2008 Annual Report

Public Sector Pension Investment Board

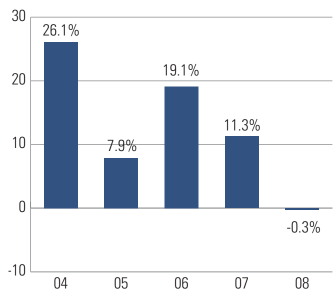
INVESTISSEMENTS PSP INVESTMENTS

2008

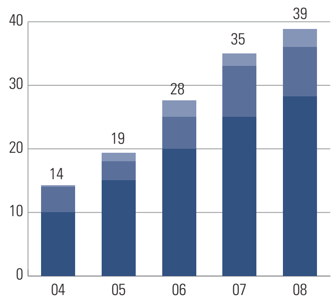
Financial Highlights

08

ANNUAL PERFORMANCE
As at March 31 (percent)

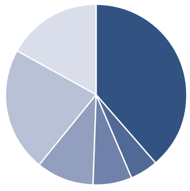


CHANGES IN NET ASSETS (CONSOLIDATED)
As at March 31 ($ billion)



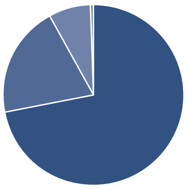
- Public Service Plan Account
- Canadian Forces Plan Account
- RCMP Plan Account
- Reserve Force Plan Account

ASSET MIX
As at March 31, 2008 (percent)



Developed World Equity	38.8%
Small Cap Developed World Equity	5.0%
Emerging Markets Equity	7.0%
Private Equity	10.2%
Real-Return Assets	19.4%
Nominal Fixed Income	19.6%
	100.0%

NET ASSETS PER PENSION PLAN
As at March 31, 2008 ($ million)



Public Service	$28,264M	72.6%
Canadian Forces	$7,819M	20.1%
RCMP	$2,787M	7.2%
Reserve Force	$55M	0.1%
Net Assets	**$38,925M**	100.0%

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Corporate Profile

Who We Are and What We Do

Profile

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

Fiscal Year 2008

- Increase of consolidated net assets by 11.3% to $38.9 billion
- Total portfolio return of -0.3% compared to Policy Benchmark of 1.2%
- Real Estate debt portfolio ramps up with over $719 million of investments and commitments
- Global Real Estate investment strategy continues with key investments and commitments in Canada, the U.S., Latin America, Germany and South Africa
- Private Equity (PE) completes the acquisition of Telesat Canada
- PE Allocation reaches 10% with total commitments of approximately $8.3 billion ($4 billion of invested capital and $4.3 billion of outstanding commitments) and performance is well ahead of PE benchmark
- The Infrastructure asset class, while still in ramp-up mode, made a significant leap forward this year, almost tripling the size of its portfolio by investing in high quality assets in Canada and abroad
- Creation of new executive positions to strengthen management: position of Vice President, Information Technology, under the leadership of the First Vice President, Chief Financial and Operations Officer and a position of Vice President, Asset Allocation Strategies and Research, in charge of economic analysis, under the leadership of the First Vice President, Asset Allocation Strategies and Research
- Employee Pension Plan governance structure introduced
- New logo created to better represent the corporation's dynamism
- Team growth from 182 employees to 229 employees

Highlights

08

Corporate Objectives

Fiscal Year 2008

The legislation governing PSP Investments requires that the annual report include its objectives for the fiscal year under review, report on the status of those objectives and outline the corporation's objectives for the next fiscal year.

OBJECTIVES	STATUS
Continue looking, with a longer term view, for new sources of returns that will complement PSP Investments' liquidity and extended investment time horizon.	COMPLETED AND ONGOING **Key accomplishments include:** Expanded activities :: Geographically, for example South Africa, Mexico, China, Brazil; :: By sector, for example Energy, Real Estate debt, Distressed debt; :: Completed acquisition of Telesat Canada.
Continue to build and strengthen our Public Markets team and portfolio as we expand our breadth of activities beyond traditional markets and diversify our public market risks.	ONGOING **Key accomplishments include:** In fiscal year 2008, the Public Markets portfolio expanded into new, non-traditional investment areas: – Hired external managers for investments in distressed debt; – Hired an external manager for global, market-neutral equity investments. :: In addition, we expanded our internal quantitative research team in fiscal year 2008.
Expand and improve our enterprise risk management activities, including investment risk under new leadership as our organization grows and evolves.	COMPLETED **Key accomplishments include:** :: Consolidated all risk management activities under one group and increased resources within the risk management team; :: Developed an Enterprise Risk Management Policy and implemented an enterprise risk management program to identify and monitor key risks facing the organization; :: Developed an Investment Risk Handbook which includes a set of policies, guidelines and procedures establishing a framework to ensure investment activities are managed in accordance with the Board's risk tolerance levels; :: Developed an Operational Risk Policy and emphasized periodic operational due diligence of external managers.
Increased surveillance of corporate governance within our public equity holdings.	COMPLETED **Key accomplishments include:** :: Reviewed proxy voting processes, including the Proxy Voting Guidelines; :: Centralized the exercise of the voting rights attached to the securities held in portfolios either managed internally or for PSP Investments by external managers; :: Initiated, with the assistance of a service provider, an engagement process with certain issuers to improve their corporate governance practices.

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Key Corporate Objectives
Fiscal Year 2009

1

ENTERPRISE RISK MANAGEMENT

Continue to build on the Enterprise Risk Management initiative begun last year by performing strategic risk reviews, monitoring and reporting on selected risks and promoting a risk culture through education and training.

2

PUBLIC MARKETS

Building on new leadership in our Public Markets group, set a course for increased internal management of our assets in areas where PSP Investments demonstrates a competitive advantage to do so and can attract the necessary talent.

3

POLICY PORTFOLIO GOVERNANCE

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

Key Objectives

Chair's Report

PAUL CANTOR
Chair

PSP Investments is an active participant in global financial markets. We have to be world-wide investors in order to achieve the diversification that is the fundamental principle of good investment management. As a result, we hold stocks and bonds in publicly traded companies all over the world, as well as real estate, private investments and infrastructure. We also hold investments in products that are known as "derivatives" because their value is "derived" from the value of financial assets.

PSP Investments owns Revera, the retirement homes and long-term care group in Canada and the United States. We own a large position in Sword Energy, an oil and gas producer in western Canada. We have a big share of Telesat Canada, the former Bell Canada satellite company. We are investors in shopping malls in Brazil and office buildings in Europe. We have an interest in a cable company in Asia, we are an investor in a pipeline in the United States and an electrical transmission system in South America and so on. But mostly, we own a lot of stocks and bonds and derivatives.

No one needs to read this report to know that a long period of global market growth has been abruptly interrupted by a series of events that have shaken the financial system around the world. PSP Investments has spent a lot of time during the year dealing with these issues and we present the results of those efforts in this report. With the support of the Board of Directors, our management group has demonstrated that they have what it takes to solve problems and mobilize the resources needed to restructure for the future.

"With the support of the Board of Directors, our management group has demonstrated that they have what it takes to solve problems and mobilize the resources needed to restructure for the future."

The role of the Board of Directors is to provide both governance and advice. With PSP Investments' accelerated growth and increased market sophistication, it has been important that the Board's expertise grow on a commensurate basis. To that end, in 2007, we asked the Nominating Committee to assist us in deepening the Board's investment management expertise in the appointment of new directors to fill vacancies and retirements. This was done and I reported to you last year on the appointment of these new directors. There is no doubt that the Board and Management, working together in 2008, assisted in containing the impact of adverse markets.

We are not finished with the market's readjustment process. In 2009, volatility will be the order of the day. Our objective at PSP Investments is to mobilize the resources needed to generate the desired return for our beneficiaries and sponsor. With that foundation in place, we need to watch for both unforeseen risks and unpredicted opportunities.

On behalf of the Board, I wish to express our appreciation for the leadership of Gordon J. Fyfe, our President and CEO, and his management group. Our thanks extends to all of the PSP Investments staff, who have worked tirelessly in difficult conditions to not only address the market challenges, but also to move forward on our strategic objectives.

I also wish to express my thanks to the members of the Board of Directors who have given generously of their time and wisdom during the past year. Our governance framework enables the Nominating Committee to propose outstanding directors for the Board, and the contributions of both the Nominating Committee and the Board are very much appreciated.

PAUL CANTOR
Chair

President's Report

GORDON J. FYFE
President and Chief Executive Officer

In the context of a significant deterioration in global financial markets throughout our fiscal year ended March 31, 2008, the total return of PSP Investments for the year was -0.3%.

This was the first time in the last five years, and since I became President, that we generated a one-year total return below that of our Policy Benchmark. However, it is important to keep in mind that in a period of severe stress and volatility, preservation of capital and minimization of investment losses are our overarching priorities.

"I am pleased to report however, that through asset class diversification, active management of public and private market investments, effective risk management and tactical investment decisions, we have outperformed our Policy Benchmark by 0.4% annualized over the past five years"

KEEPING A LONG-TERM PERSPECTIVE

I am pleased to report however, that through asset class diversification, active management of public and private market investments, effective risk management and tactical investment decisions, we have outperformed our Policy Benchmark by 0.4% annualized over the past five years. As a result, with a five-year annualized return of 12.5%, we have added $389 million in value (above benchmark) to the fund. The fund total return after inflation was 10.7% annualized over five years.

In significant short-term market downturns, it is easy for investors to lose the long-term perspective. PSP Investments is in the enviable position of having positive net cash flows for the next 22 years. With such a distant investment horizon, we are patient investors able both to commit during volatile markets and weather the storms as well as invest in long-term projects that will generate healthy returns over the long-term.

Our overall investment objective to meet our obligations is to achieve a return of 4.3% above inflation over the long-term, while prudently managing risk.

DISCIPLINED INVESTMENT APPROACH

After four years of considerable expansion, global financial markets experienced increased volatility and significant declines during the last twelve months.

In the early part of the year, with financing easily accessible, the market for quality assets quickly became overheated. In this environment, we remained disciplined and rigorous in our investment approach. We were priced out of many transactions by investors who were willing to pay aggressive multiples backed by heavy borrowing, taking-on additional risks in exchange for lower returns.

As a result, our overall rate of investments in real estate slowed somewhat. At the same time, we increased our commitments to distressed debt managers ahead of the current credit crisis.

In Real Estate, we were successful in acquiring quality office and retail assets in Brazil as well as residential housing properties in Canada and Germany. We also intensified our real estate debt portfolio with over $719 million of investments and commitments, focusing on credit quality and good loan-to-value ratios.

Our Real Estate portfolio now represents 10% of assets. With a consumer-led recession in the United States looming, we maintained a prudent approach with respect to investments in U.S. assets. Conversely, in order to benefit from opportunities in the emerging real estate markets, we have been actively developing new partnerships in Mexico, India and South Africa.

In our Private Equity portfolio, we successfully completed the Telesat Canada acquisition. With $4 billion in private equity investments, we attained our private equity allocation of 10% of total assets, after only four years and with a performance well ahead of our benchmark.

We also continued to build actively our Infrastructure portfolio which is now approaching 4% of the total assets. During the year, we purchased an interest in a natural gas pipeline delivering in the American Midwest, as well as an oil and gas trust in Alberta.

Our exposure to public markets represents 76% of our assets under management. Underperformance in our Public Markets portfolio can be explained in part by our investment philosophy of partnering with value oriented external managers. The easy credit environment of the past two years has not been favourable to value investors. We are confident, however, that value buys can lead to significant outperformance over the long term.

The performance of this portfolio has a significant impact on our overall performance. We remain committed to strengthening our own internal capabilities and are in the final stages of recruiting a new leader for our public market activities.

As we continue to seek investment opportunities around the world, we adopted a currency hedging policy in April 2006, to minimize the impact of foreign exchange fluctuations on the value of our international assets.

CREDIT CRISIS

Easy credit markets with cheap and abundant capital ground to a halt following the sub-prime market meltdown in the United States during the summer of 2007.

Fear of exposure to the U.S. sub-prime situation spread to Canada, affecting the asset backed commercial paper market. As holders of non-bank sponsored asset backed commercial paper (ABCP), we actively participated in the restructuring process designed to increase the long-term value of ABCP and to significantly reduce the risk of realized losses. While we have not escaped completely unscathed, we remain confident that over 95% of the underlying assets supporting the ABCP we currently own are of high credit quality.

PSP Investments also has exposure to the credit markets through investments in collateralized debt obligations (CDOs). Due to the turbulence in credit markets, the market for these types of investments has become illiquid. Although there are little, if any, credit losses with these investments, the distressed market conditions have had a negative impact on their fair value. PSP Investments expects, over time, to recover the unrealized losses related to these investments if they are held to maturity.

OPPORTUNITIES IN A CHALLENGING ENVIRONMENT

More importantly, as the liquidity crisis continues, the distinct competitive advantage of PSP Investments becomes increasingly clear.

With ample capital to invest and a long-term investment horizon, we are a sought after, high quality financial partner. Furthermore, we are able to invest at low valuations, paving the way for significant long-term value creation.

ENHANCED CONTROLS AND SYSTEMS

As we continue to expand beyond traditional markets, we are constantly improving our risk management activities. We have adopted an enterprise-wide risk management approach linking investment and operational risks and have consolidated and strengthened all of our risk management functions. We are also in the process of finalizing a business continuity plan to ensure we are in a position to maintain operations in the event of a major crisis such as an avian flu pandemic or a natural disaster.

"As the liquidity crisis continues, the distinct competitive advantage of PSP Investments becomes increasingly clear. With ample capital to invest and a long-term investment horizon, we are a sought after, high quality financial partner. Furthermore, we are able to invest at low valuations, paving the way for significant long-term value creation."

A number of major technology-related initiatives under the leadership of a newly created position of Vice President, Information Technology, are also underway to ensure that we have a robust and secure technology platform to support our growing activities.

2009 OBJECTIVES

Our main objective will be to establish investment areas where we have a distinct competitive advantage, areas where we can develop and leverage in-house expertise to generate attractive returns for the contributors and beneficiaries of the Plans.

As we are fast approaching the $50-billion mark in assets under management, it is quickly becoming apparent that we will be building more and more internal capability to maximize returns from both an asset class and a geographic perspective. Such global diversification will reduce overall portfolio risk while helping us achieve our investment objectives.

ACKNOWLEDGEMENTS

In closing, I want to thank all PSP Investments employees for another year of hard work under exceptionally difficult circumstances. They are first-class professionals who are dedicated to generating incremental value on behalf of clients.

I would also like to take this opportunity to welcome Neil Cunningham, First Vice President, Real Estate Investments, who joined the Management Team during the year and to congratulate him on his new responsibility in leading our Real Estate Investments Group.

Last and by no means least, allow me to acknowledge the support of our Board of Directors and in particular, of Paul Cantor, our Chairman, whose commitment to PSP Investments is absolute and who acts as a major motivating force in the success of this organization. His support and guidance through some very difficult periods of 2007 are very much appreciated. I truly believe that PSP Investments has one of the strongest and most capable Board of Directors of any pension fund in Canada. I welcome and appreciate the counsel and diligence of each of our Directors and look forward to their continued guidance.

GORDON J. FYFE
President and Chief Executive Officer

Management's Discussion of Fund Performance and Results

ECONOMIC OVERVIEW AND BACKGROUND

Fiscal year 2008 was characterized by a significant deterioration in the overall economic backdrop. While the year started on a positive note, with healthy returns recorded in most asset classes, the U.S. sub-prime mortgage crisis reached a climax in the summer months, spilling over to the broad credit markets and reverberating around the globe. With the resulting tightening in credit availability adding to the ongoing downturn in the U.S. housing market and rising crude oil prices, expectations for a modest slowdown in U.S. growth rapidly gave way to fears of recession. Equity markets tumbled, bond markets rallied, credit spreads soared and mergers and acquisitions activity dried up. Although many of the world's central banks have been cutting interest rates in response, the headwinds facing the global economy remain significant.

08

MAJOR ECONOMIES

The defining event of the past year has unquestionably been the ongoing deterioration of the U.S. housing market and the resulting credit crisis. Until August, the housing downturn had been relatively well-contained. While falling home sales continued to drag down residential construction and house prices, other key sectors of the economy – U.S. consumer spending in particular – remained strong. Meanwhile, other major industrial economies continued to record healthy growth rates. Emerging Market (EM) economies soared, with China alone accounting for almost one-third of global growth. Inflation also emerged as a notable concern, with the emerging market boom pushing commodity prices sharply higher. Food prices, in particular, soared, and crude oil hit $100 per barrel. At the same time, global stock markets continued to chalk up solid returns, with emerging markets once again leading the pack.

However, the credit crisis that unfolded between July and September gave rise to a dramatic reversal. As U.S. sub-prime mortgage defaults continued to mount, concerns about the quality of ABCP and other more complex asset backed securities such as CDOs and Structured Investment Vehicles (SIVs) led those markets to seize up. The loss of confidence led investors to shun all risky assets, and the resulting flight to safety caused interbank liquidity to dry up and credit spreads to soar. Despite significant liquidity injections into the interbank markets from the U.S. Federal Reserve, the European Central Bank (ECB), the Bank of England (BoE) and the Bank of Canada (BoC), the rising cost of credit and tightening in bank lending standards emerged as a severe headwind for the U.S. economy. Job creation slowed, consumer spending weakened, and the housing market downturn intensified. In turn, that led to widespread fears that the U.S. economy would experience its first recession since 2001, and provoke a global economic slowdown in its wake. The U.S. dollar dropped sharply, equity markets plummeted, and bonds rallied.

