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

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Non-derivative-related financial liabilities				
Amounts payable from pending trades	$ (2,288)	$ –	$ –	$ (2,288)
Securities sold short	(564)	–	–	(564)
Capital debt financing	(3,118)	(125)	(5,359)	(8,602)
Accounts payable and other liabilities	(47)	–	(14)	(61)
Total	$ (6,017)	$ (125)	$ (5,373)	$ (11,515)

($ thousands)	Less than 3 Months	3 to 12 Months	Over 1 Year	Total
Derivative-related financial assets and liabilities				
Derivative-related assets	$ 878	$ 1,398	$ 111	$ 2,387
Derivative-related liabilities	(163)	(97)	(1,815)	(2,075)
Total	$ 715	$ 1,301	$ (1,704)	$ 312

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

5. FUND TRANSFERS

PSP Investments received fund transfers of $84,236 thousand for the year ended March 31, 2010 (2009 – $85,513 thousand) from the Reserve Force Pension Fund. The transfers received are comprised of the net employer and employee contributions to the Reserve Force pension plan in respect of member service after March 1, 2007.

6. INVESTMENT INCOME (LOSS)

(A) INVESTMENT INCOME (LOSS)

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

($ thousands)	2010	2009
Interest income	$ 1,781	$ 1,132
Dividend income	1,789	1,136
Other income	890	617
Security lending income (net) [1]	41	17
Dividend expense	(112)	(89)
Interest expense (Note 8)	(237)	(184)
Transaction costs	(89)	(77)
External investment management fees [2]	(141)	(125)
	3,922	2,427
Net realized gains (losses) [3]	6,395	(17,810)
Net unrealized gains (losses)	21,537	(9,789)
Investment Income (Loss)	**$ 31,854**	$ (25,172)

[1] Includes fees on securities borrowed.

[2] These are amounts incurred for public market investments that are paid directly by PSP Investments (Note 1). This excludes amounts incurred for Private Market Investments, disclosed in Note 3 (a) (ii), and certain public market pooled fund investments in the amount of $56 thousand for the year ended March 31, 2010 (2009 – $22 thousand) that are not paid directly by PSP Investments.

[3] Includes foreign currency gains (losses) of $2,468 thousand for the year ended March 31, 2010 (2009 – $(1,555) thousand).

(B) INVESTMENT INCOME (LOSS) BY ASSET MIX

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

($ thousands)	2010	2009
World Equity		
Canadian Equity	$ 15,035	$ (9,071)
Foreign Equity:		
US Large Cap Equity	1,088	(1,091)
EAFE Large Cap Equity	964	(1,414)
Small Cap Developed World Equity	1,246	(1,246)
Emerging Markets Equity	4,002	(2,146)
Private Equity	5,865	(5,178)
Nominal Fixed Income		
Cash & Cash Equivalents	170	68
World Government Bonds	(1,471)	1,396
Canadian Fixed Income	813	643
Real Return Assets		
World Inflation-Linked Bonds	(1,104)	628
Real Estate	213	(2,739)
Infrastructure	743	424
Absolute Return [1]	4,290	(5,446)
Investment Income (Loss)	**$ 31,854**	$ (25,172)

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

NOTES TO THE FINANCIAL STATEMENTS
For the year ended March 31, 2010

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 in proportion to the annual amount of net assets in each Plan Account as follows:

	2010	2009
Public Service Pension Plan Account	**72.5%**	72.6%
Canadian Forces Pension Plan Account	**20.0**	20.1
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.3**	0.1
Total	**100.0%**	100.0%

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

(B) OPERATING EXPENSES

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

($ thousands)	**2010**	2009
Salaries and benefits	**$ 182**	$ 68
Professional and consulting fees	**32**	14
Office supplies and equipment	**38**	12
Other operating expenses	**14**	12
Depreciation of fixed assets	**24**	7
Occupancy costs	**15**	5
Custodial fees	**5**	2
Remuneration earned by Directors	**3**	1
Travel and related expenses for Directors	**1**	1
Communication expenses	**1**	–
Total	**$ 315**	$ 122