Although the U.S. Federal Reserve reacted aggressively, cutting interest rates by a cumulative 300 basis points starting in September – including a dramatic 125 basis points of cuts in January 2008 alone – the U.S. economy has started the new year on a very weak footing. Moreover, the tightening in credit conditions has spilled over to other industrialized economies. The BoC and the BoE – the two economies most vulnerable to a U.S. downturn – have already cut interest rates in response, and expectations are mounting that other central banks will follow suit.

CANADA

High commodity prices and healthy economic fundamentals continued to underpin Canada's economic performance, keeping the economy operating at full capacity, and driving the unemployment rate to a 30-year low of 5.9%. However, the sharp appreciation of the Canadian dollar and the slowdown in U.S. growth weighed on Canada's export sector. The economy has started to slow as a result. At the same time, the stronger Canadian dollar has pushed core inflation sharply lower, leaving the BoC with the room to cut interest rates by 100 basis points.

UNITED STATES

Although the U.S. economy grew at a solid average rate of more than 4% in the second and third quarters of 2007, it slowed to a mere 0.6% rate in the final quarter of the calendar year. The decline in residential investment intensified, shaving more than a full percentage point off Gross Domestic Product (GDP) growth, and firms pared back inventories instead of meeting demand through current production. The job market and consumer spending have weakened noticeably in early 2008, intensifying fears that the economy is on the verge of, or already in, recession. Yet, inflation has remained higher than the Federal Reserve would like to see, with the core measure sitting at 2.4%.

EUROPE

The European economy has performed remarkably well over the past couple of years, but the economy has slowed in response to past interest-rate hikes, the strength of the Euro, and tighter bank lending conditions. In the fourth quarter of 2007, the economy slowed to a mere 1.6% annual rate, and continued to show signs of softness in early 2008. However, with the ECB still concerned about the inflation backdrop, its policy rate has remained unchanged at 4.0% since June 2007.

JAPAN

The Japanese economy hit another weak patch, with GDP recording no growth at all in the second and third quarters of 2007. Although the economy bounced back in the fourth quarter, with growth of 3.7%, domestic spending continued to struggle, with housing weakening, and consumer confidence declining sharply. Deflation is still an issue, with the Consumer Price Index (CPI) excluding food and energy still falling year-over-year. The Bank of Japan's policy rate remained steady at 0.5%, as it has since February 2007.

EMERGING MARKETS

Emerging markets remained strong over the course of the year, chalking up growth rates more than double those recorded in the developed world. China in particular remained a powerhouse, recording double-digit growth rates throughout the year, and prompting the People's Bank of China to steadily tighten its monetary policy settings. The pace of appreciation of the currency has also picked up. Overall, emerging markets appear well-positioned to weather the U.S. slowdown, even if some moderation in the pace of growth could be in store.

FINANCIAL MARKETS

Global stock markets started the fiscal year on a solid footing, but rapidly reversed course in the wake of the credit crisis and mounting fears of recession. After recording a gain of 11.1% in U.S. dollar terms between the beginning of fiscal year 2008 and late October, the MSCI (Morgan Stanley Capital International) World Index ended the year down by 5.1%. Given the sharp appreciation in the Canadian dollar, domestic currency returns were even worse. Despite similarly strong gains early in the year, the S&P 500 lost 5.1% in U.S. dollar terms. Europe and Japan were not spared either. Only emerging markets managed to end the year on a positive note.

CANADIAN EQUITIES

The Canadian equity market had a very turbulent fiscal year. While Canadian equities were not spared the impact of the credit crisis and concerns about the U.S. economy, high commodity prices and solid domestic demand allowed the S&P TSX to outperform the main U.S. equity indices, with a gain of 4.0% in local currency terms. However, performance across sectors was mixed. Commodity-based sectors such as energy and materials posted solid gains. The information technology sector also posted strong results. In contrast, financials and the consumer sectors recorded significant losses.

U.S. EQUITIES

With recession fears building, most sectors posted losses over the course of the fiscal year. As is often the case during periods of economic weakness, small cap stocks noticeably underperformed large caps. The S&P SmallCap 600 Index lost 10.6% in U.S. dollar terms, well below the returns for the S&P 500. The credit crisis caused significant losses in financial stocks, with the S&P financials recording a hefty 27.9% loss.

EMERGING MARKET EQUITIES

Despite the turmoil brewing in global markets, virtually all EM indices ended the year in the black. The broad MSCI EM Index posted a gain of 15.9% in local currency terms. The best performing region was Latin America, with strong commodity prices helping to support a gain of 24.5% in the EM Latin America Index. The BRIC (Brazil, Russia, India, China) Index followed closely with a gain of 25.02%. The EM Europe and Middle East Index was the worst performer, with a much more modest gain of 4.2%. Despite steady losses since the beginning of the credit crisis, the high-flying Chinese indices still managed to post impressive growth, with the Shanghai Composite up 9.1% on the year.

BOND MARKETS

With concerns about a U.S. recession mounting and the U.S. Federal Reserve aggressively cutting interest rates, fiscal year 2008 was a very good year for global bonds. The 10-year U.S. Treasury rallied from a yield of 5.3% in early June 2007, to below 3.5% in January. The yield curve steepened dramatically as well, as 2-year yields dropped below 2%, while ongoing inflation concerns put some upward pressure on longer-term yields from January onward. With the BoC cutting its overnight rate by a more than modest 100 basis points, Canadian bond yields declined, but less than their U.S. counterparts. This was also the case in the UK and Europe, with yields ending the year above comparable U.S. bond yields.

REAL ESTATE

The downturn in the U.S. housing market sparked a surge in mortgage delinquencies, leading to losses in certain U.S. real estate markets. The MSCI REIT Index recorded a sharp decline of 17.9%, while mortgage finance companies posted substantial losses. Commercial real estate fared much better with rental and occupancy levels remaining strong. However, towards the end of the fiscal year, concerns over the residential sector began to spill over into this sector as well with CMBS (Commercial Mortgage-Backed Securities) spreads widening sharply. Real Estate markets in most other developing countries continued to expand, albeit at a slower pace.

COMMODITIES

Overall, fiscal year 2008 was a banner year for many commodity markets. Crude oil futures moved beyond $100 per barrel, and gold futures reached an all-time high of $1,004 per ounce. Soaring prices of agricultural goods made the headlines as well. While concerns about slower global growth weighed on the prices of many commodities in the closing months of 2007, they regained lost ground as 2008 got underway. Copper futures soared to almost $4 per pound, aluminum jumped to almost $1.30 per pound, and platinum prices climbed to more than $2,000 per ounce.

INVESTMENT POLICY AND STRATEGY

INVESTMENT OBJECTIVES

The mandate of PSP Investments is set out in section 4 of the Public Sector Pension Investment Board Act:

- To manage funds in the best interests of contributors and beneficiaries under the plans;

and

- To maximize returns without undue risk of loss, having regard to the funding, policies and requirements of the pension plans and the ability of those plans to meet their financial obligations.

Based on these statutory objectives, the following investment objectives were established:

- Absolute Performance: achieving a return (net of expenses) at least equal to the actuarial rate of return as determined by the Chief Actuary of Canada;

and

- Relative Performance: achieving a return exceeding the Policy Benchmark return by 0.5% (with a minimum value-added component equal to expenses).

ASSET MIX POLICY

In fiscal year 2008 both Real Estate and Private Equity asset classes attained their target weights ahead of the projected 4-year ramp-up period back in fiscal year 2005 when they were initially approved by the Board of Directors. Currently, all asset classes are in line with their weights and ranges prescribed by the Statement of Investment Policies, Standards and Procedures (SIP&P), with the exception of an underweight position in Infrastructure (now in its second year of ramp-up), which is being compensated by an overweight position in Canadian bonds.

The expanding opportunities set in private markets allowed for further enhancement of the diversification benefit in the investment policy through an increase in the Private Equity asset-class allocation from 8 to 10 percent and corresponding decrease in Small Cap Developed World Equities from 7 to 5 percent.

POLICY PORTFOLIO

As a result of the successful completion of the ramp-up phase in two of the three private asset classes, the majority of the Policy Portfolio is currently at target weights. It is now a much more diversified Portfolio when compared to the first fiscal year, and it is better aligned with our liabilities profile on a risk adjusted basis.

The Board of Directors approved a Rebalancing Policy in 2007 which will ensure that the target asset weights will be maintained and managed throughout the investment cycle.

The phasing in of the currency hedging policy is still under way. The combined positive effect of implementing this policy is estimated at close to $300 million for fiscal year 2008 and over $200 million since inception.

Going forward, the strengthening of our internal capabilities in asset liability management, improved Policy Portfolio monitoring, and the integration of the economic and geopolitical scenarios will better allow the Board of Directors to achieve its required objectives.

Name Asset Class	Long-Term Target Weight %	Long-Term Range %
Equities	**62**	
:: Developed World	40	
– Canadian Equity	30	24–36
– U.S. Large Cap Equity	5	4–6
– EAFE Large Cap Equity	5	4–6
:: Small Cap	5	3–9
:: Emerging Markets	7	6–8
:: Private Equity	10	5–15
Nominal Fixed Income	**15**	
:: Cash & Cash Equivalent	2	0–4
:: World Government Bonds	5	3–7
:: Canadian Fixed Income	8	4–12
Real Return Assets	**23**	
:: World Inflation-Linked Bonds	5	3–7
:: Real Estate	10	5–15
:: Infrastructure	8	5–11

ACTIVE MANAGEMENT STRATEGY

PSP Investments has an active management strategy designed to add value to the Policy Portfolio, in accordance with a risk budget, approved by the Board, which management allocates to active strategies. Within this framework, management works to optimize its "roster" of active strategies, in order to meet the value-added objectives set out above, under the "Investment Objectives" heading.

Active management involves both internal and external managers and is not limited to the asset classes of the Policy Portfolio. It includes mandates in other spheres such as currency management and tactical asset-allocation across countries and asset classes. Indeed, PSP Investments believes that the best way to achieve its active management target is through the diversification of its return sources. That process continued in fiscal year 2008: we added four new active mandates, using internal and external managers.

FUND PERFORMANCE AND INVESTMENT RESULTS

INVESTMENT RESULTS

In fiscal year 2008, the Consolidated Pension Plan Account produced an investment loss of $0.1 billion before expenses. This compares with investment income of $3.5 billion generated in fiscal year 2007. The net decrease of $3.6 billion reflects a consolidated rate of return of -0.3% on an average net asset base of $37.3 billion for the Consolidated Pension Plan Account in fiscal year 2008, compared to a return of 11.3% on an average net asset base of $30.4 billion in fiscal year 2007.

PERFORMANCE MEASUREMENT AND EVALUATION

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

BENCHMARKS

PSP Investments' Statement of Investment Policies, Standards and Procedures (SIP&P) defines the relevant benchmarks for each of the asset classes. A combined Policy Portfolio Benchmark is constructed using the asset class benchmarks weighted by their allocations as established in the SIP&P. The return for each asset class is compared to the relevant benchmark return, while the Consolidated Pension Plan Account return is compared to the Policy Portfolio Benchmark return.

RATES OF RETURN

In fiscal year 2008, the Consolidated Pension Plan Account's rate of return of -0.3% was 1.5 percentage points below the Policy Benchmark rate of return of 1.2%. Over the last four fiscal years the Consolidated Pension Plan Account achieved a rate of return above that set by its Policy Benchmark. Over the last four fiscal years the Consolidated Pension Plan Account has posted a rate of return of 9.3% as compared to the Policy Benchmark rate of return of 8.9% over that same period.

Our holdings in ABCP and CDOs were significant contributors to underperformance in fiscal year 2008 versus the Policy Benchmark return. As at March 31, 2008, PSP Investments held $1,972 million of ABCP with a fair value of $1,522 million. The difference reflects a write-down of approximately $450 million, decreasing the overall rate of return by approximately 1.2%. Our investment in CDOs, through a notional exposure of $1.4 billion, reflects a write-down of approximately $470 million, decreasing the overall rate of return by approximately 1.2%. The investment losses related to ABCP and the CDOs are unrealized as at March 31, 2008, and generally reflect deteriorated credit market conditions and related mark downs. There are very little, if any, credit losses in both ABCP and CDOs and the possibility of recovering the nominal investment value in a subsequent period is probable if general credit conditions improve. The losses were not allocated to any particular asset class but are included in PSP Investments' total return.

A significant source of value-added in fiscal year 2008 came from the Real Estate and Private Equity asset classes. Real Estate (included in real return assets) generated a rate of return of 21.9%, surpassing the Policy Benchmark rate of return of 7.6% by 14.3% and was the primary driver of value-added in the Real Return asset class. Private Equity (included in Equities) generated a rate of return of 10.1%, surpassing the Policy Benchmark rate of return of 3.7% by 6.4%. As a result of the PE team's careful fund and asset selection, the Private Equity Portfolio has not experienced the negative performance (J curve effect) typically experienced during the early years of such a portfolio.

Equities underperformed the benchmark return primarily due to the underperformance of related public market asset classes in fiscal year 2008, partially offset by the aforementioned private equity outperformance. Over a four-year period, equities generated a rate of return of 10.7%, surpassing the Policy Benchmark rate of return of 10.6% by 0.1%, primarily due to the Private Equity and Canadian Equity asset classes outperforming their respective benchmarks. The performance in fixed income outperformed its benchmark return in fiscal year 2008 primarily due to the performance of the Canadian Fixed Income asset class. As is the case with the equity portfolio, the fixed income portfolio has generated a rate of return of 5.0% surpassing the Policy Benchmark rate of return of 4.9% by 0.1% over the last four years, primarily due to Canadian Fixed Income outperforming its benchmark.

RATES OF RETURN ON CONSOLIDATED PENSION PLAN ACCOUNT

(AS OF MARCH 31, 2008)

	One Year		Four Years Annualized	
Name Asset Class	Portfolio Returns %	Benchmark Returns %	Portfolio Returns %	Benchmark Returns %
Equities				
:: Developed World :: Small Cap :: Emerging Markets :: Private Equity	-2.7	-2.3	10.7	10.6
Nominal Fixed Income				
:: Cash & Cash Equivalent :: World Government Bonds :: Canadian Fixed Income	6.4	6.2	5.0	4.9
Real Return Assets				
:: World Inflation-Linked Bonds :: Real Estate :: Infrastructure	14.8	7.0	14.6	7.7
Total Return	-0.3	1.2	9.3	8.9

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Assets and Expenses

CHANGE IN NET ASSETS

The Consolidated Pension Plan Account began fiscal year 2008 with net assets of $35.0 billion at market value. Consolidated net contributions during the year added $4.2 billion. After factoring in the net loss from operations, consolidated net assets as of the fiscal year 2008 year-end were $38.9 billion at market value.

EXPENSES

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The cost of operating PSP Investments during fiscal year 2008 totaled $138 million, compared to $103 million in fiscal year 2007. That total includes operating expenses ($77 million in fiscal year 2008 versus $52 million in fiscal year 2007) and external investment management fees ($61 million in fiscal year 2008 versus $51 million in fiscal year 2007). The higher costs can be attributed primarily to the growth in assets under management and to a continuing shift to actively managed assets, which entail considerably higher expense than passive mandates. Actively managed assets, such as absolute return strategies and private investments, experienced the highest growth in fiscal year 2008. In fiscal year 2008, expenses amounted to 0.37% of average net assets or 0.21% of average net assets, when external investment management fees are excluded (compared with 0.34% and 0.17%, respectively, in fiscal year 2007).

Expenses, on an absolute dollar basis, are expected to increase in fiscal year 2009 principally due to increasing asset size and investment in PSP Investments' operations. Technology will be an important factor affecting fiscal year 2009 expenses. This reflects continuation of major initiatives that began in previous years, along with new initiatives requiring additional capital expenditures planned for in fiscal year 2009 and beyond. The new initiatives call for major investments in public market systems, data governance, risk management systems and private market systems. Increasing capabilities in private markets will result in higher operating costs and important investments in systems and support groups. PSP Investments employs various measures that help maintain tight financial controls such as budgeting, forecasting and benchmarking processes.

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

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Risk Management

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RISK MANAGEMENT GOVERNANCE

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

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

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

During the last period, PSP Investments developed its enterprise risk management framework through a proposed Enterprise Risk Management Policy outlining the guiding principles for, among others, the strategic risk review encompassing short-term and long-term business strategies and objectives for PSP Investments, the annual risk assessment for all business units, the risk monitoring and reporting process for the Board of Directors, as well as the development of enterprise risk awareness of all employees. Enterprise risks encompass all risks inherent in PSP Investments' activities including, but not limited to, investment risk and operational risk.

The enterprise risk framework adopted many of the guiding principles of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This framework has been presented to PSP Investments' senior management and has led to the identification of the major risks PSP Investments is currently facing and for which action plans are being developed to more effectively monitor such risk.

INTERNAL CONTROLS

The internal control environment is derived from the COSO model. Assisted by internal auditors, PSP Investments reviews annually its control environment, general controls and key controls in all departments.

The control functions are carried out at various levels: investment and operations' managers, risk management, compliance, internal and external audit.

Internal policies and procedures provide a framework for the implementation of the main corporate controls. Corporate policies are approved by the Board of Directors and include, among other things, authority delegation, contract signatures, risk management, human resources and internal audit. Corporate procedures present precise and specific guidelines for the adequate execution of internal processes.

INVESTMENT RISK MANAGEMENT

PSP Investments defines investment risk as all risks inherent in the investment process, including financial risks, model risk and valuation risk.

Financial risks include market risk, credit risk and liquidity risk:

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

- Credit risk is the risk of loss resulting from the failure of a borrower or counterparty to honor its financial or contractual obligations.

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

INVESTMENT RISK CONTROL

PSP Investments has developed an Investment Risk Handbook (the Handbook), which contains an Investment Risk Policy, and is in the process of being approved by the Board of Directors, as well as Investment Risk Guidelines and Procedures approved by senior management.

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

INVESTMENT RISK MEASUREMENT

The measure used to evaluate market and credit risk for risk measurement purposes is 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. In addition to VaR, PSP Investments uses other investment risk measures including stress testing, scenario analysis and sensitivity analysis.

OPERATIONAL RISK MANAGEMENT

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

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

COMPLIANCE

The objective of compliance activities is to ensure PSP Investments' adherence to laws and regulations, and internal policies and procedures. The main activities are carried out through daily monitoring of transactions and activities ensuring compliance with the Code of Conduct, policies and procedures, and industry regulations. Compliance is integrated in the Risk Management Group and reports quarterly to the Audit and Conflicts Committee of the Board of Directors.

Governance

08

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

LEGISLATED MANDATE

The legislated mandate of PSP Investments, as established by the Public Sector Pension Investment Board Act (the "Act"), is to manage funds received "in the best interests of the contributors and beneficiaries" of the Public Service, Canadian Forces, Royal Canadian Mounted Police (RCMP) and Reserve Force pension plans ("the Plans"); and to invest "with a view to achieving a maximum rate of return without undue risk of loss, having regard to the funding, policies and requirements of the Plans and the ability of those Plans to meet their financial obligations".

RELATIONSHIP TO PENSION PLANS

Effective April 1, 2000, the federal government created three new pension plan funds – one each for the existing Public Service, Canadian Forces and RCMP pension plans. These pension funds receive the employer and employee contributions in respect of each plan to provide for liabilities for service since April 1, 2000. The balances (that is, contributions after payment of benefits accrued since April 1, 2000, and after plan administration expenses) are transferred to separate accounts at PSP Investments, to be invested in accordance with the approved investment policy and strategy.

On March 1, 2007, the federal government established the Reserve Force Pension Plan and amounts deposited in this plan from such date are to be transfered to PSP Investments pursuant to the terms of the establishing regulation and within the meaning of the Act. The government is the sponsor and administrator of the Plans. The President of the Treasury Board is responsible for the Public Service Plan, the Minister of National Defence for the Canadian Forces Plan and the Reserve Force Plan, and the Minister of Public Safety for the RCMP Plan.

The President and CEO and the Chair meet once a year with the Advisory Committees of the Plans. In fiscal year 2008, the President and CEO met with the representatives of the Plans in December 2007. PSP Investments also communicates on an ongoing basis with the Chief Actuary of Canada and with Treasury Board officers.

ACCOUNTABILITY AND REPORTING

PSP Investments' President and CEO is appointed by and reports to the Board of Directors. The Board of Directors reports to Parliament through the President of the Treasury Board, who is responsible for PSP Investments' legislation and is required to table its annual report in Parliament. PSP Investments is required to provide quarterly financial statements and the annual report to the President of the Treasury Board, the Minister of National Defence and the Minister of Public Safety.

SELECTION OF DIRECTORS

A Board of Directors comprised of twelve members, including the Chair, governs PSP Investments. As at March 31, 2008, eleven board positions were occupied and the vacant position was in the process of being filled. The Governor in Council appoints all members of the Board of Directors on the recommendation of the President of the Treasury Board.

All of PSP Investments' Directors are considered to be "independent" for the purposes of Canadian securities legislation; therefore all committees of the Board are composed entirely of independent directors.

Qualified candidates for directorship are selected and recommended to the President of the Treasury Board by an eight-member Nominating Committee that operates at arm's length from the Board of Directors. PSP Investments' legislation disqualifies as directors, members of the Senate, the House of Commons and provincial legislatures, federal government employees and those entitled to benefits from the Plans (The list of Directors may be found on page 42). Biographical information about each of the Directors may also be viewed on PSP Investments' website: **www.investpsp.ca** under "About PSP – Board of Directors".

DUTIES OF DIRECTORS

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

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

The Terms of Reference describing the roles and responsibilities of the Board Chair and the Board of Directors may be viewed in their entirety on PSP Investments' website: **www.investpsp.ca** under "Governance – Duties & Responsibilities".

BOARD COMMITTEES

The Board of Directors has established four standing committees and one sub-committee to assist in the fulfillment of its obligations:

- Investment Committee
- Governance Committee
- Human Resources and Compensation Committee
- Audit and Conflicts Committee
- Investment Sub-Committee

The Investment Committee includes all the members of the Board. The composition of the other committees is set out on page 43 of this report. All of PSP Investments' Directors are considered to be "independent" for the purposes of Canadian securities legislation; therefore all committees of the Board are composed entirely of independent directors.

The Terms of Reference describing the roles and responsibilities of the Board Committees may be viewed in their entirety on PSP Investments' website: **www.investpsp.ca** under "Governance – Overview".

DIRECTORS' COMPENSATION

The approach to director remuneration adopted by the Board, on the recommendation of the Governance Committee, reflects key requirements of the Act, which state that: (a) the Board should include a "sufficient number of directors with proven financial ability or relevant work experience such that the Board will be able to effectively achieve its objectives"; and (b) that directors' compensation should be set "having regard to the remuneration received by persons having similar responsibilities and engaged in similar activities". The Board reviews directors' compensation once every two years and considers whatever changes may be warranted based on a report and recommendations provided by the Governance Committee. The most recent review was conducted in fiscal year 2007 with the assistance of Executive Risk Governance Advisors, an independent compensation consultant. There were no adjustments to the Board of Directors' compensation in fiscal year 2008 as the next review will be conducted in fiscal year 2009.

Each director receives an annual retainer of $25,000 and meeting fees of $1,500 for each Board of Directors' meeting and $1,000 for each committee meeting. However, only a single fee is paid when Board and Investment Committee meetings are held concurrently. Should a Board meeting or any standing or ad hoc committee of the Board last less than one hour, the meeting fee is reduced to $500. In recognition of the significant additional time and responsibility demanded of the chairs of Board committees, committee chairs receive an additional retainer of $7,500 per year. The Board Chair – who is responsible for the effective overall operation of the Board and its activities, as well as for the relationship between the Board and management, and for PSP Investments' reporting relationship to its stakeholders – is paid a total of $115,000 per annum in recognition of those services, while foregoing all other retainers and meeting fees. The Board met 17 times during fiscal year 2008 and its committees held 21 meetings. In recognition of the added impact on Board members who are not from central Canada, an additional fee of $1,000 is paid to directors who attend a meeting in person if their primary residence is not in Québec or Ontario. The compensation paid to directors during fiscal year 2008 is summarized in Note 9 to the financial statements of PSP Investments.

CONFLICT OF INTEREST PROCEDURES FOR DIRECTORS

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

- Require directors to give written notice to the Board of Directors of the nature and extent of the directors' interest in a transaction or proposed transaction.

In fiscal year 2008, the Board of Directors reviewed the Code of Conduct and a number of amendments were made to take into account the continued growth in the number of employees, volume of assets entrusted to PSP Investments' management and the changing nature of the investment business.

- Prohibit directors from voting on a resolution or participating in a discussion in any circumstances if the directors have a conflict of interest, including, but not limited to transactions involving their interests.

- Require the disclosure of any other business activity which, directly or indirectly, affects the activities of, or is in competition with, PSP Investments.

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

ASSESSMENT OF BOARD PERFORMANCE

The regulations adopted under the Act require that the Board of Directors set out in the annual report the procedures in place for the assessment of its own performance. A formal performance evaluation policy, adopted in accordance with those requirements, focuses on procedures designed to encourage frank and confidential discussions between the Chair and individual directors, as well as between the Chair and the President and CEO of PSP Investments. To facilitate the assessment process, guidelines for evaluating the performance of the Chair, the individual performance of all Board members, of the chairs of the Board committees and of the Board as a whole are distributed once a year to every director as well as to the President and CEO. The guidelines take the form of a questionnaire. Directors submit their completed questionnaires to the Chair of the Governance Committee, who summarizes the information and presents it to the Board of Directors. The Board discussion focuses on concerns and opportunities for improvement, what is working properly or has improved since previous assessments.

CODE OF CONDUCT

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

The Code of Conduct includes a whistle-blowing provision, designed to encourage officers and employees to step forward and report any questionable practices or apparent instances of non-compliance. The Code of Conduct also provides that an employee may report non-compliance with the Code of Conduct or questionable financial practices to the Compliance Officer in all confidentiality in accordance with PSP Investments' Whistle-Blowing Procedures.

Among other things, the Code of Conduct deals with overall honesty and integrity; compliance with the Code of Conduct and the law; conflict of interest procedures for officers and employees; the integrity of accounting records and financial information; the handling and use of confidential information; prohibitions on insider trading; the reporting of personal investment transactions; receiving or giving entertainment or gifts; external appointments or employment within any organisation or association; political activities; and dealings with public officials.

In fiscal year 2008, the Board of Directors reviewed the Code of Conduct and a number of amendments were made to take into account the continued growth in the number of employees, volume of assets entrusted to PSP Investments' management and the changing nature of the investment business. The Audit and Conflicts Committee is responsible for monitoring the application of the Code of Conduct. The Code of Conduct may be viewed on PSP Investments' website: **www.investpsp.ca** under "Governance – Code of Conduct".

PROXY VOTING GUIDELINES

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

The Guidelines focus on areas considered important in terms of their potential impact on performance:

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

In order to increase the surveillance of corporate governance within its public equity holdings, PSP Investments has reviewed its proxy voting processes in fiscal year 2008. PSP Investments has centralized the exercice of the voting rights attached to the securities held in portfolios either managed internally or for PSP Investments by external managers. In certain markets, PSP Investments, with the assistance of a service provider, has initiated an engagement process with certain issuers to improve their corporate governance practices.

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

POLICY ON SOCIAL AND ENVIRONMENTAL RESPONSIBILITY

The primary responsibility of PSP Investments is to provide for the financial benefit of contributors and beneficiaries of the Plans from which it receives funds, and to support the fulfillment of the pension promise explicit in those plans. That responsibility notwithstanding, the Policy on Social and Environmental Responsibility states that we believe that the adoption of socially responsible policies and practices in the corporations and entities in which we invest will enhance long-term shareholder value. The Policy on Social and Environmental Responsibility may be viewed on PSP Investments' website: **www.investpsp.ca** under "Investments – Investment policies – Policy on Social & Environmental Responsibility".

In 2006, PSP Investments joined the Canadian Coalition for Good Governance and in 2007, Gordon J. Fyfe, President and CEO, became a member of its Board of Directors. Since 2006, PSP Investments is a signatory of the Carbon Disclosure Project, which is a group of 385 institutional investors representing $57 trillion in assets under management who are encouraging public companies to disclose how they are managing climate risk issues that may be affecting their business.

SPECIAL EXAMINATION

The Budget Implementation Act of 2005 made PSP Investments subject to the provisions of sections 132 to 147 of the Financial Administration Act (FAA). Pursuant to those FAA provisions, each parent Crown corporation shall cause a Special Examination in respect of PSP Investments and its subsidiaries to be carried out at least once every five years. Previously the Special Examination had to be conducted once every six years. The most recent Special Examination was conducted in fiscal year 2006, the results of which were presented in a Special Examination Report dated November 15, 2005. The Special Examination found that there were no significant deficiencies in PSP Investments' systems and practices.

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Compensation

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

The underlying philosophy of PSP Investments' compensation policy is to attract and retain talented employees, who are often solicited by other organizations which need to fill roles similar to the roles at PSP Investments, and to reward performance and reinforce business strategies and priorities. This philosophy recognizes the fundamental value added by a motivated and committed team. The recruitment and retention of employees who are performance-oriented are fundamental to achieving PSP Investments' objectives.

In order to attract and retain talented employees, the Board has established a Compensation Policy that aims to maintain total compensation at a fair and competitive level. Our compensation plans are aligned with PSP Investments' strategic plan and integrated with business performance measurement. In addition, our Employee Performance Management and Professional Development Planning process contributes to improving business performance and employee engagement.

Total compensation is comprised of all aspects of remuneration usually provided to officers of a company including base salary, annual (short-term) incentive, deferred (long-term) incentive, benefits, pension and other remuneration.

Our reference market is a representative sample of organizations in the pension fund and investment management industry, the entire financial services industry, and other selected samples, if appropriate, for the positions being benchmarked. Data from these external reference markets are gathered periodically and on ad-hoc basis using compensation surveys generated by well-established specialized compensation consulting firms. As stated in PSP Investments' Compensation Policy, to remain competitive, PSP Investments targets the following:

1. Base salaries at the median of the external market;
2. Incentive plans with potential payouts superior to the median of the external market while resulting in significant total cash compensation (base salary + incentive) potential for superior performance; and
3. Benefits that compare favorably to the external market.

To ensure that the Officers' compensation is aligned with the organization's Compensation Policy, the Board has commissioned the consulting firm Mercer to recommend appropriate compensation adjustments, more specifically for the completion of the annual compensation review process.

BASE SALARY

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

INCENTIVE PLANS

PSP Investments offers an annual and a deferred incentive plan for its employees and Officers. These plans are designed to ensure that total compensation reflects PSP Investments' principles and objectives and is competitive with the external reference market.

ANNUAL INCENTIVE PLANS

The PSP Investments Annual Incentive Plan for Investment Professionals (the "Investment Plan") was established in February 2005, with effect from April 1, 2004. It is provided to: (i) employees who are investment professionals; and (ii) other employees who are not covered by another annual incentive plan and who are designated by the Chief Executive Officer and approved by the Human Resources and Compensation Committee.

The PSP Investments Annual Incentive Plan for Professional, Technical and Administrative Employees (the "Professionals Plan") was established with effect from April 1, 2006. It is provided to non-investment personnel and includes employees who are in a professional, technical or administrative position and who are not designated as investment professionals.

Both the Investment Plan and the Professionals Plan (the "Annual Incentive Plans") are designed to: (i) reward participants for the achievement of superior and sustained performance; (ii) attract and retain high caliber employees; and (iii) align the interests of participants with PSP Investments' stakeholders.

The Annual Incentive Plans are cash based plans that pay a percentage of base salary to participants based on the achievement of strategic objectives and investment performance on the assets managed by PSP Investments. Under the Investment Plan, the target annual incentive will be based on: (i) investment performance which may include any combination of (x) the total fund investment performance of PSP Investments, (y) the investment performance of a particular asset class, or (z) the investment performance of a portfolio; and (ii) the achievement of individual strategic objectives. Under the Professionals Plan, the target incentive will be based on the total fund investment performance of PSP Investments and on the achievement of strategic objectives.

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

The achievement of investment performance targets is determined either based on the basis points rate of return in excess of the benchmark rate of return, less the net rate of return, or on the dollar amount of the benchmark, less the net profits. The maximum performance factor for achievement of investment performance is 2.5 times for the first three years of the plan and 5 times thereafter, with target performance having a performance factor of 1.0.

The determination of whether such individual strategic objectives have been met is made through an assessment by an employee's superior at the end of such fiscal year. The maximum performance factor for achievement of strategic objectives is 1.5, with target performance having a performance factor of 1.0.

The annual incentive earned each fiscal year is based on the level of performance achieved. No annual incentive is paid for performance levels less than threshold.

On cessation of employment because of death, retirement or disability, a pro-rated award will be paid. As a general rule, no award is paid on termination of employment without serious reason. On resignation or termination of employment for serious reason, all earned and unpaid awards are automatically forfeited.

In fiscal year 2008, the total fund investment performance of PSP Investments ended below the incentive threshold and, therefore, no payouts were earned for that component of the annual incentive. The four-year performance ended just above threshold and generated an incentive payment slightly above the threshold for the participants with target annual incentive based on the investment performance of a particular asset class.

The results of the strategic objectives component of the annual incentive review indicate that objectives were exceeded and, therefore, generated the right for the employees to receive an incentive award between their target and their maximum payout.

The total incentive amount earned under the Investment Plan was $3,929,219 in 2008, $5,334,698 in 2007, and $3,255,700 in 2006. The total incentive amount earned under the Professionals Plan was $2,178,961 in 2008, $2,523,640 in 2007, and $1,604,828 in 2006.

DEFERRED INCENTIVE PLAN

The PSP Investments Deferred Incentive Plan (the "Deferred Incentive Plan") was established in February 2005 with effect from April 1, 2004. It is provided to: (i) employees who are senior investment professionals; and (ii) other employees who are not covered by another deferred incentive plan and are designated by the Chief Executive Officer and approved by the Human Resource and Compensation Committee.

The Deferred Incentive Plan is designed to: (i) reward participants for the achievement of superior and sustained performance; (ii) attract and retain high caliber employees; and (iii) align the interest of participants with PSP Investments' stakeholders.

The Deferred Incentive Plan is a cash based plan that pays a percentage of base salary to participants based on the achievement of investment performance on the assets managed by PSP Investments. The target annual incentive will be based on investment performance which may include any combination of: (i) the total fund investment performance of PSP Investments; (ii) the investment performance of a particular asset class; or (iii) the investment performance of a portfolio. However, the sole performance measure to be used for participants without direct investment management responsibility is the total fund investment performance of PSP Investments.