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

8. CAPITAL DEBT FINANCING

As of March 31, 2010, PSP Capital Inc. has $649 million (2009 – $1,579 million) of short-term promissory notes outstanding with maturity dates between 14 and 120 days of issuance, of which $3,243 thousand (2009 – $5,386 thousand) has been allocated to the Reserve Force Pension Plan Account and included in Note 3 (a) as a short-term investment-related liability. As at March 31, 2010, PSP Capital Inc. has $1 billion (2009 – $1 billion) of medium-term notes issued and outstanding, of which $3,412 thousand (2009 – $3,412 thousand) has been allocated to the Reserve Force Pension Plan Account. These medium-term notes bear interest of 4.57% per annum and have a maturity date of December 9, 2013. These medium-term notes are included in Note 3 (a) as a long-term investment-related liability. As at March 31, 2010, the fair value of these medium-term notes is $1,073 million (2009 – $1,054 million), of which $5,359 thousand (2009 – $3,597 thousand) has been allocated to the Reserve Force Pension Plan Account. The maximum authorized by the Board of Directors for both the short-term promissory notes and medium-term notes is $2 billion. The capital raised, primarily used to finance investments in the Real Estate and Infrastructure asset classes, is unconditionally and irrevocably guaranteed by PSP Investments and is in accordance with the approved PSP Investments' corporate policy for leverage.

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

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

($ thousands)	**2010**	2009
Short-term promissory notes	**$ 31**	$ 150
Medium-term notes	**206**	34
Total	**$ 237**	$ 184

9. CAPITAL MANAGEMENT

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

- To invest fund transfers, outlined in Note 5, in the best interests of the beneficiaries and contributors under the *Superannuation Acts*. The funds received are invested with a view of achieving a maximum rate of return, without undue risk of loss, with regards to the funding, policies and requirements of the pension plans established under the *Superannuation Acts*. The funds are also invested in accordance with the Investment Risk Management policies which are outlined in Note 4.
- To maintain an appropriate credit rating to achieve access to the capital markets at the lowest cost of capital. Through PSP Capital Inc., and its leverage policies, PSP Investments has the ability to raise capital by issuing short-term promissory notes and medium-term notes. Note 8 provides information on the capital debt financing and Note 4 (c) provides information on PSP Investments' liquidity. Additionally, as at March 31, 2010, PSP Investments has an operating line of credit of $10 million (2009 – $10 million). As at March 31, 2010, no amounts have been withdrawn (2009 – nil).

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2010

10. GUARANTEES AND INDEMNITY

PSP Investments provides indemnification to its Directors, its Officers and to certain PSP Investments representatives who are asked to serve on boards of directors (or like bodies) or investment advisory boards (or like bodies) of entities in which PSP Investments or its wholly-owned subsidiaries have made an investment or have a financial interest. As a result, but subject to the Act, PSP Investments may be required to indemnify these representatives for costs incurred, such as claims, actions or litigations in connection with the exercise of their duties, unless the liability of such a representative relates to a failure to act honestly and in good faith. To date, PSP Investments has not received any claims nor made any payment for such indemnity.

As part of investment transactions, PSP Investments and its subsidiaries guaranteed letter of credit facilities. The beneficiaries of these letter of credit facilities have the ability to draw against these facilities to the extent that the contractual obligations, as defined in the related agreements, are not met. As at March 31, 2010, the maximum exposure of the Plan was $49 thousand (2009 – $50 thousand).

As at March 31, 2010, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan would assume the obligation up to $1,375 thousand (2009 – $1,375 thousand) plus interest and other related costs.

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

11. COMMITMENTS

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

($ thousands)	**2010**	2009
Private Equity	**$ 15,755**	$ 15,796
Real Estate	**6,960**	6,125
Infrastructure	**2,136**	1,966
Public markets	**1,637**	1,972
Total	**$ 26,488**	$ 25,859