At the beginning of each fiscal year, each participant in the Deferred Incentive Plan will be advised of his or her target and maximum annual incentive award. The performance measures chosen and the weighting given to each depend on the participant's position level. For the first four years of the plan, participants will go through a transition period building up to a rolling four year period for investment performance.

The achievement of investment performance targets is determined either based on the basis points rate of return in excess of the benchmark rate of return, less the net rate of return, or on the dollar amount of the benchmark less the net profits. The maximum performance factor for achievement of investment performance is 2.5 for the first three years of the plan and 5.0 thereafter, with target performance having a performance factor of 1.0. The incentive earned each fiscal year is based on the level achieved. No incentive is paid for performance of less than threshold.

A participant's award is determined each fiscal year and the amount is credited to the participant and will be held for the following two fiscal years. The amount credited to the participant will be positively adjusted at the end of the two-year deferral period based on the total fund rate of return over the two-year deferral period. This deferral feature is designed to retain our team over a longer period than the Annual Incentive Plans.

On cessation of employment because of death, retirement or disability, a pro-rated award and any award previously credited to the participant will be paid. As a general rule, no pro-rated or previously credited award is paid on termination of employment without serious reason. On resignation or termination of employment for serious reason, all earned and unpaid awards are automatically forfeited.

The incentive award earned for fiscal year 2008 by a participant was determined on the participant's earned base salary, target incentive for said fiscal year and performance levels achieved during the associated performance period in relation to the value added objectives. The incentive earned by the plan participants closely follows those of the Annual Incentive Plans asset results. The amounts paid in fiscal year 2008 were amounts earned in fiscal year 2006 with a two-year deferred payment.

In fiscal year 2008, the total fund investment performance of PSP Investments ended below the incentive threshold and, therefore, no awards were earned for that component of the Deferred Incentive Plan. For the participants with target deferred incentive based on the investment performance of a particular asset class, awards were earned depending on the performance of said asset class.

The total incentive amount paid under the Deferred Incentive Plan was $2,560,349 in 2008, $2,496,381 in 2007, and $175,296 in 2006.

GROUP INSURANCE BENEFITS

A new group insurance plan was introduced in the fall of 2007 which provides the following group insurance benefits: health and dental care, long-term disability, critical illness, life insurance, accidental death and dismemberment and an employee assistance program. The new insurance plan is intended to ensure a proper balance between employee needs, competitiveness with our peer group and an evolution in the cost structure as a result of PSP Investments' growth.

OTHER REMUNERATION

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

RETIREMENT BENEFITS

All employees of PSP Investments participate in the Public Sector Pension Investment Board Pension Plan ("Employee Pension Plan") and all eligible employees participate in the Supplemental Employee Retirement Plan of the Public Sector Pension Investment Board ("the SERP"). The Employee Pension Plan provides indexed pension benefits equal to 2% of the employee's best average of the three consecutive years of base salary earnings for each year of service.

The benefits payable under the Employee Pension Plan are limited by reason of the requirements in respect of registered pension plans under the *Income Tax Act* (Canada). The SERP has been established for all employees, as an unfunded arrangement, to provide defined benefits in excess of the Employer Pension Plan, where such benefits are so limited. The employees participating in the Employee Pension Plan and the SERP contribute 3.5% of their base salary, up to the maximum contribution under the *Income Tax Act* (Canada).

RETIREMENT BENEFITS

Name	Number of Years of Credited Service	Annual Benefit		Accrued Obligation at Start Year	Compensatory Increase	Non-Compensatory Increase	Accrued Obligation at Year End
		At Year End	At Age 65				
Gordon J. Fyfe	4.50	$39,800	$173,100	$272,100	$83,100	$10,000	$365,200
Neil Cunningham	0.42	$1,600	$63,500	–	$11,200	$3,000	$14,200
Joanne Tosini	3.58	$12,600	$86,100	$57,600	$22,500	$4,000	$84,100
Derek Murphy	4.08	$21,100	$94,700	$138,400	$58,100	$7,800	$204,300
John Valentini	3.00	$16,000	$119,100	$77,900	$34,000	$6,900	$118,800

Notes

- The above table includes the retirement benefits from both the Employee Pension Plan and the Supplemental Employee Retirement Plan.
- Compensatory increase includes the increase in service cost in the year and the effect of any plan amendments provided in the year.
- Non-compensatory increase includes the increase in interest cost in the year and the effect of any change in assumption made in the year.

SUMMARY COMPENSATION TABLE

Compensation earned during the fiscal year 2008 by the six most highly compensated officers of PSP Investments and its subsidiaries consisted of the following:

Name	Fiscal Year	Base Salary	Annual Incentive Plan	Deferred Incentive Plan[4]	Benefits and Other Compensation	Pension and SERP Plans	Total Compensation
Gordon J. Fyfe[1] President and Chief Executive Officer	2008	$466,000	$153,780	$546,163	$32,062	$83,100	$1,281,105
	2007	$450,000	$660,800	$504,400	$35,000	$72,500	$1,722,700
	2006	$425,000	$555,900	–	$35,000	$70,000	$1,085,900
Neil Cunningham[2] First Vice President Real Estate Investments	2008	$240,365	$531,026	$314,612	$19,562	$11,200	$1,116,765
	2007	$195,000	$364,700	$338,500	$15,000	–	$913,200
	2006	$180,100	$285,400	–	$14,000	–	$479,500
Joanne Tosini Vice President Real Estate Investments	2008	$200,000	$524,720	$279,871	$12,062	$22,500	$1,039,153
	2007	$180,000	$336,622	$106,056	$10,000	$18,600	$651,278
	2006	$162,540	$253,851	–	$9,226	$19,600	$445,217
Derek Murphy First Vice President Private Equity Investments	2008	$300,000	$200,165	$257,093	$22,062	$58,100	$837,420
	2007	$275,000	$332,900	$322,200	$25,000	$43,800	$998,900
	2006	$221,000	$244,100	–	$25,000	$56,600	$546,700
John Valentini[3] First Vice President, Chief Financial and Operations Officer	2008	$290,000	$174,400	$83,383	$22,062	$34,000	$603,845
	2007	$275,000	$204,782	–	$22,000	$32,200	$533,982
	2006	$243,102	$119,120	–	$22,000	$30,400	$414,622
Derek Watchorn[5] President and Chief Executive Officer of Revera Inc.	2007	$568,880	$426,938	$199,552	$34,261	$9,500	$1,239,131
	2006	$550,000	$134,100	–	$33,225	$9,000	$726,325
	2005	$550,000	$257,000	–	$31,883	$8,250	$847,133

Notes

1 If Mr. Fyfe's employment is terminated for any reason other than for good and sufficient cause, he is entitled to a payment equal to two times his base salary, plus two times the average annual amount earned under the Investment Plan and the Deferred Incentive Plan for the three-year period prior to the termination. Mr. Fyfe is subject to post employment non-solicitation of employees and confidentiality obligations.

2 Mr. Cunningham was promoted to the position of First Vice President Real Estate Investments effective on November 9, 2007.

3 Mr. Valentini was one of the employees whose compensation was the highest for the 2008 fiscal year exclusively. If Mr. Valentini's employment is terminated for any reason other than for good and sufficient cause, he is entitled to a payment equal to one time his base salary, plus one year of annual incentive equivalent to the greater of either the previous year's annual incentive payment or the annual target incentive at the time of departure. Mr. Valentini is subject to post employment non-solicitation of employees and confidentiality obligations.

4 Awards paid in fiscal 2008 were earned in fiscal 2006.

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

Glossary

A

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

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

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

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

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

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

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

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

B

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

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

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

C

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

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

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

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

CREDIT RISK
The risk of loss linked to the capacity of a borrower or a counterparty to meet its financial obligations.

Glossary

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

D

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

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

E

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

F

FAIR VALUE (OR MARKET VALUE)
The most recent price at which a security transaction took place.

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

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

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

I

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

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

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

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

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

M

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, or factors affecting all securities traded in the market.

Glossary

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

O

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

P

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

PENSION PLAN ACCOUNT (OR PLAN ACCOUNT)
Separate accounts established by PSP Investments for each of the pension plan funds to receive the pension fund's net contributions as well as the allocation of its investments and the results of its operations. There are four (4) pension plan accounts, one for each pension plan fund.

PENSION PLAN FUND
Created effective April 1, 2000, by the federal government to receive the employer and employee net contributions in respect of the pension plans to provide for liabilities for service since April 1, 2000. There are four (4) pension plan funds, one for each of the Public Service Pension Plan; the Canadian Forces Pension Plan and the Royal Canadian Mounted Police (RCMP) Pension Plan. As of April 2007, PSP Investments started to receive contributions for the fund of the Reserve Force Pension Plan.

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

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

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

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

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

PROXY VOTING RIGHTS
Written authorization by a shareholder for someone else to represent them and vote their shares at a shareholders' meeting, generally under stipulated guidelines or conditions.

R

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

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

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

Glossary

S

SOCIAL INVESTING
An investment process that uses screens to select or avoid investing in certain companies or industries to reflect religious, economic, political, social or personal priorities.

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

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

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

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

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

T

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

V

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

Directory

Board of Directors and Investment Committee

Jamie Baillie, President and Chief Executive Officer, Credit Union Atlantic
Halifax, Nova Scotia

Bob Baldwin, Consultant
(formerly Director of Social and Economic Policy, Canadian Labour Congress)
Ottawa, Ontario

Cheryl Barker, Corporate Director
(formerly President, Manitoba Telecom Services)
Winnipeg, Manitoba

Paul Cantor, Chair of the Board, PSP Investments
Senior Adviser, Bennett Jones LLP
(formerly Chairman and Chief Executive Officer, National Trust Company)
Toronto, Ontario

Léon Courville, Corporate Director
(formerly President, National Bank of Canada)
Lac Brome, Québec

Tony R. Gage, Corporate Director
(formerly Chair of the Board, Phillips, Hager & North Investment Management Ltd)
Victoria, British Columbia

Jean Lefebvre, Corporate Director
(formerly Senior Vice President, TAL Global Asset Management)
Montréal, Québec

Keith G. Martell, Executive Chair of the Board, First Nations Bank of Canada
Saskatoon, Saskatchewan

Michael P. Mueller, Corporate Director
(formerly President and Chief Executive Officer, MDS Capital Corporation)
Toronto, Ontario

Anil K. Rastogi, Corporate Director
(formerly Vice President and Chief Information Officer, McCain Foods Limited)
North York, Ontario

William J. Saunderson, Corporate Director
(formerly Chair, Ontario International Trade Corporation)
Toronto, Ontario

Directory

Committees and Sub-Committee

AUDIT AND CONFLICTS COMMITTEE

Jamie Baillie

Cheryl Barker

Tony R. Gage

Keith G. Martell, Chair

Anil K. Rastogi

William J. Saunderson

HUMAN RESOURCES AND
COMPENSATION COMMITTEE

Bob Baldwin

Tony R. Gage

Jean Lefebvre

Keith G. Martell

Michael P. Mueller, Chair

GOVERNANCE COMMITTEE

Bob Baldwin, Chair

Cheryl Barker

Léon Courville

Anil K. Rastogi

William J. Saunderson

INVESTMENT SUB-COMMITTEE

Jamie Baillie

Léon Courville

Tony R. Gage, Chair

Jean Lefebvre

Keith G. Martell

Michael P. Mueller

Directory

Attendance of Directors Board and Commitees

	Board of Directors/ Investment Committee		Audit and Conflicts Committee	Governance Committee	Human Resources and Compensation Committee	Investment Sub-Committee
	Regular	Special				
Number of meetings Fiscal Year 2008	8	9	5	5	5	6
Jamie Baillie[1]	7/8	9/9	4/5	–	–	5/5
Bob Baldwin	8/8	7/9	–	5/5	5/5	–
Cheryl Barker	7/8	7/9	5/5	5/5	–	–
Paul Cantor[2]	7/8	9/9	4/5	5/5	4/5	5/6
Léon Courville[3]	6/8	9/9	–	3/5	–	3/5
Tony R. Gage	8/8	8/9	5/5	–	5/5	6/6
Jean Lefebvre	8/8	4/9	–	–	5/5	6/6
Keith G. Martell[4]	8/8	9/9	5/5	–	5/5	6/6
Michael P. Mueller[5]	8/8	7/9	–	–	5/5	6/6
Anil K. Rastogi[6]	8/8	8/9	5/5	5/5	–	–
William J. Saunderson	6/8	6/9	4/5	5/5	–	–

Notes

1 Mr. Baillie was appointed a member of the Audit and Conflicts Committee and of the Investment Sub-Committee on April 5, 2007.

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

3 Mr. Courville was appointed a member of the Governance Committee and of the Investment Sub-Committee on April 5, 2007.

4 Mr. Martell was appointed a member and Chair of the Audit and Conflicts Committee on April 30, 2007.

5 Mr. Mueller was appointed Chair of the Human Resources and Compensation Committee on April 30, 2007, in replacement of Mr. Keith G. Martell.

6 Mr. Rastogi was appointed a member of the Governance Committee on April 5, 2007.

Directory

Management

Guy Archambault
First Vice President, Human Resources

Neil Cunningham
First Vice President, Real Estate Investments

Assunta Di Lorenzo
First Vice President and General Counsel

Gordon J. Fyfe
President and Chief Executive Officer

Bruno Guilmette
First Vice President, Infrastructure Investments

Anne-Marie Laurendeau
Director, Communications and Government Relations

Pierre Malo
First Vice President, Asset Allocation Strategies and Research

Derek Murphy
First Vice President, Private Equity

John Valentini
First Vice President, Chief Financial and Operations Officer

Financial Statements and Notes to the Financial Statements

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08

Management's Responsibility for Financial Reporting

The consolidated financial statements of the Public Sector Pension Investment Board ("PSP Investments") as well as the financial statements of the Public Service, the Canadian Forces, the Royal Canadian Mounted Police, and the Reserve Forces Pension Plan Accounts (the "financial statements") have been prepared by management and approved by the Board of Directors. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Management is responsible for the contents of the financial statements and the financial information contained in the annual report.

PSP Investments maintains records and systems of internal control and supporting procedures to provide reasonable assurance that PSP Investments' assets are safeguarded and controlled, and that transactions are in accordance with the applicable provisions of Part X of the Financial Administration Act and, as appropriate, the *Public Sector Pension Investment Board Act (the "Act")*, the accompanying regulations, the by-laws, and the Statement of Investment Policies, Standards and Procedures (the "SIP & P").

In this regard, investments of PSP Investments held during the year ended March 31, 2008 were in accordance with the *Act* and the SIP&P.

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

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

Gordon J. Fyfe
President and Chief Executive Officer
May 2, 2008

John Valentini
First Vice-President and Chief Financial and Operations Officer
May 2, 2008

Investment Certificate

The *Public Sector Pension Investment Board Act* (the "*Act*") requires that a certificate be signed by a director on behalf of the Board of Directors, stating that the investments of the Public Sector Pension Investment Board ("PSP Investments") held during the financial year were in accordance with the *Act* and PSP Investments' investment policies, standards and procedures. Accordingly, the Investment Certificate follows:

"The investments of PSP Investments held during the year ended March 31, 2008, were in accordance with the Act and PSP Investments' Statement of Investment Policies, Standards and Procedures".

Paul Cantor
Chairperson
May 15, 2008

Public Sector Pension Investment Board

AUDITORS' REPORT

To the President of the Treasury Board

We have audited the Consolidated Balance Sheet of the Public Sector Pension Investment Board ("PSP Investments") as at March 31, 2008 and the Consolidated 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 PSP Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of PSP Investments as at March 31, 2008 and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied, except for the change in the method of accounting for financial instruments as explained in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

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

Deloitte & Touche LLP

Chartered Accountants

Montreal, Canada
May 2, 2008

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 2, 2008

CONSOLIDATED BALANCE SHEET

As at March 31

($ millions)	2008	2007
ASSETS		
Investments (Note 3 (a))	$ 42,176	$ 35,704
Investment-related assets (Note 3 (a))	2,333	1,927
Cash	4	8
Other assets (Note 4)	23	19
TOTAL ASSETS	$ 44,536	$ 37,658
LIABILITIES		
Investment-related liabilities (Note 3 (a))	$ 5,536	$ 2,633
Accounts payable and accrued liabilities	75	57
	5,611	2,690
NET ASSETS	$ 38,925	$ 34,968
Share Capital (Note 5)	$ –	$ –
Public Service Pension Plan Account	28,264	25,410
Canadian Forces Pension Plan Account	7,819	7,033
Royal Canadian Mounted Police Pension Plan Account	2,787	2,525
Reserve Force Pension Plan Account	55	–
NET ASSETS	$ 38,925	$ 34,968

Commitments (Note 13)

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

On behalf of the Board of Directors:

Paul Cantor
Chairman

Keith Martell
Director and Chair of the
Audit and Conflicts Committee

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

For the year ended March 31

($ millions)	2008	2007
INVESTMENT INCOME (LOSS) (Note 7)		
Interest, dividends and other income	$ 1,140	$ 1,023
Net realized gains	1,563	2,202
Change in unrealized appreciation (depreciation) in value of investments	(2,839)	240
	(136)	3,465
EXPENSES		
Operating expenses (Note 9)	$ 77	$ 52
External investment management fees	61	51
	138	103
NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME (Note 10)	$ (274)	$ 3,362

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

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2008	2007
NET ASSETS, BEGINNING OF YEAR (as previously reported)	$ 34,968	$ 27,616
Change in accounting policy – financial instruments (Note 2)	(6)	–
NET ASSETS, BEGINNING OF YEAR (as restated)	$ 34,962	$ 27,616
Fund transfers (Note 6)	4,237	3,990
Net income (loss) from operations and comprehensive income	(274)	3,362
Increase in net assets for the year	3,963	7,352
NET ASSETS, END OF YEAR	$ 38,925	$ 34,968

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

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

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

Plan Accounts

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 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 CONSOLIDATED 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

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 distribution 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 each Pension Fund are recorded in their 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 consolidated financial statements, management must make certain estimates and assumptions which can affect the reported values of assets and liabilities, principally the valuation of investments, related income and expenses and note disclosures. Actual results may differ from estimates.

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

2. CHANGES IN ACCOUNTING POLICIES

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

Section 3855 – Financial Instruments – recognition and measurement establishes criteria for the recognition, derecognition, measurement and classification of financial instruments. As an investment company, PSP Investments is largely exempt from this new standard. However, it is required to measure the fair value of its market quoted securities using the bid price for long positions and the ask price for short positions. In addition, all transaction costs associated with its assets or liabilities are required to be recognized immediately in net income. The effect of adopting the new standard is presented in the Consolidated Statement of Changes in Net Assets as a Change in accounting policy – financial instruments. Transaction costs incurred for the current year are presented net of investment income in Note 7(a).

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

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

Future Accounting Changes

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS

(a) Investment Portfolio

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

($ millions)	2008		2007	
Asset Class	**Fair Value**	**Cost**	**Fair Value**	**Cost**
Developed World Equity				
Canadian Equity	$ 7,476	$ 6,955	$ 6,513	$ 5,190
US Large Cap Equity	1,527	1,743	2,164	1,953
EAFE Large Cap Equity	1,845	1,968	1,721	1,402
Small Cap Developed World Equity	1,421	1,670	2,223	2,035
Emerging Markets Equity	1,852	1,630	1,886	1,537
Private Equity	4,087	3,956	1,661	1,661
Nominal Fixed Income				
Cash Equivalents	3,049	3,045	2,282	2,313
World Government Bonds	1,792	1,801	1,763	1,804
Canadian Fixed Income	8,271	8,689	8,504	8,524
Real Return Assets				
World Inflation-linked Bonds	144	136	298	281
Real Estate	5,297	4,210	4,073	3,603
Infrastructure	1,572	1,540	489	459
Absolute Return	3,843	3,910	2,127	2,064
INVESTMENTS	$ 42,176	$ 41,253	$ 35,704	$ 32,826
Investment-Related Assets				
Amounts receivable from pending trades	$ 1,781	$ 1,777	$ 1,631	$ 1,604
Derivative-related receivables	552	85	296	70
Total investment-related assets	$ 2,333	$ 1,862	$ 1,927	$ 1,674
Investment-Related Liabilities				
Amounts payable for pending trades	$ (1,981)	$ (1,983)	$ (1,403)	$ (1,403)
Securities sold short	(727)	(746)	(531)	(542)
Derivative-related payables	(1,277)	(52)	(196)	(59)
Capital debt financing (Note 11)	(1,551)	(1,551)	(503)	(503)
Total investment-related liabilities	$ (5,536)	$ (4,332)	$ (2,633)	$ (2,507)
NET INVESTMENTS	$ 38,973	$ 38,783	$ 34,998	$ 31,993

NOTES TO THE CONSOLIDATED 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 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 CONSOLIDATED 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 it will receive $872 million of MAV1 Class A-1 notes, $600 million of MAV1 Class A-2 notes, $103 million of MAV1 Class B notes, $49 million of MAV1 Class C notes, $143 million of MAV3 TA tracking notes and $205 million of MAV3 IA tracking notes. The MAV1 notes are expected to return approximately Banker's Acceptance ("BA") + 30 bps. The TA tracking notes and the IA tracking notes will reflect the net return and maturity of the respective series' underlying assets. For the purpose of valuation, the restructured floating rate notes of MAV1 were proxied to comparable 7-year floating rate notes as at March 31, 2008. The Class A-1 and Class A-2 notes are expected to be AA-rated and the Class B and Class C notes, while not expected to be rated, were established at a credit rating of BBB for valuation purposes, and accordingly, were proxied to floating rate notes with similar credit quality and terms. TA tracking notes were assumed to be AAA-rated and to have a maturity of 9 years and a return of BA + 40 bps. The TA tracking notes were proxied to comparable floating rate notes as at March 31, 2008. The IA tracking notes contain principally assets that have exposure to US subprime loans and mortgages. A valuation of the IA tracking notes was performed based on the credit quality of the underlying assets.

NOTES TO THE CONSOLIDATED 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 PSP Investments' ABCP as at March 31, 2008, is equal to approximately $1,522 million, representing a write-down of approximately $450 million.

The ABCPs are reported as Canadian fixed income under the investment portfolio (Note 3(a)). The write-down in ABCP is included as part of the absolute return on investment income in Note 7(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 $70 million; extending the maturity term by one year would increase the provision by $55 million. 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 or 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 CONSOLIDATED FINANCIAL STATEMENTS
For the year ended March 31, 2008

3. INVESTMENTS (continued)

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

($ millions)		2008		2007	
INVESTMENTS		Notional Value	Fair Value	Notional Value	Fair Value
Equity and Commodity Derivatives					
Futures [2]		$ 876	$ 8	$ 1,715	$ 5
Total Return Swaps [2]		5,160	(41)	4,313	51
Variance Swaps		229	(3)	684	(2)
Warrants		38	10	45	6
Options:	Listed-purchased	188	6	95	1
	Listed-written	197	(6)	121	(3)
	OTC-purchased [1]	–	–	731	73
	OTC-written	–	–	110	(2)
Currency Derivatives					
Forwards		14,356	(183)	11,141	–
Swaps		833	(71)	720	(12)
Options:	OTC-purchased	1,730	32	868	9
	OTC-written	917	(27)	136	–
Interest Rate Derivatives					
Bond forwards		2,766	2	2,128	7
Futures [2]		1,426	–	582	–
Interest Rate Swaps		5,492	16	1,931	6
Inflation Swaps		–	–	195	-
Total Return Swaps [2]		3,367	15	2,411	(16)
Swaptions		7,219	–	–	–
Options:	Listed-purchased	868	1	505	3
	Listed-written	1,229	(3)	505	(3)
Credit Derivatives					
Swaps:	Purchased	62	29	69	8
	Written	1,351	(510)	1,467	(31)
		$ 48,304	$ (725)	$ 30,472	$ 100

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

[2] As at March 31, 2008, some futures and total return swaps have been equitized by fixed income securities and other assets in the amount of $9.4 billion (2007 – $7.8 billion).

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

3. INVESTMENTS (continued)

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

($ millions)	2008	2007
Derivative-related receivables	$ 552	$ 296
Derivative-related payables	(1,277)	(196)
	$ (725)	$ 100

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

($ millions)	2008	2007
Under 1 year	$ 34,589	$ 24,216
1 to 5 years	11,741	4,607
Over 5 years	1,974	1,649
	$ 48,304	$ 30,472

(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 only 3.4%. This is offset by an overweight in the Canadian fixed income asset class.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(c) Investment Asset Mix (continued)

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

($ millions)	2008			2007		
Asset Class	Fair Value		Policy Portfolio	Fair Value		Policy Portfolio
Developed World Equity						
Canadian Equity	$ 11,538	29.6%	30.0%	$ 10,328	29.5%	30.0%
US Large Cap Equity	1,763	4.5	5.0	2,498	7.1	5.0
EAFE Large Cap Equity	1,831	4.7	5.0	1,720	4.9	5.0
Small Cap Developed World Equity	1,930	5.0	5.0	2,936	8.4	7.0
Emerging Markets Equity	2,726	7.0	7.0	2,501	7.1	7.0
Private Equity	3,972	10.2	10.0	1,669	4.8	8.0
Nominal Fixed Income						
Cash Equivalents	1,547	4.0	2.0	388	1.1	2.0
World Government Bonds	2,248	5.8	5.0	1,663	4.8	5.0
Canadian Fixed Income	4,849	12.4	8.0	5,426	15.5	8.0
Real Return Assets						
World Inflation-linked Bonds	2,211	5.7	5.0	1,714	4.9	5.0
Real Estate	4,029	10.3	10.0	3,596	10.3	10.0
Infrastructure	1,343	3.4	8.0	479	1.4	8.0
Absolute Return	(1,014)	(2.6)	n.a.	80	0.2	n.a.
NET INVESTMENTS	$ 38,973	100.0%	100.0%	$ 34,998	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 CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(d) Investment Risk Management (continued)

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

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

(e) Foreign Currency Risk

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

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

	2008		2007	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
(in Canadian $)	($ millions)		($ millions)	
US Dollar	**$ 5,822**	**52.8%**	$ 6,235	53.7%
Euro	**2,294**	**20.8**	2,036	17.5
British Pound	**917**	**8.3**	805	6.9
Yen	**640**	**5.8**	704	6.1
Brazilian Real	**432**	**3.9**	273	2.3
Others	**931**	**8.4**	1,568	13.5
	$ 11,036	**100.0%**	$ 11,621	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 $7,168 million ($5,306 million US, €1,016 million and £35 million) which are not included in the foreign currency exposure table above.

NOTES TO THE CONSOLIDATED 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, PSP Investments' highest concentration of credit risk is with the Government of Canada through holdings of $2.3 billion of Government of Canada issued securities. In order to minimize derivative contract credit risk, PSP Investments deals only with counterparties that are major financial institutions with a minimum credit rating of "A" as at the trade date, as supported by a recognized credit rating agency by utilizing an internal credit-limit monitoring process, as well as through the use of credit mitigation techniques such as master-netting arrangements (which provide for certain rights of offset) and obtaining collateral, including the use of credit-support annexes, where appropriate.

(g) Market Risk

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, volatility in share and commodity prices, interest rate, foreign exchange or other risk variables affecting all securities traded in the market. PSP Investments has a diversification strategy to mitigate risk whereby it invests in a diversified portfolio of investments based on the criteria established in its SIP&P. Derivative financial instruments, traded either on exchanges or over the counter, are also used to mitigate the impact of market risk.

Market risk is measured using the method known as Value at Risk (VaR). VaR is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. PSP Investments has chosen a yearly 95% confidence interval to measure and report VaR. Generally, changes in VaR between reporting periods are due to changes in the level of exposure, volatilities and/or correlations among asset classes. Although VaR is a widely-accepted risk measure, it must be complemented by other risk measures. PSP Investments therefore uses stress testing and scenario analysis to examine the impact on financial results of abnormally large movements in risk factors.

(h) Interest Rate Risk

Interest rate risk refers to the effect on the fair value of PSP Investments' net asset value due to fluctuations in interest rates. Changes in interest rates will directly affect the fair value of PSP Investments' assets.

As at March 31, 2008, the fixed income asset class was managed with an average duration of 6.1 years (2007 – 5.7 years). An increase of 1% in interest rates would result in a decline in the value of the fixed income securities of 6.1%, or $291 million.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(h) Interest Rate Risk (continued)

The terms to maturity of the bonds held in the Canadian fixed income asset class, as at March 31, 2008, are as follows:

	Terms to Maturity					
($ millions)	Within 1 Year	1 to 5 Years	6 to 10 Years	Over 10 Years	2008 Total	2007 Total
Government of Canada bonds	$ –	$ 1,116	$ 245	$ 418	$ 1,779	$ 2,191
Provincial and Territorial bonds	50	324	373	593	1,340	1,522
Municipal bonds	–	79	36	5	120	94
Corporate bonds	108	584	447	471	1,610	1,623
Total	$ 158	$ 2,103	$ 1,101	$ 1,487	$ 4,849	$ 5,430

(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

PSP Investments participates in securities lending programs whereby it lends securities in order to enhance portfolio returns. Any such securities lending requires collateral in cash, high quality debt instruments or shares securities with a fair value equal to no less than 102% of the value of the securities lent. As at March 31, 2008, securities with an estimated fair value of $5,097 million (2007 – $4,212 million) were loaned out, while securities contractually receivable as collateral had an estimated fair value of $5,292 million (2007 – $4,401 million).

(k) Securities Collateral

PSP Investments deposited or pledged securities with a fair value of $411 million (2007 – $98 million) as collateral with various financial institutions. Securities with a fair value of $31 million (2007 – $469 million) have been received from various financial institutions as collateral.

NOTES TO THE CONSOLIDATED 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 $2,900 million.

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

PSP Investments' infrastructure asset class is comprised of investments which are owned by either PSP Investments or its wholly-owned subsidiaries and managed by general partners or external advisors. The underlying investments comprise a diversified portfolio of infrastructure assets and publicly-traded securities. As at March 31, 2008, the total amount of financing included in the infrastructure portfolio for direct investments controlled by PSP Investments is approximately $350 million.

Investment management and performance incentive fees are generally incurred for the above private market investments and are paid either by the investment directly, through capital contributions from PSP Investments or offset against distributions received from the investment. Investment management fees in private market investments generally vary between 0.2% and 5.5% of the total invested amount. For the year ended March 31, 2008, investment management fees of $123 million (2007 – $61 million) were recorded either as part of the cost of the private market investments or against investment income.

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

4. OTHER ASSETS

Other assets, as at March 31, consist of the following:

($ millions)	2008	2007
Fixed assets	$ 18	$ 8
Other assets	5	11
	$ 23	$ 19

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2008

5. SHARE CAPITAL

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

6. FUND TRANSFERS

During the year, PSP Investments received fund transfers of $ 4,237 million (2007 – $3,990 million) from the Pension Funds. The transfers received are comprised of net current employer and employee contributions to their respective pension plans in respect of member service after April 1, 2000 for the Public Service, Canadian Forces and Royal Canadian Mounted Police Pension Funds. The transfers received from the Reserve Force Pension Fund are comprised of net current employer and employee contributions in respect of member service after March 1, 2007.

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

($ millions)	2008	2007
Public Service Pension Fund	$ 3,057	$ 2,971
Canadian Forces Pension Fund	842	738
Royal Canadian Mounted Police Pension Fund	282	281
Reserve Force Pension Fund	56	n.a.
	$ 4,237	$ 3,990

7. INVESTMENT INCOME

(a) Investment Income

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

($ millions)	2008	2007
Interest income	$ 674	$ 459
Dividend income	371	303
Other income	109	256
Security lending income	9	5
Transaction costs	(23)	–
	1,140	1,023
Net realized gains	1,563	2,202
Net unrealized gains (losses)	(2,839)	240
Investment income (loss)	$ (136)	$ 3,465

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2008

7. INVESTMENT INCOME (continued)

b) Investment Income by Asset Mix

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

($ millions)	2008	2007
Developed World Equity		
Canadian Equity	$ 242	$ 1,298
US Large Cap Equity	(464)	228
EAFE Large Cap Equity	(237)	472
Small Cap Developed World	(626)	131
Emerging Markets Equity	181	390
Private Equity	262	(4)
Nominal Fixed Income		
Cash Equivalents	56	22
World Government Bonds	167	(44)
Canadian Fixed Income	294	284
Real Return Assets		
World Inflation-linked Bonds	79	(27)
Real Estate	754	651
Infrastructure	28	18
Absolute return	(872)	46
Investment income (loss)	$ (136)	$ 3,465

Investment income includes foreign currency realized losses of $585 million (2007 – $130 million) and foreign currency unrealized losses of $374 million (2007 – $441 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2008

8. INVESTMENT PERFORMANCE

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

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

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

The internal rate of return methodology is used to calculate the returns for the real estate, private equity and infrastructure asset classes for the years ended March 31, 2008 and March 31, 2007.

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

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

The total portfolio return includes the performance impact of absolute return strategies. Hedging investment returns are either netted against the return of the respective hedged assets, as is the case with private asset classes, or included in total return, as in the case of public markets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2008

9. OPERATING EXPENSES

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

($ thousands)	2008	2007
Salaries and benefits	$ 34,584	$ 28,420
Professional and consulting fees	20,509	9,024
Office supplies and equipment	6,882	5,691
Other operating expenses	6,265	3,065
Depreciation of fixed assets	3,189	1,521
Occupancy costs	2,523	1,814
Custodial fees	2,041	1,642
Remuneration earned by Directors	762	718
Communication expenses	163	118
Travel and related expenses for Directors	162	176
	$ 77,080	$ 52,189

Professional and consulting fees paid and accrued to the external auditors include audit fees of $396,000 (2007 – $328,000), audit-related fees of $76,000 (2007 – $67,000) and non-audit fees of $20,000 (2007 – $19,500). Audit fees of $418,500 (2007 – $457,000) and non-audit fees of $103,000 (2007 – $58,000) were paid and accrued to the internal auditors of PSP Investments.

During the year, advisory fees of $87,000 were paid to Mercer Human Resource Consulting (2007 – $44,000) for compensation-related matters.

Total remuneration earned by Directors in fiscal year 2008 includes: 1) an annual retainer of $90,000 for the Board Chairperson and $25,000 for each Director including the Chairperson; 2) an annual retainer of $7,500 for each committee chair; 3) Board meeting fees of $1,500 per meeting ($500 for meetings less than one hour); 4) Committee meeting fees of $1,000 per meeting ($500 for meetings less than one hour); and 5) a travel time meeting fee of $1,000 if the Director's primary residence is outside Quebec and Ontario at the time of the meeting. Separate fees are not paid for investment committee meetings when they are held concurrently with Board meetings. The Board Chairperson is not eligible for Board and committee meeting fees. In addition to remuneration, Directors are reimbursed for travel and accommodation expenses incurred in attending Board and committee meetings.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2008

10. ALLOCATION OF NET INCOME FROM OPERATIONS AND COMPREHENSIVE INCOME

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

(a) Investment Income

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

(b) Expenses

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

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

	2008	2007
Public Service Pension Plan Account	**72.6%**	72.4%
Canadian Forces Pension Plan Account	**20.1**	20.4
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.1**	n.a.
	100.0%	100.0%

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended March 31, 2008

11. PSP CAPITAL INC.

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

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

The operating expenses incurred by PSP Capital Inc., were allocated to each plan account as described in Note 10 (b).

12. GUARANTEES AND INDEMNITY

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

As 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, PSP Investments would assume the obligation up to $403 million plus interest and other related costs.

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

13. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, 2008, the outstanding commitments in private equity-related, real estate-related, infrastructure-related and public market-related investments amounted to $7,762 million ($4,349 million for private equity investments, $2,035 million for real estate investments, $855 million for a public market investment and $523 million for infrastructure investments).

Public Service Pension Plan Account

AUDITORS' REPORT

To the President of the Treasury Board

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

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Public Service Pension Plan Account as at March 31, 2008 and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied, except for the change in the method of accounting for financial instruments as explained in Note 2 to the financial statements, on a basis consistent with that of the preceding year.

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

Deloitte & Touche LLP

Chartered Accountants

Montreal, Canada
May 2, 2008

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 2, 2008

Public Service Pension Plan Account

BALANCE SHEET

As at March 31

($ millions)	2008	2007
ASSETS		
Investments (Note 3 (a))	$ 30,620	$ 25,940
Investment-related assets (Note 3 (a))	1,693	1,401
Other assets	13	7
Due from the Canadian Forces Pension Plan Account (Note 7)	12	2
Due from the Royal Canadian Mounted Police Pension Plan Account (Note 7)	4	1
TOTAL ASSETS	$ 32,342	$ 27,351
LIABILITIES		
Investment-related liabilities (Note 3 (a))	$ 4,019	$ 1,914
Accounts payable and accrued liabilities	59	27
	4,078	1,941
NET ASSETS	$ 28,264	$ 25,410
Accumulated net income from operations and comprehensive income	$ 7,131	$ 7,334
Accumulated fund transfers	21,133	18,076
NET ASSETS	$ 28,264	$ 25,410

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

Public Service Pension Plan Account

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

For the year ended March 31

($ millions)	2008	2007
INVESTMENT INCOME (LOSS) (Note 5)		
Interest, dividends and other income	$ 829	$ 743
Net realized gains	1,138	1,597
Change in unrealized appreciation (depreciation) in value of investments	(2,065)	177
	(98)	2,517
EXPENSES		
Operating expenses (Note 7)	56	38
External investment management fees	45	37
	101	75
NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME	(199)	2,442
Accumulated net income from operations and comprehensive income, beginning of year (as previously reported)	7,334	4,892
Change in accounting policy – financial instruments (Note 2)	(4)	–
Accumulated net income from operations and comprehensive income, beginning of year (as restated)	7,330	4,892
Accumulated net income from operations and comprehensive income, end of year	$ 7,131	$ 7,334

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

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2008	2007
NET ASSETS, BEGINNING OF YEAR (as previously reported)	$ 25,410	$ 19,997
Change in accounting policy – financial instruments (Note 2)	(4)	–
NET ASSETS, BEGINNING OF YEAR (as restated)	$ 25,406	$ 19,997
Fund transfers (Note 4)	3,057	2,971
Net income (loss) from operations and comprehensive income	(199)	2,442
Increase in net assets for the year	2,858	5,413
NET ASSETS, END OF YEAR	$ 28,264	$ 25,410

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

Public Service Pension Plan Account

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Valuation of Investments

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

Fair values of investments are determined as follows:

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

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

Unit values, reflecting the quoted market prices, using the bid price for long positions and the ask price for short positions of the underlying securities, are used to present the fair value of pooled funds.

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

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

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

(f) All listed derivative financial instruments are recorded at fair value using quoted market prices with the bid price for long positions and the ask price for short positions. For derivatives traded over-the-counter (OTC), appropriate valuation techniques, such as discounted cash flows using current market yields, are used to determine fair value.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

Investment income is made up of dividends, accrued interest income, realized gains and losses on the disposal of investments and 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 Public Service Pension Fund are recorded in its respective plan account.

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

2. CHANGES IN ACCOUNTING POLICIES

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

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

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

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

Future Accounting Changes

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

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

3. INVESTMENTS

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

($ millions)	2008		2007	
Asset Class	Fair Value	Cost	Fair Value	Cost
Developed World Equity				
Canadian Equity	$ 5,427	$ 5,053	$ 4,732	$ 3,771
US Large Cap Equity	1,109	1,267	1,572	1,419
EAFE Large Cap Equity	1,339	1,429	1,251	1,019
Small Cap Developed World Equity	1,032	1,213	1,615	1,479
Emerging Markets Equity	1,344	1,183	1,370	1,117
Private Equity	2,967	2,873	1,207	1,207
Nominal Fixed Income				
Cash Equivalents	2,215	2,211	1,658	1,681
World Government Bonds	1,301	1,307	1,281	1,311
Canadian Fixed Income	6,005	6,309	6,178	6,194
Real Return Assets				
World Inflation-linked Bonds	105	99	217	204
Real Estate	3,846	3,056	2,959	2,618
Infrastructure	1,141	1,118	355	333
Absolute Return	2,789	2,839	1,545	1,499
INVESTMENTS	$ 30,620	$ 29,957	$ 25,940	$ 23,852
Investment-Related Assets				
Amounts receivable from pending trades	$ 1,293	$ 1,290	$ 1,185	$ 1,166
Derivative-related receivables	400	62	216	51
Total investment-related assets	$ 1,693	$ 1,352	$ 1,401	$ 1,217
Investment-Related Liabilities				
Amounts payable from pending trades	$ (1,438)	$ (1,440)	$ (1,020)	$ (1,019)
Securities sold short	(528)	(542)	(386)	(394)
Derivative-related payables	(926)	(38)	(143)	(43)
Capital debt financing (Note 8)	(1,127)	(1,127)	(365)	(365)
Total investment-related liabilities	$ (4,019)	$ (3,147)	$ (1,914)	$ (1,821)
NET INVESTMENTS	$ 28,294	$ 28,162	$ 25,427	$ 23,248

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 $1,432 million has been allocated to the Plan, of third-party or non-bank sponsored asset backed commercial paper ("ABCP") that suffered a liquidity disruption in mid-August 2007. The maturity dates of these ABCPs range from August 13, 2007 to December 28, 2008. At the dates at which PSP Investments acquired the investments, the non-bank sponsored ABCP were rated R-1 (high) by DBRS Limited ("DBRS"), the highest credit rating for commercial paper. The ABCP last traded in the active market on or about August 13, 2007, and currently there are no market quotations available for the ABCP.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(a) Investment Portfolio (continued)

Under the Investors' Committee restructuring plan, the LSS/Hybrid Assets will be split into two separate and distinct master asset vehicles ("MAV"); the first, currently referred to as MAV1, in which case investors will self insure and separately commit to fund margin calls under existing leveraged super senior swaps up to their pro rata share; and the second, referred to as MAV2, whereby investors will be able to draw on a margin funding facility to be provided by certain investors, foreign banks and Canadian banks. PSP Investments will be participating in MAV1. Within the MAV1, the LSS/Hybrid assets will be further restructured into different classes (Class A-1, Class A-2, Class B and Class C) of floating rate notes in order to permit a credit rating to be obtained on two of these notes (Class A-1 and Class A-2). A third MAV, referred to as MAV3, will include series secured exclusively by Traditional Assets ("TA") or by Ineligible Assets ("IA").

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

The successful restructuring scenario uses the restructured notes, as contemplated under the Framework Agreement, as a proxy measure to value the current ABCP holdings. A successful restructuring scenario would result in PSP Investments receiving a mix of Class A-1, Class A-2, Class B and Class C floating rate notes in connection with MAV1 and TA and IA tracking notes in connection with MAV3. Under the Investors' Committee restructuring plan, PSP Investments estimates that the Plan will receive $633 million of MAV1 Class A-1 notes, $436 million of MAV1 Class A-2 notes, $75 million of MAV1 Class B notes, $35 million of MAV1 Class C notes, $104 million of MAV3 TA tracking notes and $149 million of MAV3 IA tracking notes. The MAV1 notes are expected to return approximately Banker's Acceptance ("BA") + 30 bps. The TA tracking notes and the IA tracking notes will reflect the net return and maturity of the respective series' underlying assets. For the purpose of valuation, the restructured floating rate notes of MAV1 were proxied to comparable 7-year floating rate notes as at March 31, 2008. The Class A-1 and Class A-2 notes are expected to be AA-rated and the Class B and Class C notes, while not expected to be rated, were established at a credit rating of BBB for valuation purposes, and accordingly, were proxied to floating rate notes with similar credit quality and terms. TA tracking notes were assumed to be AAA-rated and to have a maturity of 9 years and a return of BA + 40 bps. The TA tracking notes were proxied to comparable floating rate notes as at March 31, 2008. The IA tracking notes contain principally assets that have exposure to US subprime loans and mortgages. A valuation of the IA tracking notes was performed based on the credit quality of the underlying assets.

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

3. INVESTMENTS (continued)

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

Based on the above valuation methodology, management's best estimate of the fair value of the Plan's ABCP as at March 31, 2008, is equal to approximately $1,105 million, representing a write-down of approximately $327 million.

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

The fair value was established as a function of the information available as at March 31, 2008, which includes certain assumptions used in the valuation model such as interest rate spreads, assumed credit rating of restructured notes, expected returns and maturity of restructured notes. Varying certain key elements of the valuation technique will have an impact on the write-down on ABCP as at March 31, 2008. For example, increasing interest rate spreads by 50 bps will increase the provision by $51 million for the Plan; extending the maturity term by one year would increase the provision by $40 million for the Plan. The fair value of ABCP may change in future periods as a result of fluctuations in the major elements of the valuation methodology.

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

Notional values are not recorded as assets or liabilities as they represent the face amount of the contract to which a rate or price is applied in order to calculate the exchange of cash flows. Notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions. Rather, it serves as the basis upon which the cash flows and the fair value of the contracts are determined.

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(b) Derivative Financial Instruments (continued)

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

($ millions)		2008		2007	
INVESTMENTS		Notional Value	Fair Value	Notional Value	Fair Value
Equity and Commodity Derivatives					
Futures [2]		$ 636	$ 6	$ 1,252	$ 4
Total Return Swaps [2]		3,746	(30)	3,148	37
Variance Swaps		166	(2)	499	(2)
Warrants		27	7	33	5
Options:	Listed-purchased	137	4	69	1
	Listed-written	143	(5)	89	(2)
	OTC-purchased [1]	–	–	534	53
	OTC-written	–	–	80	(2)
Currency Derivatives					
Forwards		10,422	(133)	8,133	–
Swaps		605	(52)	526	(9)
Options:	OTC-purchased	1,256	24	633	6
	OTC-written	666	(20)	99	–
Interest Rate Derivatives					
Bond forwards		2,008	2	1,553	6
Futures [2]		1,035	–	425	–
Interest Rate Swaps		3,987	12	1,410	5
Inflation Swaps		–	–	142	–
Total Return Swaps [2]		2,444	11	1,760	(12)
Swaptions		5,241	–	–	–
Options:	Listed-purchased	631	1	369	2
	Listed-written	892	(2)	369	(2)
Credit Derivatives					
Swaps:	Purchased	46	21	50	6
	Written	980	(370)	1,071	(23)
		$ 35,068	$ (526)	$ 22,244	$ 73

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

(2) As at March 31, 2008, some futures and total return swaps have been equitized by fixed income securities and other assets in the amount of $6.8 billion (2007 – $5.7 billion).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(b) Derivative Financial Instruments (continued)

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

($ millions)	2008	2007
Derivative-related receivables	$ 400	$ 216
Derivative-related payables	(926)	(143)
	$ (526)	$ 73

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

($ millions)	2008	2007
Under 1 year	$ 25,111	$ 17,678
1 to 5 years	8,523	3,362
Over 5 years	1,434	1,204
	$ 35,068	$ 22,244

(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 only 3.4%. This is offset by an overweight in the Canadian fixed income asset class.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(c) Investment Asset Mix (continued)

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

($ millions)	2008			2007		
Asset Class	Fair Value		Policy Portfolio	Fair Value		Policy Portfolio
Developed World Equity						
Canadian Equity	$ 8,377	29.6%	30.0%	$ 7,504	29.5%	30.0%
US Large Cap Equity	1,280	4.5	5.0	1,815	7.1	5.0
EAFE Large Cap Equity	1,329	4.7	5.0	1,250	4.9	5.0
Small Cap Developed World Equity	1,401	5.0	5.0	2,133	8.4	7.0
Emerging Markets Equity	1,979	7.0	7.0	1,817	7.1	7.0
Private Equity	2,884	10.2	10.0	1,212	4.8	8.0
Nominal Fixed Income						
Cash Equivalents	1,123	4.0	2.0	282	1.1	2.0
World Government Bonds	1,632	5.8	5.0	1,208	4.8	5.0
Canadian Fixed Income	3,521	12.4	8.0	3,942	15.5	8.0
Real Return Assets						
World Inflation-linked Bonds	1,605	5.7	5.0	1,245	4.9	5.0
Real Estate	2,925	10.3	10.0	2,613	10.3	10.0
Infrastructure	975	3.4	8.0	348	1.4	8.0
Absolute Return	(737)	(2.6)	n.a.	58	0.2	n.a.
NET INVESTMENTS	$ 28,294	100.0%	100.0%	$ 25,427	100.0%	100.0%

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

In addition to the different asset classes outlined in the asset mix policy, PSP Investments employs a number of absolute return strategies, consisting of derivative financial products such as those in Note 3 (b), to enhance returns by changing the investment asset mix, enhancing equity and fixed income portfolio returns and managing foreign currency exposures.

(d) Investment Risk Management

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(d) Investment Risk Management (continued)

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

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

(e) Foreign Currency Risk

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

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

	2008		2007	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
(in Canadian $)	($ millions)		($ millions)	
US Dollar	**$ 4,227**	**52.8%**	$ 4,529	53.7%
Euro	**1,666**	**20.8**	1,479	17.5
British Pound	**666**	**8.3**	585	6.9
Yen	**464**	**5.8**	512	6.1
Brazilian Real	**313**	**3.9**	198	2.3
Others	**676**	**8.4**	1,139	13.5
	$ 8,012	**100.0%**	$ 8,442	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 $5,204 million ($3,852 million US, €738 million and £25 million) which are not included in the foreign currency exposure table above.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(f) Credit Risk

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

As at March 31, 2008, the Plan's highest concentration of credit risk is with the Government of Canada through holdings of $1.6 billion of Government of Canada issued securities. In order to minimize derivative contract credit risk, PSP Investments deals only with counterparties that are major financial institutions with a minimum credit rating of "A" as at the trade date, as supported by a recognized credit rating agency by utilizing an internal credit-limit monitoring process, as well as through the use of credit mitigation techniques such as master-netting arrangements (which provide for certain rights of offset) and obtaining collateral, including the use of credit-support annexes, where appropriate.

(g) Market Risk

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, volatility in share and commodity prices, interest rate, foreign exchange or other risk variables affecting all securities traded in the market. PSP Investments has a diversification strategy to mitigate risk whereby it invests in a diversified portfolio of investments based on the criteria established in its SIP&P. Derivative financial instruments, traded either on exchanges or over the counter, are also used to mitigate the impact of market risk.

Market risk is measured using the method known as Value at Risk (VaR). VaR is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. PSP Investments has chosen a yearly 95% confidence interval to measure and report VaR. Generally, changes in VaR between reporting periods are due to changes in the level of exposure, volatilities and/or correlations among asset classes. Although VaR is a widely-accepted risk measure, it must be complemented by other risk measures. PSP Investments therefore uses stress testing and scenario analysis to examine the impact on financial results of abnormally large movements in risk factors.

(h) Interest Rate Risk

Interest rate risk refers to the effect on the fair value of PSP Investments' net asset value due to fluctuations in interest rates. Changes in interest rates will directly affect the fair value of PSP Investments' assets.

As at March 31, 2008, the fixed income asset class was managed with an average duration of 6.1 years (2007 – 5.7 years). An increase of 1% in interest rates would result in a decline in the value of the fixed income securities of 6.1%, or $211 million.

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

3. INVESTMENTS (continued)

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

	Terms to Maturity					
($ millions)	Within 1 Year	1 to 5 Years	6 to 10 Years	Over 10 Years	2008 Total	2007 Total
Government of Canada bonds	$ –	$ 810	$ 178	$ 303	$ 1,291	$ 1,599
Provincial and Territorial bonds	36	236	270	431	973	1,113
Municipal bonds	–	57	26	4	87	69
Corporate bonds	78	424	326	342	1,170	1,164
Total	$ 114	$ 1,527	$ 800	$ 1,080	$ 3,521	$ 3,945

(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 $3,701 million (2007 – $3,075 million) were loaned out, while securities contractually receivable as collateral had an estimated fair value of $3,842 million (2007 – $3,213 million).

(k) Securities Collateral
The Plan deposited or pledged securities with a fair value of $298 million (2007 – $71 million) as collateral with various financial institutions. Securities with a fair value of $23 million (2007 – $342 million) have been received from various financial institutions as collateral.

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

3. INVESTMENTS (continued)

(l) Private Market Investments
PSP Investments' real estate asset class is comprised of investments which are owned by either PSP Investments or its wholly-owned subsidiaries and managed by general partners or external advisors. The underlying investments comprise a diversified portfolio of income-producing properties, third party loans and public and private funds. The real estate asset class is accounted for in the investment portfolio net of all financings. The fair market value of financings in the real estate portfolio generally will not exceed 50% of the gross fair market value of the portfolio. As at March 31, 2008, the total amount of financing included in the real estate portfolio for direct investments controlled by PSP Investments is approximately $2,100 million.

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

PSP Investments' infrastructure asset class is comprised of investments which are owned by either PSP Investments or its wholly-owned subsidiaries and managed by general partners or external advisors. The underlying investments comprise a diversified portfolio of infrastructure assets and publicly-traded securities. As at March 31, 2008, the total amount of financing included in the infrastructure portfolio for direct investments controlled by PSP Investments is approximately $250 million.

Investment management and performance incentive fees are generally incurred for the above private market investments and are paid either by the investment directly, through capital contributions from PSP Investments or offset against distributions received from the investment. Investment management fees in private market investments generally vary between 0.2% and 5.5% of the total invested amount. For the year ended March 31, 2008, investment management fees of $91 million (2007 – $44 million) were recorded either as part of the cost of the private market investments or against investment income.

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

4. FUND TRANSFERS

During the year, PSP Investments received fund transfers of $3,057 million (2007 – $2,971 million) from the Public Service Pension Fund. The transfers received are comprised of net current employer and employee contributions to the Public Service pension plan in respect of member service after April 1, 2000.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

5. INVESTMENT INCOME

(a) Investment Income

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

($ millions)	2008	2007
Interest income	$ 490	$ 333
Dividend income	269	220
Other income	79	186
Security lending income	7	4
Transaction costs	(16)	–
	829	743
Net realized gains	1,138	1,597
Net unrealized gains (losses)	(2,065)	177
Investment income (loss)	$ (98)	$ 2,517

(b) Investment Income by Asset Mix

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

($ millions)	2008	2007
Developed World Equity		
Canadian Equity	$ 176	$ 943
US Large Cap Equity	(337)	166
EAFE Large Cap Equity	(172)	343
Small Cap Developed World	(454)	95
Emerging Markets Equity	132	283
Private Equity	190	(3)
Nominal Fixed Income		
Cash Equivalents	41	16
World Government Bonds	121	(32)
Canadian Fixed Income	214	206
Real Return Assets		
World Inflation-linked Bonds	57	(20)
Real Estate	548	473
Infrastructure	20	13
Absolute return	(634)	34
Investment income (loss)	$ (98)	$ 2,517

Investment income includes foreign currency realized losses of $424 million (2007 – $95 million) and foreign currency unrealized losses of $271 million (2007 – $322 million).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

6. INVESTMENT PERFORMANCE

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

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

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

The internal rate of return methodology is used to calculate the returns for the real estate, private equity and infrastructure asset classes for the years ended March 31, 2008 and March 31, 2007.

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

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

The total portfolio return includes the performance impact of absolute return strategies. Hedging investment returns are either netted against the return of the respective hedged assets, as is the case with private asset classes, or included in total return, as in the case of public markets.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

7. EXPENSES

(a) Allocation of Expenses

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

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

	2008	2007
Public Service Pension Plan Account	**72.6%**	72.4%
Canadian Forces Pension Plan Account	**20.1**	20.4
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.1**	n.a.
	100.0%	100.0%

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

(b) Operating Expenses

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

($ thousands)	**2008**	2007
Salaries and benefits	**$ 25,107**	$ 20,576
Professional and consulting fees	**14,889**	6,533
Office supplies and equipment	**4,997**	4,120
Other operating expenses	**4,549**	2,219
Depreciation of fixed assets	**2,315**	1,101
Occupancy costs	**1,832**	1,313
Custodial fees	**1,482**	1,189
Remuneration earned by Directors	**553**	520
Communication expenses	**118**	86
Travel and related expenses for Directors	**117**	127
	$ 55,959	$ 37,784

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

8. PSP CAPITAL INC.

As at March 31, 2008, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $1,551 million (2007 – $503 million) of short term promissory notes outstanding with maturity dates within 32 to 364 days of issuance, of which $1,127 million (2007 – $365 million) has been allocated to the Public Service Pension Plan Account and included in Note 3 (a) as investment-related liability. The maximum authorized by the Board of the Directors for the short term and medium term notes is $3 billion and $1 billion, respectively. As at March 31, 2008, there are no medium term notes issued and outstanding. The capital raised was used primarily to finance real estate and infrastructure investments and is unconditionally and irrevocably guaranteed by PSP Investments.

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

The operating expenses incurred by PSP Capital Inc. were allocated to each plan account as described in Note 7 (a) and includes interest expenses on the short term promissory notes of $37 million (2007 – $13 million).

9. GUARANTEES AND INDEMNITY

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

As at March 31, 2008, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan would assume the obligation up to $292 million plus interest and other related costs.

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

10. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, 2008, the outstanding commitments in private equity-related, real estate-related, infrastructure-related and public market-related investments amounted to $5,635 million ($3,157 million for private equity investments, $1,477 million for real estate investments, $621 million for a public market investment and $380 million for infrastructure investments).

Canadian Forces Pension Plan Account

AUDITORS' REPORT

To the Minister of National Defence

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

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Canadian Forces Pension Plan Account as at March 31, 2008 and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied, except for the change in the method of accounting for financial instruments as explained in Note 2 to the financial statements, on a basis consistent with that of the preceding year.

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

Deloitte & Touche LLP

Chartered Accountants

Montreal, Canada
May 2, 2008

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 2, 2008

Canadian Forces Pension Plan Account

BALANCE SHEET

As at March 31

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

Commitments (Note 10)

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

On behalf of the Board of Directors:

Paul Cantor
Chairman

Keith Martell
Director and Chair of the
Audit and Conflicts Committee

Canadian Forces Pension Plan Account

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

For the year ended March 31

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

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

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

ORGANIZATION

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

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Valuation of Investments

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

Fair values of investments are determined as follows:

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

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

Unit values, reflecting the quoted market prices, using the bid price for long positions and the ask price for short positions of the underlying securities, are used to present the fair value of pooled funds.

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

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

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

(f) All listed derivative financial instruments are recorded at fair value using quoted market prices with the bid price for long positions and the ask price for short positions. For derivatives traded over-the-counter (OTC), appropriate valuation techniques, such as discounted cash flows using current market yields, are used to determine fair value.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Transaction Costs

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

Income Recognition

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

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

Translation of Foreign Currencies

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

Fund Transfers

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

Income Taxes

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

Use of Estimates

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

2. CHANGES IN ACCOUNTING POLICIES

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

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

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

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

Future Accounting Changes

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS

(a) Investment Portfolio

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(a) Investment Portfolio (continued)

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(a) Investment Portfolio (continued)

Under the Investors' Committee restructuring plan, the LSS/Hybrid Assets will be split into two separate and distinct master asset vehicles ("MAV"); the first, currently referred to as MAV1, in which case investors will self insure and separately commit to fund margin calls under existing leveraged super senior swaps up to their pro rata share; and the second, referred to as MAV2, whereby investors will be able to draw on a margin funding facility to be provided by certain investors, foreign banks and Canadian banks. PSP Investments will be participating in MAV1. Within the MAV1, the LSS/Hybrid assets will be further restructured into different classes (Class A-1, Class A-2, Class B and Class C) of floating rate notes in order to permit a credit rating to be obtained on two of these notes (Class A-1 and Class A-2). A third MAV, referred to as MAV3, will include series secured exclusively by Traditional Assets ("TA") or by Ineligible Assets ("IA").

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(a) Investment Portfolio (continued)

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

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

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

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

(b) Derivative Financial Instruments

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

Notional values are not recorded as assets and liabilities as they represent the face amount of the contract to which a rate or price is applied in order to calculate the exchange of cash flows. Notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions. Rather, it serves as the basis upon which the cash flows and the fair value of the contracts are determined.

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(b) Derivative Financial Instruments (continued)

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

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

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

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

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

3. INVESTMENTS (continued)

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

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

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

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

(c) Investment Asset Mix
The Statement of Investment Policies, Standards and Procedures (“SIP&P”) sets out the manner in which the assets shall be invested for the four Plan Accounts. Investments are classified by asset mix category as set out in the SIP&P based on the economic intent of the investment strategies of the underlying assets. Differences between the actual asset mix and the policy portfolio targets are due principally to target weights of certain asset classes which have yet to be attained. For instance, the infrastructure asset class has a policy portfolio target weight of 8.0% and an actual asset weight of only3.4%. This is offset by an overweight in the Canadian fixed income asset class.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(c) Investment Asset Mix (continued)

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

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

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

In addition to the different asset classes outlined in the asset mix policy, PSP Investments employs a number of absolute return strategies, consisting of derivative financial products such as those in Note 3 (b), to enhance returns by changing the investment asset mix, enhancing equity and fixed income portfolio returns and managing foreign currency exposures.

(d) Investment Risk Management

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(d) Investment Risk Management (continued)

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

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

(e) Foreign Currency Risk

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(f) Credit Risk

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

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

(g) Market Risk

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, volatility in share and commodity prices, interest rate, foreign exchange or other risk variables affecting all securities traded in the market. PSP Investments has a diversification strategy to mitigate risk whereby it invests in a diversified portfolio of investments based on the criteria established in its SIP&P. Derivative financial instruments, traded either on exchanges or over the counter, are also used to mitigate the impact of market risk.

Market risk is measured using the method known as Value at Risk (VaR). VaR is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. PSP Investments has chosen a yearly 95% confidence interval to measure and report VaR. Generally, changes in VaR between reporting periods are due to changes in the level of exposure, volatilities and/or correlations among asset classes. Although VaR is a widely-accepted risk measure, it must be complemented by other risk measures. PSP Investments therefore uses stress testing and scenario analysis to examine the impact on financial results of abnormally large movements in risk factors.

(h) Interest Rate Risk

Interest rate risk refers to the effect on the fair value of PSP Investments' net asset value due to fluctuations in interest rates. Changes in interest rates will directly affect the fair value of PSP Investments' assets.

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

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

3. INVESTMENTS (continued)

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

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

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

(j) Securities Lending
The Plan participates in securities lending programs whereby it lends securities in order to enhance portfolio returns. Any such securities lending requires collateral in cash, high quality debt instruments or shares securities with a fair value equal to no less than 102% of the value of the securities lent. As at March 31, 2008, securities with an estimated fair value of $1,024 million (2007 – $842 million) were loaned out, while securities contractually receivable as collateral had an estimated fair value of $1,064 million (2007 – $880 million).

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(l) Private Market Investments

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

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

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

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

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

4. FUND TRANSFERS

During the year, PSP Investments received fund transfers of $842 million (2007 – $738 million) from the Canadian Forces Pension Fund. The transfers received are comprised of net current employer and employee contributions to the Canadian Forces pension plan in respect of member service after April 1, 2000.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

5. INVESTMENT INCOME

(a) Investment Income

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

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

(b) Investment Income by Asset Mix

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

6. INVESTMENT PERFORMANCE

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

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

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

The internal rate of return methodology is used to calculate the returns for the real estate, private equity and infrastructure asset classes for the years ended March 31, 2008 and March 31, 2007.

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

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

The total portfolio return includes the performance impact of absolute return strategies. Hedging investment returns are either netted against the return of the respective hedged assets, as is the case with private asset classes, or included in total return, as in the case of public markets.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

7. EXPENSES

(a) Allocation of Expenses

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

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

	2008	2007
Public Service Pension Plan Account	**72.6%**	72.4%
Canadian Forces Pension Plan Account	**20.1**	20.4
Royal Canadian Mounted Police Pension Plan Account	**7.2**	7.2
Reserve Force Pension Plan Account	**0.1**	n.a.
	100.0%	100.0%

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

(b) Operating Expenses

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

8. PSP CAPITAL INC.

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

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

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

9. GUARANTEES AND INDEMNITY

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

As at March 31, 2008, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan would assume the obligation up to $81 million plus interest and other related costs.

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

10. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, 2008, the outstanding commitments in private equity-related, real estate-related, infrastructure-related and public market-related investments amounted to $1,560 million ($874 million for private equity investments, $409 million for real estate investments, $172 million for a public market investment and $105 million for infrastructure investments).

Royal Canadian Mounted Police Pension Plan Account

AUDITORS' REPORT

To the Minister of Public Safety

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

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Royal Canadian Mounted Police Pension Plan Account as at March 31, 2008 and the results of its operations and changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied, except for the change in the method of accounting for financial instruments as explained in Note 2 to the financial statements, on a basis consistent with that of the preceding year.

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

Deloitte & Touche LLP

Chartered Accountants

Montreal, Canada
May 2, 2008

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
May 2, 2008

Royal Canadian Mounted Police Pension Plan Account

BALANCE SHEET

As at March 31

($ millions)		2008		2007
ASSETS				
Investments (Note 3 (a))	$	3,020	$	2,579
Investment-related assets (Note 3 (a))		167		139
Other assets		1		1
TOTAL ASSETS	$	3,188	$	2,719
LIABILITIES				
Investment-related liabilities (Note 3(a))	$	396	$	190
Accounts payable and accrued liabilities		1		3
Due to the Public Service Pension Plan Account (Note 7)		4		1
		401		194
NET ASSETS	$	2,787	$	2,525
Accumulated net income from operations and comprehensive income	$	721	$	741
Accumulated fund transfers		2,066		1,784
NET ASSETS	$	2,787	$	2,525

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

Royal Canadian Mounted Police Pension Plan Account

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

For the year ended March 31

($ millions)	2008	2007
INVESTMENT INCOME (LOSS) (Note 5)		
Interest, dividends and other income	$ 80	$ 74
Net realized gains	109	160
Change in unrealized appreciation (depreciation) in value of investments	(198)	17
	(9)	251
EXPENSES		
Operating expenses (Note 7)	6	4
External investment management fees	4	3
	10	7
NET INCOME (LOSS) FROM OPERATIONS AND COMPREHENSIVE INCOME	(19)	244
Accumulated net income from operations and comprehensive income, beginning of year (as previously reported)	741	497
Change in accounting policy – financial instruments (Note 2)	(1)	–
Accumulated net income from operations and comprehensive income, beginning of year (as restated)	740	497
Accumulated net income from operations and comprehensive income, end of year	$ 721	$ 741

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

STATEMENT OF CHANGES IN NET ASSETS

For the year ended March 31

($ millions)	2008	2007
NET ASSETS, BEGINNING OF YEAR (as previously reported)	$ 2,525	$ 2,000
Change in accounting policy – financial instruments (Note 2)	(1)	–
NET ASSETS, BEGINNING OF YEAR (as restated)	$ 2,524	$ 2,000
Fund transfers (Note 4)	282	281
Net income (loss) from operations and comprehensive income	(19)	244
Increase in net assets for the year	263	525
NET ASSETS, END OF YEAR	$ 2,787	$ 2,525

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Fair values of investments are determined as follows:

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

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

Unit values, reflecting the quoted market prices, using the bid price for long positions and the ask price for short positions of the underlying securities, are used to present the fair value of pooled funds.

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

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

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

(f) All listed derivative financial instruments are recorded at fair value using quoted market prices with the bid price for long positions and the ask price for short positions. For derivatives traded over-the-counter (OTC), appropriate valuation techniques, such as discounted cash flows using current market yields, are used to determine fair value.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Transaction Costs

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

Income Recognition

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

Investment income is made up of dividends, accrued interest income, realized gains and losses on the disposal of investments and 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 Royal Canadian Mounted Police Pension Fund are recorded in its respective plan account.

Income Taxes

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

Use of Estimates

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

2. CHANGES IN ACCOUNTING POLICIES

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

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

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

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

Future Accounting Changes

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS

(a) Investment Portfolio

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

($ millions)	2008		2007	
Asset Class	Fair Value	Cost	Fair Value	Cost
Developed World Equity				
Canadian Equity	$ 535	$ 493	$ 470	$ 375
US Large Cap Equity	109	124	156	141
EAFE Large Cap Equity	132	141	124	101
Small Cap Developed World Equity	102	119	161	147
Emerging Markets Equity	133	118	137	111
Private Equity	293	283	120	120
Nominal Fixed Income				
Cash Equivalents	218	218	165	167
World Government Bonds	128	130	127	130
Canadian Fixed Income	592	621	614	616
Real Return Assets				
World Inflation-linked Bonds	10	10	22	20
Real Estate	379	301	294	260
Infrastructure	113	110	35	33
Absolute Return	276	279	154	150
INVESTMENTS	$ 3,020	$ 2,947	$ 2,579	$ 2,371
Investment-Related Assets				
Amounts receivable from pending trades	$ 127	$ 127	$ 118	$ 115
Derivative-related receivables	40	6	21	5
Total investment-related assets	$ 167	$ 133	$ 139	$ 120
Investment-Related Liabilities				
Amounts payable from pending trades	$ (142)	$ (142)	$ (101)	$ (101)
Securities sold short	(52)	(53)	(39)	(39)
Derivative-related payables	(92)	(4)	(14)	(4)
Capital debt financing (Note 8)	(110)	(110)	(36)	(36)
Total investment-related liabilities	$ (396)	$ (309)	$ (190)	$ (180)
NET INVESTMENTS	$ 2,791	$ 2,771	$ 2,528	$ 2,311

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 $141 million has been allocated to the Plan, of third-party or non-bank sponsored asset backed commercial paper ("ABCP") that suffered a liquidity disruption in mid-August 2007. The maturity dates of these ABCPs range from August 13, 2007 to December 28, 2008. At the dates at which PSP Investments acquired the investments, the non-bank sponsored ABCP were rated R-1 (high) by DBRS Limited ("DBRS"), the highest credit rating for commercial paper. The ABCP last traded in the active market on or about August 13, 2007, and currently there are no market quotations available for the ABCP.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(a) Investment Portfolio (continued)

Under the Investors' Committee restructuring plan, the LSS/Hybrid Assets will be split into two separate and distinct master asset vehicles ("MAV"); the first, currently referred to as MAV1, in which case investors will self insure and separately commit to fund margin calls under existing leveraged super senior swaps up to their pro rata share; and the second, referred to as MAV2, whereby investors will be able to draw on a margin funding facility to be provided by certain investors, foreign banks and Canadian banks. PSP Investments will be participating in MAV1. Within the MAV1, the LSS/Hybrid assets will be further restructured into different classes (Class A-1, Class A-2, Class B and Class C) of floating rate notes in order to permit a credit rating to be obtained on two of these notes (Class A-1 and Class A-2). A third MAV, referred to as MAV3, will include series secured exclusively by Traditional Assets ("TA") or by Ineligible Assets ("IA").

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

The successful restructuring scenario uses the restructured notes, as contemplated under the Framework Agreement, as a proxy measure to value the current ABCP holdings. A successful restructuring scenario would result in PSP Investments receiving a mix of Class A-1, Class A-2, Class B and Class C floating rate notes in connection with MAV1 and TA and IA tracking notes in connection with MAV3. Under the Investors' Committee restructuring plan, PSP Investments estimates that the Plan will receive $62 million of MAV1 Class A-1 notes, $43 million of MAV1 Class A-2 notes, $7 million of MAV1 Class B notes, $4 million of MAV1 Class C notes, $10 million of MAV3 TA tracking notes and $15 million of MAV3 IA tracking notes. The MAV1 notes are expected to return approximately Banker's Acceptance ("BA") + 30 bps. The TA tracking notes and the IA tracking notes will reflect the net return and maturity of the respective series' underlying assets. For the purpose of valuation, the restructured floating rate notes of MAV1 were proxied to comparable 7-year floating rate notes as at March 31, 2008. The Class A-1 and Class A-2 notes are expected to be AA-rated and the Class B and Class C notes, while not expected to be rated, were established at a credit rating of BBB for valuation purposes, and accordingly, were proxied to floating rate notes with similar credit quality and terms. TA tracking notes were assumed to be AAA-rated and to have a maturity of 9 years and a return of BA + 40 bps. The TA tracking notes were proxied to comparable floating rate notes as at March 31, 2008. The IA tracking notes contain principally assets that have exposure to US subprime loans and mortgages. A valuation of the IA tracking notes was performed based on the credit quality of the underlying assets.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(a) Investment Portfolio (continued)

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

Based on the above valuation methodology, management's best estimate of the fair value of the Plan's ABCP as at March 31, 2008, is equal to approximately $109 million, representing a write-down of approximately $32 million.

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

The fair value was established as a function of the information available as at March 31, 2008, which includes certain assumptions used in the valuation model such as interest rate spreads, assumed credit rating of restructured notes, expected returns and maturity of restructured notes. Varying certain key elements of the valuation technique will have an impact on the write-down on ABCP as at March 31, 2008. For example, increasing interest rate spreads by 50 bps will increase the provision by $5 million for the Plan; extending the maturity term by one year would increase the provision by $4 million for the Plan. The fair value of ABCP may change in future periods as a result of fluctuations in the major elements of the valuation methodology.

(b) Derivative Financial Instruments

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

Notional values are not recorded as assets or liabilities as they represent the face amount of the contract to which a rate or price is applied in order to calculate the exchange of cash flows. Notional values do not represent the potential gain or loss associated with the market or credit risk of such transactions. Rather, it serves as the basis upon which the cash flows and the fair value of the contracts are determined.

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

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(b) Derivative Financial Instruments (continued)

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

($ millions)		2008		2007	
INVESTMENTS		Notional Value	Fair Value	Notional Value	Fair Value
Equity and Commodity Derivatives					
Futures (2)		$ 63	$ 1	$ 120	$ –
Total Return Swaps (2)		370	(3)	302	4
Variance Swaps		16	–	48	–
Warrants		3	1	3	–
Options:	Listed-purchased	13	–	7	–
	Listed-written	14	–	8	–
	OTC-purchased (1)	–	–	51	5
	OTC-written	–	–	8	–
Currency Derivatives					
Forwards		1,028	(13)	780	–
Swaps		60	(5)	50	(1)
Options:	OTC-purchased	124	2	61	1
	OTC-written	66	(2)	10	–
Interest Rate Derivatives					
Bond forwards		198	–	149	–
Futures (2)		102	–	41	–
Interest Rate Swaps		393	1	135	–
Inflation Swaps		–	–	14	–
Total Return Swaps (2)		241	1	169	(1)
Swaptions		517	–	–	–
Options:	Listed-purchased	62	–	35	–
	Listed-written	88	–	35	–
Credit Derivatives					
Swaps:	Purchased	4	2	5	1
	Written	97	(37)	103	(2)
		$ 3,459	$ (52)	$ 2,134	$ 7

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

(2) As at March 31, 2008, some futures and total return swaps have been equitized by fixed income securities and other assets in the amount of $0.7 billion (2007 – $0.5 billion).

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

3. INVESTMENTS (continued)

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

($ millions)	2008	2007
Derivative-related receivables	$ 40	$ 21
Derivative-related payables	(92)	(14)
	$ (52)	$ 7

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

($ millions)	2008	2007
Under 1 year	$ 2,477	$ 1,695
1 to 5 years	841	324
Over 5 years	141	115
	$ 3,459	$ 2,134

(c) Investment Asset Mix
The Statement of Investment Policies, Standards and Procedures ("SIP&P") sets out the manner in which the assets shall be invested for the four Plan Accounts. Investments are classified by asset mix category as set out in the SIP&P based on the economic intent of the investment strategies of the underlying assets. Differences between the actual asset mix and the policy portfolio targets are due principally to target weights of certain asset classes which have yet to be attained. For instance, the infrastructure asset class has a policy portfolio target weight of 8.0% and an actual asset weight of only3.4%. This is offset by an overweight in the Canadian fixed income asset class.

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

3. INVESTMENTS (continued)

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

($ millions)	2008			2007		
Asset Class	Fair Value		Policy Portfolio	Fair Value		Policy Portfolio
Developed World Equity						
Canadian Equity	$ 826	29.6%	30.0%	$ 746	29.5%	30.0%
US Large Cap Equity	127	4.5	5.0	180	7.1	5.0
EAFE Large Cap Equity	131	4.7	5.0	124	4.9	5.0
Small Cap Developed World Equity	138	5.0	5.0	212	8.4	7.0
Emerging Markets Equity	195	7.0	7.0	181	7.1	7.0
Private Equity	284	10.2	10.0	121	4.8	8.0
Nominal Fixed Income						
Cash Equivalents	111	4.0	2.0	28	1.1	2.0
World Government Bonds	161	5.8	5.0	120	4.8	5.0
Canadian Fixed Income	346	12.4	8.0	392	15.5	8.0
Real Return Assets						
World Inflation-linked Bonds	159	5.7	5.0	124	4.9	5.0
Real Estate	289	10.3	10.0	259	10.3	10.0
Infrastructure	96	3.4	8.0	35	1.4	8.0
Absolute Return	(72)	(2.6)	n.a.	6	0.2	n.a.
NET INVESTMENTS	$ 2,791	100.0%	100.0%	$ 2,528	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		2007	
Currency	**Fair Value**	**% of Total**	Fair Value	% of Total
(in Canadian $)	($ millions)		($ millions)	
US Dollar	**$ 417**	**52.8%**	$ 452	53.7%
Euro	**164**	**20.8**	147	17.5
British Pound	**66**	**8.3**	58	6.9
Yen	**46**	**5.8**	51	6.1
Brazilian Real	**31**	**3.9**	20	2.3
Others	**67**	**8.4**	113	13.5
	$ 791	**100.0%**	$ 841	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 $513 million ($380 million US, €73 million and £3 million) which are not included in the foreign currency exposure table above.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(f) Credit Risk

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

As at March 31, 2008, the Plan's highest concentration of credit risk is with the Government of Canada through holdings of $0.2 billion of Government of Canada issued securities. In order to minimize derivative contract credit risk, PSP Investments deals only with counterparties that are major financial institutions with a minimum credit rating of "A" as at the trade date, as supported by a recognized credit rating agency by utilizing an internal credit-limit monitoring process, as well as through the use of credit mitigation techniques such as master-netting arrangements (which provide for certain rights of offset) and obtaining collateral, including the use of credit-support annexes, where appropriate.

(g) Market Risk

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment, volatility in share and commodity prices, interest rate, foreign exchange or other risk variables affecting all securities traded in the market. PSP Investments has a diversification strategy to mitigate risk whereby it invests in a diversified portfolio of investments based on the criteria established in its SIP&P. Derivative financial instruments, traded either on exchanges or over the counter, are also used to mitigate the impact of market risk.

Market risk is measured using the method known as Value at Risk (VaR). VaR is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. PSP Investments has chosen a yearly 95% confidence interval to measure and report VaR. Generally, changes in VaR between reporting periods are due to changes in the level of exposure, volatilities and/or correlations among asset classes. Although VaR is a widely-accepted risk measure, it must be complemented by other risk measures. PSP Investments therefore uses stress testing and scenario analysis to examine the impact on financial results of abnormally large movements in risk factors.

(h) Interest Rate Risk

Interest rate risk refers to the effect on the fair value of PSP Investments' net asset value due to fluctuations in interest rates. Changes in interest rates will directly affect the fair value of PSP Investments' assets.

As at March 31, 2008, the fixed income asset class was managed with an average duration of 6.1 years (2007 – 5.7 years). An increase of 1% in interest rates would result in a decline in the value of the fixed income securities of 6.1%, or $21 million.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(h) Interest Rate Risk (continued)

The terms to maturity of the bonds held in the Canadian fixed income asset class, as at March 31, 2008, are as follows:

	Terms to Maturity					
($ millions)	Within 1 Year	1 to 5 Years	6 to 10 Years	Over 10 Years	2008 Total	2007 Total
Government of Canada bonds	$ –	$ 80	$ 18	$ 30	$ 128	$ 153
Provincial and Territorial bonds	4	23	27	42	96	106
Municipal bonds	–	6	3	–	9	6
Corporate bonds	8	42	32	34	116	127
Total	$ 12	$ 151	$ 80	$ 106	$ 349	$ 392

(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 $365 million (2007 – $295 million) were loaned out, while securities contractually receivable as collateral had an estimated fair value of $379 million (2007 – $308 million).

(k) Securities Collateral

The Plan deposited or pledged securities with a fair value of $29 million (2007 – $7 million) as collateral with various financial institutions. Securities with a fair value of $2 million (2007 – $33 million) have been received from various financial institutions as collateral.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

3. INVESTMENTS (continued)

(l) Private Market Investments

PSP Investments real estate asset class is comprised of investments which are owned by either PSP Investments or its wholly-owned subsidiaries and managed by general partners or external advisors. The underlying investments comprise a diversified portfolio of income-producing properties, third party loans and public and private funds. The real estate asset class is accounted for in the investment portfolio net of all financings. The fair market value of financings in the real estate portfolio generally will not exceed 50% of the gross fair market value of the portfolio. As at March 31, 2008, the total amount of financing included in the real estate portfolio for direct investments controlled by PSP Investments is approximately $200 million.

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

PSP Investments infrastructure asset class is comprised of investments which are owned by either PSP Investments or its wholly-owned subsidiaries and managed by general partners or external advisors. The underlying investments comprise a diversified portfolio of infrastructure assets and publicly-traded securities. As at March 31, 2008, the total amount of financing included in the infrastructure portfolio for direct investments controlled by PSP Investments is approximately $30 million.

Investment management and performance incentive fees are generally incurred for the above private market investments and are paid either by the investment directly, through capital contributions from PSP Investments or offset against distributions received from the investment. Investment management fees in private market investments generally vary between 0.2% and 5.5% of the total invested amount. For the year ended March 31, 2008, investment management fees of $8 million (2007 – $4 million) were recorded either as part of the cost of the private market investments or against investment income.

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

4. FUND TRANSFERS

During the year, PSP Investments received fund transfers of $282 million (2007 – $281 million) from the Royal Canadian Mounted Police Pension Fund. The transfers received are comprised of net current employer and employee contributions to the Royal Canadian Mounted Police pension plan in respect of member service after April 1, 2000.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

5. INVESTMENT INCOME

(a) Investment Income

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

($ millions)	2008	2007
Interest income	$ 48	$ 33
Dividend income	26	22
Other income	8	19
Security lending income	–	–
Transaction costs	(2)	–
	80	74
Net realized gains	109	160
Net unrealized gains (losses)	(198)	17
Investment income (loss)	$ (9)	$ 251

(b) Investment Income by Asset Mix

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

($ millions)	2008	2007
Developed World Equity		
Canadian Equity	$ 17	$ 94
US Large Cap Equity	(33)	16
EAFE Large Cap Equity	(17)	34
Small Cap Developed World	(45)	10
Emerging Markets Equity	13	28
Private Equity	19	–
Nominal Fixed Income		
Cash Equivalents	4	2
World Government Bonds	12	(3)
Canadian Fixed Income	21	21
Real Return Assets		
World Inflation-linked Bonds	6	(2)
Real Estate	54	47
Infrastructure	2	1
Absolute return	(62)	3
Investment income (loss)	$ (9)	$ 251

Investment income includes foreign currency realized losses of $42 million (2007 – $9 million) and foreign currency unrealized losses of $27 million (2007 – $31 million).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

6. INVESTMENT PERFORMANCE

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

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

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

The internal rate of return methodology is used to calculate the returns for the real estate, private equity and infrastructure asset classes for the years ended March 31, 2008 and March 31, 2007.

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

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

The total portfolio return includes the performance impact of absolute return strategies. Hedging investment returns are either netted against the return of the respective hedged assets, as is the case with private asset classes, or included in total return, as in the case of public markets.

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

7. EXPENSES

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

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

	2008	2007
Public Service Pension Plan Account	72.6%	72.4%
Canadian Forces Pension Plan Account	20.1	20.4
Royal Canadian Mounted Police Pension Plan Account	7.2	7.2
Reserve Force Pension Plan Account	0.1	n.a.
	100.0%	100.0%

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

(b) Operating Expenses
Operating expenses consist of the following for the year ended March 31:

($ thousands)	2008	2007
Salaries and benefits	$ 2,490	$ 2,046
Professional and consulting fees	1,477	650
Office supplies and equipment	495	410
Other operating expenses	451	221
Depreciation of fixed assets	230	110
Occupancy costs	182	131
Custodial fees	147	118
Remuneration earned by Directors	55	52
Communication expenses	12	8
Travel and related expenses for Directors	12	13
	$ 5,551	$ 3,759

NOTES TO THE FINANCIAL STATEMENTS

For the year ended March 31, 2008

8. PSP CAPITAL INC.

As at March 31, 2008, PSP Capital Inc., a wholly-owned subsidiary of PSP Investments, has $1,551 million (2007 – $503 million) of short term promissory notes outstanding with maturity dates within 32 to 364 days of issuance, of which $110 million (2007 – $36 million) has been allocated to the Royal Canadian Mounted Police Pension Plan Account and included in Note 3 (a) as an investment-related liability. The maximum authorized by the Board of the Directors for the short term and medium term notes is $3 billion and $1 billion, respectively. As at March 31, 2008, there are no medium term notes issued and outstanding. The capital raised was used primarily to finance real estate and infrastructure investments and is unconditionally and irrevocably guaranteed by PSP Investments.

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

The operating expenses incurred by PSP Capital Inc., were allocated to each plan account as described in Note 7 (a) and includes interest expenses on the short term promissory notes of $4 million (2007 – $1 million).

9. GUARANTEES AND INDEMNITY

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

As at March 31, 2008, PSP Investments agreed to guarantee, as part of an investment transaction, a non-revolving term loan. In the event of a default, the Plan would assume the obligation up to $29 million plus interest and other related costs.

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

10. COMMITMENTS

PSP Investments and its subsidiaries have committed to enter into investment transactions, which will be funded over the next several years in accordance with agreed terms and conditions. As at March 31, 2008, the outstanding commitments in private equity-related, real estate-related, infrastructure-related and public market-related investments amounted to $556 million ($312 million for private equity investments, $146 million for real estate investments, $61 million for a public market investment and $37 million for infrastructure investments).

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.

Reserve Force Pension Plan Account

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).

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